# Compliance Auditing
of
Public Expenditure and Revenue

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# FOREWORD

Compliance audit is the starting point of audit. It examines transactions relating to expenditure, receipts, assets and liabilities of Government for compliance with provisions of the Constitution of India and applicable laws, rules, regulations, orders and instructions issued in pursuance of the provisions of the Constitution of India.

Earlier, the emphasis of our Department was primarily on compliance audit. Over time, different types of audits evolved. Today we have three broad categories – compliance audit, performance audit and financial audit. While recognizing these variations, it cannot be denied that the entire edifice of different audits is constructed on the foundation of compliance audit. It provides the framework for conducting audits and reporting on the degree of compliance with stipulated criteria. In fact, all other forms of audit may be said to start from compliance audit, which can be considered the Gangotri or the original source of all audits.

As the cornerstone of all audits, it is important that Indian Audit and Accounts Service Officer Trainees are well acquainted with the intricacies of compliance audit. Literature and guidance material on the subject is extensive and dispersed through the Comptroller and Auditor General's DPC Act, 1971, C&AG's Manual of Standing Orders, Regulations on Audit and Accounts, 2007 and various sectoral audit manuals. This volume, 'Compliance Auditing', is an effort to consolidate the relevant issues and prepare a reading material that provides a conceptual basis for compliance auditing in the public sector and explains the scope of audit. It offers a practical methodology to carry out compliance audit of public expenditure and revenue, combined with detailed audit check-lists for each type of expenditure and revenue, suitably illustrated from audit reports.

I am confident this book will serve as an extremely useful and practical reference for the Officer Trainees as they embark on their careers. In fact, it will boost confidence levels of all those entrusted with planning and conducting compliance audits for government and its varied entities.

Date: 24th May, 2016
Place: New Delhi

**AJANTA DAYALAN**
Deputy Comptroller and Auditor General

# PREFACE

The curriculum of the Indian Audit and Accounts Service (IA&AS) Officer Trainees (OTs) underwent a significant modification during the year 2014 leading to introduction of a subject titled 'Compliance Auditing'. It is one of the core subjects that are taught to the officer trainees as a part of the theoretical inputs during the first year of their induction training at the National Academy of Audit and Accounts (NAAA), Shimla.

Total period of training is for two years, of which 15 weeks is foundation course common to all the civil service new recruits organised by DoPT at certain stations followed by induction training for IA&AS Officer Trainees (OTs) at the NAAA, Shimla.

The curriculum includes Public Finance, Public Policy and Administration, Public Expenditure Revenue and Resource Management, Book-keeping in the Government, Book-keeping in the Private Sector, Public Sector Financial Reporting and Private Sector Financial Reporting. The titles of the subjects on auditing are Principles of Public Sector Auditing, Financial Auditing, Compliance Auditing and Performance Auditing. IT skills and IT Audit are two more subjects that are taught aimed at imparting the skills to audit the automated environment.

During their second year starting from January IA&AS OTs undergo eight months practical training in the AG Office. It includes carrying out audits as a part of a team and leading a team. They return to the Academy for two months during August and September to demonstrate how they carried out the audits. This phase of training includes a module on organisational theory and human resource management.

This book is aimed to provide a conceptual basis for compliance auditing in the public sector, explain its subject matter, scope and contours and offer a practical methodology to carry out compliance audit of public expenditure and revenue. Nearly two hundred audit findings from the Audit Reports of all the States and Union covering Economic, Social, General and Revenue Service Sectors are given as illustrations. When this subject is taught during the second semester, Officer Trainees are already with familiar the principles of the public sector auditing and public expenditure management which are taught during the first semester. Other readers of this book like young Group Officers are expected to be familiar with the contents in those two books of the Academy, 'Essay on Principles of Public Sector Auditing' and 'Public Expenditure Revenue and Resource Management '.

This book covers compliance auditing of public expenditure and revenue. Resources part has been excluded in order to keep the size of this book manageable. More importantly, audit of resources needs comprehensive treatment by taking in account not only the aspects of safeguarding resources from risk of loss, waste etc., but also environmental aspects. Academy has plans to bring out a separate book on compliance auditing of public resources.

Credits for bringing out this book are due to my earlier team of Directors Bijit Mukeherjee, Vidhu Sood, Vishwanath Jadon and the present team of directors Sudha Rajan, Venkatnathan and Saliesh Jhakotia. Assistance and support of Ranjit Singh, Senior Audit Officer in this book is invaluable. Thanks are due to Ajay Kumar Tiwari, Sesh Pal, Hira Lal and his team. Thank are also due to Sikander Singh and his team and Karam Chand who provided secretarial assistance.

While we have taken every possible effort to remove printing errors, it is possible that some may remain. If the reader comes across any such error, s(he) is requested to indicate the same to us so that we can make necessary corrections in the forthcoming editions. Further suggestions for improvement of the book are eagerly solicited.

6th May, 2016
Shimla

**L.V. Sudhir Kumar**
Director General
National Academy of Audit and Accounts

# INTRODUCTION

The Comptroller and Auditor General's Manual of Standing Orders, 1991 (MSO) and its Second Edition 2002 has several references to compliance testing as an audit procedure. Though the term Compliance Audit is not used, MSO explains regularity audit and propriety audit in detail. The Regulations on Audit and Accounts, 2007 devoted a complete chapter for Compliance Audit.

MSO, in the Chapter on Audit of Computerised Systems (3.22.4), says, 'controls in a computer information system reflect the policies, procedures, practices and organisational structures designed to provide reasonable assurance that the intended objectives will be achieved. They *ensure effectiveness and efficiency of operations, reliability of financial reporting and compliance with the rules and regulations*. It further says that computer systems are efficient and achieve results accurately and at great speed only if they function in the manner they are designed to and such controls as are provided are effective. It is, therefore, important for the Auditor to verify that not only adequate controls exist, but that they also function effectively. Such controls should also be commensurate with the risk assessed so as to reduce the impact of identified risks to acceptable levels. The key controls for ensuring the above will have to be identified, evaluated and compliance tested. This description of audit applies even for entities which are not operating in computerised environment. MSO (Para 1.1.4) uses the terms regularity audit and propriety audit while dealing with audit of compliance with rules (italics are authors').

MSO, in the Chapter on Integrated Audit of Departments (3.9.19), says, 'audit should examine and comment upon the arrangements for securing and enforcing accountability at different levels of the department with particular reference to the availability of appropriate internal control mechanisms in *all areas of its functioning* in a manner that facilitates the achievement of the *overall goals and objectives of the department* (italics are authors).

The phrases in italics in the above paragraphs when read together point out that there are three aspects of functioning of any public sector entity. They are, an entity's service operations should be efficient and effective, its financial reporting should be reliable and that the entity should comply with rules and regulations. The purposes of the first two aspects are quite clear. Entity's service delivery operations are expected to be efficient so that citizens get value for their money. Entity's financial reporting is expected to reliable to meet the user's needs. However, the purpose of compliance with the rules is not clearly evident. What is the purpose of complying with the rules? Is it compliance for the sake of compliance?

International Standards of Supreme Audit Institutions (ISSAI) 400 on Compliance Auditing says that compliance auditing is the independent assessment of whether a given subject matter is in *compliance* with applicable authorities identified as criteria. It does not identify the purpose of compliance with authorities or rules. Compliance with the rules just for the sake of compliance cannot be termed as its 'purpose'. For that matter, the financial statements prepared by the entities are expected to be in compliance with the accounting standards issued by the authorities concerned. Here the purpose of financial audit is to provide an assurance that financial reporting of the entity is reasonably reliable. That is because financial statements are prepared in accordance with the accounting standards. These standards are framed in such a way that if accounts are prepared accordingly, they will depict a reasonably reliable picture of financial position and financial performance of the entity. The financial reporting is in compliance with the financial reporting standards. The purpose is to provide a reliable financial report.

In order to find the purpose of compliance with rules, regulations or authorities, we have to turn our attention to Chapter 6 of Regulations on Audit and Accounts, 2007. The following is the text (Regulations 43 and 44).

> Compliance audit examines the transactions relating to expenditure, receipts, assets and liabilities of Government for compliance with the provisions of the Constitution of India and the applicable laws; and the rules, regulations, orders and instructions issued by the competent authority either in pursuance of the provisions of the Constitution of India and the laws or by virtue of the powers formally delegated to it by a superior authority (43).
>
> Compliance audit also includes an examination of the rules, regulations, orders and instructions for their legality, adequacy, transparency, propriety and prudence and effectiveness that is whether these are:
>
> (a) *Intra vires* the provisions of the Constitution of India and the laws (legality);
>
> (b) Sufficiently comprehensive and ensure effective control over Government receipts, expenditure, assets and liabilities with sufficient safeguards against loss due to waste, misuse, mismanagement, errors, frauds and other irregularities (adequacy);
>
> (c) Clear and free from ambiguity and promote observance of probity in decision making (transparency); (d) judicious and wise (propriety and prudence); and (e) effective and achieve the intended objectives and aims (effectiveness)."

Regulations on Audit and Accounts, 2007 makes it clear that the rules framed by authorities have a purpose. The rules should ensure effective control over government (public)

resources with sufficient safeguards against loss due to waste, misuse, mismanagement, errors, fraud and other irregularities. Rules should be comprehensive to control the resources from the possibility of misuse. Rules should promote probity, propriety and prudence in decision making. So, the primarily purpose of these rules is to safeguard resources from the possibility of loss arising out of any act of omission or commission. A separate set of rules penalise such acts and procedures for applicable penalties.

We know that any public sector entity is created to deliver a service. Some entities may be entrusted with regulatory function or mix of regulation and service delivery. The primary function of any public sector entity is to fulfil its service delivery mandate. Their operational performance is expected to be efficient and effective. This is the *first* responsibility.

In order to carry out their operations, the entities are provided with financial resources, i.e. budget. Through these financial resources, the entities acquire all other resources, like men, material, assets, land, building, etc. that they need for their activities. While fulfilling their operational mandate, the public sector entities are also expected to safeguard all the resources at their disposal (with which they are entrusted) at all times from loss due to waste, misuse, mismanagement, theft, etc. All resources belong to the people and that is the way they are supposed to be handled. Safeguard of all its resources at all times (till they are used/ consumed in service delivery) is the *second* responsibility.

Entities are expected to keep an 'account' of all financial transactions and document all the related administrative and operational actions. Keeping an account of financial transactions in the books of accounts, consolidation in the prescribed schedules and reporting within financial reporting framework is the third responsibility.

The Executive is expected to safeguard all the resources at all times. Certain laws, regulations, rules and instructions are made and modified from time to time to achieve this broad objective. 'Resources' include *financial resources and all other resources acquired through it*, such as men (labour, HR), material, other consumables, equipment, assets, land, building, infrastructure, etc. They are required by the entity for its service delivery function. Budget (financial resources) is the primary resource. Entity acquires (procures, constructs etc.) all other resources through budget/financial resources. They are paid for from the budget. Sometimes equipment, assets, etc. could be on rent or lease. Infrastructure could be acquired/ created in PPP mode. Government mobilises financial resources through levy and collection of taxes, charges/fees, sale, borrowings, etc. When it is said that entities are expected to safeguard the resources at all times, it means (a) during their acquisition/creation, (b) when not in use/ waiting to be consumed or utilised in service delivery operations (their physical safeguard,

storage, upkeep, maintenance), (c) during utilization or consumption, and (d) during delivery of service delivery output (products, goods, services) to the recipients or disposal of excess/ surplus of material/equip/asset/scrap etc.

Providing an assurance on this aspect of functioning of an entity is compliance audit. To what extent the entity could safeguard each of these resources at different stages from the risk of loss due to waste, misuse, mismanagement, errors, frauds and other irregularities arising out of non-compliance with the applicable rules translates into audit objectives of compliance audit.

Legislature exercises control to safeguard the nation's natural resources which include land, *(including mines/minerals)*, water *(glaciers, rivers, lakes, territorial ocean/sea)*, air, flora and fauna (forest, plant & animal species, habitat), intangible resources *(radio frequency, bandwidth)*, etc. Laws, regulation and rules are made to safeguard natural resources from the risk of loss or damage during their authorised sale *(land)*, lease, profit sharing arrangements *(oil blocks)*, exploitation *(mining, felling trees)*, and also from risk of unauthorised exploitation, illegal sale/consumption, excessive depletion, degradation, pollution etc. Certain laws and rules also made for regeneration of depleting resources, their sustainable exploitation *(prevention of excessive fishing, grazing),* sustainable development, use of renewable sources, etc. Certain laws and rules are also made for promoting specific positive externalities or public good *(health-infectious diseases, family planning, education, affirmative action for vulnerable groups, gardens, parks, forest, clean streets, public toilets etc.).* To find the extent to which the applicable laws, rules, regulations have succeeded in their purpose can be audit objectives for compliance audit.

Legislature also seeks to safeguard its citizens *(its human resources, particularly the vulnerable ones)* from negative externalities *(pollution, drugs, narcotics, contagious diseases, traffic hazards, fire hazards, radiation,)*, from market exploitation *(monopoly, unfair competition, price rigging, consumer rights, weights & measures, quality controls, working hours, wages, working conditions, industrial safety etc.),* from discrimination *(gender, religion, ethnicity),* from threats to life *(internal/external, civil/criminal),* threat to livelihood *(displacement)* threat to their property etc. Certain laws and rules are made for discouraging, preventing and penalising negative externalities. To what extent these negative externalities are prevented and addressed by complying with those laws and rules *(to what extent they are enforced)* translate into audit objectives of compliance audit.

The purpose of the compliance audit is thus to provide an assurance on the extent to which the entity could safeguard the resources that are entrusted to it or for which it is responsible, by complying with the applicable rules.

One has to remember that there is a trade-off between compliance and efficiency. There are three aspects to this trade-off. The *first* aspect is the balance between the ex-ante controls in the form of rules and ex-post targets of service delivery. The *second* aspect is related to the risk management. Usually, rules are framed at a particular point of time taking into account the risk anticipated at that point of time. Rules once framed stay for a long period of time. Meanwhile some of the risks change or disappear, and new risks emerge. The extant rule may not be able to address the changed risk scenario and thus becomes redundant. In some instances, the rule hinders the activity. This calls for an amendment to the rule. In fact 'Regulations on Audit and Accounts, 2007' calls for examination of rules for their legality, adequacy, transparency, propriety and prudence. The *third* aspect is a broader one. In a democracy, all the resources at the disposal of the government (Executive) are public resources. Through their elected Legislature, people would like to know how their resources are being safeguarded by the Executive. Apart from efficient delivery of service, the Executive is also accountable for the way they manage the public resources. It has to be demonstrated by following the rules and explaining the reasons for discretion or deviation justifying purpose served by doing so.

Compliance Auditing is about providing an assurance on whether an entity could safeguard all resources entrusted to it at all times. However it is unfair to expect absolute compliance. It would be very expensive even for a small shop owner to ensure that theft is completely ruled out. He would tolerate certain minimum loss where the cost of preventing it would be more than that loss. In compliance audit the assurance is about to what extent the entity could reasonably safeguard its resources. Safeguarding resources from loss contributes of economy in public expenditure.

Economy referred to the performance auditing is achieved through recommending improvements operational process/operational activities. Improvement in the way operations are carried, substitute inputs, new operational technologies etc., contribute to the economy referred to in the performance audit. It is about getting more output (quantity, quality) from same level of inputs. Compliance audit contributes to economy by high-lighting instances of non-compliance to rules that are in place to safeguard the resources. Preventing loss of resources due to waste, misuse, mismanagement, theft, etc., contributes to the economy of public expenditure. Inability to appreciate this difference results in performance audits featuring a number of compliance audit findings and vice versa.

Compliance auditing as distinct type of audit in the private sector emerged in 20th Century as a response to the efforts of the Governments to regulate and control business practices. Governments stepped in to protect the interest of consumers, investors and the citizens. Laws, regulations, policies, and procedures were enforced by the Government to

ensure such control. It became the responsibility of private sector auditors to verify whether these rules were being followed by the private sector entities.

Private sector entities have to comply with legislations and regulations that prevent unfair competition, damage to environment, neglect of safety, health, welfare of employees etc. Non-compliance to such regulations by private sector entities may invite penalties. Private sector auditors are particularly concerned in such cases because certain penalties have an impact on company's balance sheet.

International Auditing and Assurance Standards Board (IAASB) established by International Federation of Accountants (IFAC) is a body for setting Accounting (IFRS) as well as Auditing Standards (ISA) for private sector accountants/auditors. Among others, it issued ISA 250 (International Standard of Auditing 250) 'Consideration of Laws and Regulations in an Audit of Financial Statements' for carrying such compliance audit in private sector.

ISA 250 distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows:

(a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations; and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); noncompliance with such laws and regulations may therefore have a material effect on the financial statements.

Private Sector in different countries have similar auditing standards or practice notes for this purpose. American Institute of Certified Public Accountants (AICPA) has 4 sets of standards; SAS (Statements of Auditing Standards), SSAE (Statements on Standards for Attestation Engagements), SSARS (Statement on Standards for Accounting & Review Services) and SSCS (Statements on Standards for Consultancy Services). SAS 117 of AICPA says 'obtain sufficient and appropriate audit evidence to form opinion and report at the level required in the governmental audit requirement on whether the entity complied with applicable compliance requirements'. Compliance attest engagements under SSAE 10 are related to an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants etc. Australia has similar standards, Australian Auditing Standard (ASA) 250 and Australian Standards on Assurance Engagements (ASAE) 3100. Similarly Canada has Canadian Auditing Standard (CAS 250) and Canadian Standard on Assurance Engagements (CSAE).

There is a similar kind of compliance audit in the public sector of USA, where the Federal Government each year provides over $400 billion in grants to local and tribal governments, colleges, universities and other non-profit organizations. Their accounts are audited by private sector auditors, Certified Public Accountants (CPAs). For entities that receive $ 500,000 or more, in addition to certifying the accounts, private sector auditors are required to examine their compliance to conditions stipulated in the grant. This is known as single audit (both financial audit and compliance audit) and has to be carried out under The Single Audit Act of 1984 and OMB Circular A-133.

International Public Sector Accounting Standards Board (IPSASB) of IFAC (formerly Public Sector Committee of IFAC) provides guidance on financial auditing public sector. International Public Sector Accounting Standards (IPSAS) issued by IPSASB for the public sector run almost parallel to the International Financial Reporting Standards (IFRS) for the private sector. IFAC in 1994 issued guidance for compliance auditing in public sector. It is titled 'Study 3: Auditing for Compliance with Authorities: A Public Sector Perspective of the Public Sector Committee, IFAC'.

INTOSAI developed a set of auditing standards/guidelines for the use of government auditors titled as ISSAIs (International Standards of Supreme Audit Institutions). INTOSAI Professional Standards Committee (PSC) headed by SAI Denmark and its sub-committee Compliance Audit Sub-committee (CAS) headed by SAI Norway in 2010 developed three guidelines/standards for compliance audit.

- ISSAI 4000–General Introduction to Guidelines on Compliance Audit;
- ISSAI 4100–Guidelines for compliance audits performed separately from the audit of financial statements (separate audit or related to performance audit)
- ISSAI 4200–Compliance Audit Guidelines related to audit of financial statements

It defines compliance auditing as obtaining assurance as to whether activities, financial transactions and/or information are, in all material respects, in compliance with the authorities which govern the audited entity. This involves reporting on the degree to which the audited entity follows rules, laws and regulations, policy, established codes, agreed upon terms or general principles of sound public sector financial management and conduct of public sector officials. Compliance auditing may encompass the assessment both of compliance with formal criteria of what should be (regularity) and/or with the general principles of sound public sector financial management and conduct of public sector officials of what could be (propriety).

It says that compliance auditing as performed by SAIs may cover a wide range of subject matters and may vary widely on an international basis. Compliance auditing comprises several audit approaches, types of criteria, evidence gathering procedures and reporting formats. Compliance auditing is generally performed either:

- Related to the audit of financial statements (in which case ISSAI 4200 provides additional guidance),

An audit of financial statements focuses obtaining sufficient and appropriate audit evidence regarding those laws and regulations that have a direct effect on the determination of material amounts and disclosures in the financial statements. For compliance audits performed together with the audit of financial statements, the Compliance Audit Guidelines supplement the Financial Audit Guidelines (ISSAIs 1000-2999).

- Separately from the audit of financial statements (in which case ISSAI 4100 provides additional guidance), or performed together with performance auditing

Compliance auditing may also be planned, performed and reported on separately from the audit of financial statements, and ISSAI 4100 provides guidance on this. Compliance auditing performed as a task of its own may be carried out on a regular basis or on an ad hoc basis as a separate, identifiable audit task related to a specific subject matter chosen for audit.

In both the cases Audit provides reasonable assurance or a limited assurance.

We can see that ISSAI 4200 of INTOSAI is nothing but replication of ISA 250 of IFAC. ISSAI 4200, 'compliance that has bearing on the financial statements' is exactly similar to that of ISA 250. Similarly, ISSAI 4100, 'compliance that has no bearing on financial statement' is mere replication of IFAC Guidance, Study 3: Auditing for Compliance with Authorities: A Public Sector Perspective. Fundamental Principles of Compliance Auditing (ISSAI 400) which came much later in 2013 is a summarized extract of ISSAI 4000, 4100 and 4200.

INTOSAI guidance is inadequate for the compliance auditing in the public sector. We have seen in the earlier chapter that the purpose of rules, regulations and instructions in the government is to safeguard the resources from the risk loss, waste, misuse etc. Rules governing the functioning of public sector entities are integral to the framework under which the executive is made accountable to the legislature. They are ex-ante controls. They exist as a measure to safeguard public resources. Compliance to these rules by public sector entities is as important as efficient delivery of services and reliable financial reporting. Compliance audit in public sector seeks to provide an assurance on to extent the entity could safeguard the resources.

Having explained the purpose of the compliance auditing in the public sector and how it is distinct from performance auditing and financial auditing, this text book in the remaining chapters offers to provide guidance for planning and conducting compliance audits. Chapter-1 explains the compliance auditing is the Indian public sector Chatper-3 explains the subject matter and scope compliance auditing. Chapter-4 deals with review of internal controls that seek to safeguard resources and the substantive testing. The remaining chapters are organized in such a way that each chapter briefly explains the controls governing a resource and the stages it goes through. Attempt is made to be as comprehensive as possible and also as concise as possible. Audit findings in the Audit Reports of Union and State Governments are given as illustrations. The following codes are used States and Union in the illustrations.

AN -Andaman & Nicobar Islands; AP -Andhra Pradesh; AR -Arunachal Pradesh;

AS -Assam; BR -Bihar; CG –Chhattisgarh; CH –Chandigarh;

DD -Daman and Diu; DL –Delhi; DN -Dadra & Nagar Haveli; GA –Goa; GJ –Gujarat;

HP -Himachal Pradesh; HR –Haryana; JH –Jharkhand; JK -Jammu & Kashmir;

KA –Karnataka; KL –Kerala; LD –Lakshadweep; MH –Maharashtra;

ML –Meghalaya; MN –Manipur; MP -Madhya Pradesh; MZ –Mizoram;

NL -Nagaland; OD –Odisha; PB -Punjab; PY –Puducherry; RJ –Rajasthan;

SK –Sikkim; TS-Telangana; TN -Tamil Nadu; TR -Tripura; UK –Uttarakhand;

UP -Uttar Pradesh; WB -West Bengal;

UN – Union Government (CIV- Civil, COM-Commercial, DEF- defence, RLY- Railway)

## CHAPTER -1

# Compliance Auditing in Indian Public Sector

Audit scope specifies the focus, extent, and boundary of a particular audit. Audit scope indicates the physical location of the audit, the organizational units that will be examined, the processes and activities that will be included, and the time period that will be covered. This chapter is not about audit scope in its strict sense but about the range or ambit of compliance audits in Indian Audit and Accounts Department.

The three essential functions of any Government are Resource Mobilization, Resource Allocation and Public Expenditure Management.

Resource mobilization: Taxation is a matter of policy. The Legislature decides whom to tax, whom to exempt, to what extent, for what period etc. This in turn is influenced by various stakeholders. This tax policy is administered by the tax department. CAG conducts audit of tax levy & collection efforts (Tax Administration) of Union and States, through audit of all tax departments (Revenue Audit). Resource mobilization is the responsibility of Finance Ministry (Union and States). Tax departments work under Finance Ministry. Thus it is an audit of Finance Ministry. CAG also conducts audit of non-tax resources and examines internal and external borrowings, disinvestment, privatization (sale) of existing public sector utilities.

Resource allocation: Legislatures will have their priorities for the sectors and programs and thus allocates resources (Budget). As it is the domain of policy, audit does not comment on this matter. However, Audit examines certain aspects of allocation such as whether allocations to Union and States were made in accordance with the Finance Commission recommendations, devolution of finances to the Local Bodies etc. Resource allocation may sometimes include the allocation of natural resources Public Expenditure Management: Almost all the Departments/ Ministries are primarily spending departments (Expenditure Audit). Union Government comprises of about 50 Ministries with about 120 Demands for Grants and Railways. It is the same in a smaller scale for all the State Governments. Spending Ministries can be grouped into three sectors.

Economic Services Sector (Minerals, Industries, Power, Transport etc.)

Social Services Sector (Health, Education, Welfare, Food Security etc.)

General Services Sector (Defence, Police, Administration, Legislature etc.)

Since expenditure and revenue in a year have to have some kind of balance, Aggregate Fiscal Discipline. Audit involves examination of issues related to budget deficits and debt management as well. Fiscal Responsibility & Budget Management (FRBM) Act, 2003 (amendment 2012) enables review of its compliance by the Audit.

## *Union Government*

### *Economic Services Sector*

Audit of Railways is carried out by 18 offices headed by Principle Directors (PDs) at 14 locations assisted by Directors, Deputy Directors (Group Officers). It has a dedicated cadre of Sr. Audit Officers (Sr. AOs), Audit Officers (AOs), Asst. Audit Officers (AAOs) and Audit Assistants (Sr. Auditors/Auditors). Audit of this sector is commonly referred to as *Railway Audit*.

Audit of Posts & Communication is carried out by an office at Delhi headed by DG who is assisted by 14 Group Officers at 12 locations. It has a dedicated cadre of Sr. AOs /AOs, AAOs and Auditors. Audit of this sector is commonly referred to as *P&T Audit*.

Audit of all other Economic Services Ministries/Departments (Minerals, Industry, Power, Transport, Public Works, Agriculture etc.) is carried out by 13 offices headed by Principle Directors (PDs) assisted by 34 Director/Dy. Directors. Most of public sector undertakings (PSUs) about 400, most of them making profits fall under these ministries. There is a dedicated cadre of Sr. AOs/AOs, AAOs and Auditors. Audit of this sector is known as *Commercial Audit.*

## *Social, General and Revenue Sector*

Audit of Defence Ministry is carried by 6 offices headed by DG/PDs at 8 locations assisted by 20 Director/ Dy. Directors. It is commonly referred to as *Defence Audit* and is organised into audit of Army, Navy, Air Force and Ordnance Factories. Defence Audit has a dedicated cadre of Sr. AOs/AOs, AAOs and Auditors.

Audit of the remaining Ministries/Department of Social, General Sector and Revenue Sector is carried out by 11 offices headed by DGs/PDs at 9 locations (called PD/DG (Central) Offices). They are assisted by 48 Directors/ Dy. Directors, and they in turn by Sr. AOs /Os, AAOs and Auditors. Audit of Social and General Sector is commonly referred to as *Civil Audit*. Audit of Revenue Sector is referred to as *Revenue Audit*.

*IT Audit* is the term used when an automated activity of any entity in any of sector or its IT environment is audited.

## *State Government*

### *Economic, Social, General and Revenue Sectors*

Functions of the State Governments are also organised into these sector. Audit of 30 State Governments (and Puducherry UT with Legislature) is carried out by 39 Accountants General (AGs)/Principle AGs (PAGs) assisted by about 140 Deputy AGs/Senior DAGs (Group Officers). There are 2 AGs/PAGs in 11 States, the larger ones, and one each in other States. Each State has its own cadre of AO, AAOs, Auditors and other support staff. Audit in AG offices is also organised sectorally; Economic (*Works Audit, Forest Audit, Commercial Audit*), State Revenue (Revenue Audit) Social (*Civil Audit*) Sectors.

A ministry or department in any sector usally consists of administrative department with its subordinate offices and also depending on the nature of the activities consists of attached offices, commercial public sector undertakings, non profit autonomous bodies, boards etc.. usually each one of them is considered as a unit to be audited. However, depending on the audit scope, an entity would also mean the department where a number of units are selected as a representative audit sample. Compliance audits are carried in all the sectors. Annual audit plan of the office contains list of entities/units selected for compliance audit (audit assignments) during the year.

The entire compliance audit activity is carried out in the form of a number of Audit Assignments (Audits), i.e. audit of entities and subordinate offices of Ministries/Department. Duration of audit vary from one week (small sub-ordinate office, entity) to several (8 weeks) depending on the volume and/or the complexity of audit. Audits are carried out by Audit Teams (Audit Parties). One Sr. Audit Officer/Audit Officer and his/her team of 2 to 3 members (AAOs, Auditors) constitute an Audit Party.

In all there are about 1,000 Audit Parties carry out compliance audit of Central Government entities who audit about 10,000 'offices' (units) in a year and about 2,000 Audit Parties carry out compliance audit of State Governments' entities. In a year about 40,000 units of various departments in all the sector are subject to compliance audit.

Audit of units result in issue of Local Audit Reports or Inspection Reports (IRs) to the audited entities. The IRs issued to the units contain audit findings (objections/observations/ IR Paras). The Audited entity/unit/Department then corresponds with the Audit Office, providing the replies to the audit observations. Very significant audit observations with high materiality (about 5 to 10% of the audit findings in the Inspection Reports) are processed to feature in the Audit Reports as Draft Paras, Long Draft Paras and Thematic Audits. They are usually presented as separate Compliance Audit Reports or as a section in the Audit Reports. In an year about 75 compliance audit reports are presented to the State Legislatures and 25 reports to the Parliament.

## Provisions in the CAG's DPC Act and Regulations on Audit & Accounts

All the operative sections of the CAG's (Duties, Powers and Conditions of Service) Act, 1971 (DPC Act) provide for compliance auditing. Regulations on Audit and Accounts 2007 (Regulations) elaborate on these provisions in the DPC Act.

Chapter 6 of Regulations says that Compliance Audit involves examination of transactions for *compliance with* provisions of constitutions, applicable laws, related rules, regulations, orders and instructions of competent authority. *In addition to this*, it also involves examination of rules, regulations, orders, and instructions to examine their legality, transparency, propriety, prudence, adequacy and effectiveness.

Section-13 of the DPC Act provides for audit of all expenditure transactions from consolidated fund, contingency fund and public account. Section 17 provides for audit of stores and stock kept in any office or department of the Union or of a State. Chapter 6 of Regulations elaborates it under the broad heading of 'Audit of Assets and Liabilities'. It says besides stores and stock, Audit by C&AG shall extend to all other assets and liabilities including ongoing, completed works, investments, loans & advances, deposits, cash balances, internal and external borrowings, guarantees given by the Governments, reserves and sinking funds. Section 13 of Act provides for audit of trading, manufacturing, profit & loss accounts, balance sheets and other subsidiary accounts kept in any department. It is implied that Section 13 and Section 17 together provide for audit of not only of stores & stock but all the assets and liabilities described above. Thus all types of expenditure transactions are open to audit by the C&AG. If read with Section-16, all the transactions of all the departments in the Union and State Governments including receipts and revenue are open to audit.

Section-16 of DPC Act provides for audit of all receipts payable into consolidated fund; to satisfy himself that the related rules and procedures are designed to secure an effective check on the assessment; collection and allocation of revenue are being duly observed. This section implies both tax receipts and all other forms of receipts. The use of word allocation can be interpreted as audit of allocation of revenue to various bodies, entities etc. It could also mean audit of allocation of revenue from Union to States to Local Bodies. Tax department enforces compliance of tax laws and rules. How well the rules were applied is the subject matter of compliance audit. As a spending entity, tax department also complies with the rules that safeguard its resources, its spending, thus also audited under Section 13.

There could be other forms of receipts that are payable to consolidated fund of India, like borrowings, issue of bonds etc., sale/lease of government assets, sale/lease of resources, revenue sharing contracts etc. Since all these receipts flow into consolidated fund of India, their

audit is within the power of C&AG. Such audits may require obtaining related information from third party. Chapter 12 of the Regulations provides for obtaining such information required for audit.

Section 14, 15, 19 and 20 provide for compliance audit of government entities that are not regular departments but are in the nature of for-profit public sector companies (Government Companies) and statutory corporations (Corporations), not-for-profit public sector autonomous bodies and other non-governmental bodies and authorities that receive grant/ loan etc., from the Governments.

Government Companies and Corporations of Union and State Governments are open to audit under the provisions of Section 19 (1), (2) and (3) of the DPC Act. Chapter 8 and 9 of Regulations explain that in addition to the supplementary audit of annual accounts of a Government company or a deemed Government company, or financial audit of accounts of a corporation, CAG may conduct test audits. This audit shall cover transactions of the company, corporation with a view to examining their regularity, propriety, probity, economy, efficiency and effectiveness and report on cases of failure of compliance with laws, rules and regulations, cases of infraction, waste, mismanagement, frauds and other irregularities. The scope of test audit may extend to more than one financial year. This test audit or test check is the compliance audit as explained in Chapter 6 of Regulations. It is to be carried out to the extent relevant.

Audit of bodies and authorities other than Government Establishments and Companies is provided under Sections 14, 15, and 20 of the DPC Act. The expression 'authority' means a person or body exercising power or command vested in it by virtue of the Constitution or any law made by the legislature. The expression 'body' means an aggregate of persons, whether incorporated or unincorporated, and includes an institution or organisation set up as an autonomous organisation under a specific statute or as a society registered under the Societies Registration Act, 1860 or Indian Trusts Act, 1882 or any other statute, voluntary organisation or non-Government organisation, urban or rural local self-Government institution, co-operative society, society or club, etc.

Section 14 (1) and (2) provide for audit of receipts and expenditure of any body or authority substantially financed from consolidated fund of India, subject to the provisions of any law for the time being in force applicable to that body or authority, as the case may be. Chapter 8 of the Regulations explains that compliance audit of a substantially financed body or authority shall be conducted in accordance with the Regulations prescribed in Chapters 6 to the extent relevant. It is possible that a grant may not be entirely from consolidated fund but also a way of assigning specified tax or a duty. Such receipts can be treated as grant from consolidated fund because such revenue belongs to consolidated fund.

Section 15 (1) says where a grant or loan is provided to a body or authority for a specific purpose, C&AG shall scrutinize the procedures by which sanctioning authority satisfies himself about fulfilment of conditions of grant. Section 15(1) does not refer to audit of receipt & expenditure the way it is mentioned in Section 14.

Section 20 is about audit of bodies or authorities not covered in 14, 15 & 19. Entities under 14 & 15 should be receiving grants or loans to qualify for audit. Entities under 19 should be companies or corporations created by legislature. There can be several entities that do not fall under 14, 15 & 19. Section 20 is perhaps providing for all other types of entities such as regulatory bodies and other governing structures that evolved in the recent past or yet to evolve. Section 20(1) does not explain the nature of such bodies. Perhaps it is kept open because it is difficult to predict what kind of bodies or authorities would emerge. Under Section 20(1) the C&AG is entrusted with audit of such entities.

Under Section 20(2) CAG proposes to take up the audit of such entity, if he is of opinion that audit of such entity is necessary in the public interest. These audits are to be conducted within the terms and conditions agreed upon between C&AG and the concerned Government.

All types of bodies like NGOs, Self Help Groups (SHG) etc., to whom grants/ advances are given (as mode of service delivery) are open to audit under Section 20. No one can argue with the basic principle that whoever is entrusted with the public resources is accountable to the public. It is difficult to argue that CAG can't audit such arrangements and can't have access to related records maintained by the non-governmental bodies. It should be the same with various kinds of partnerships of the government with private entities like Joint Ventures, PPP. In these cases also it would be difficult to argue that CAG can't audit such arrangements and can't have access to the related records of the private entities should qualify for audit by CAG.

## CHAPTER -2

# Subject Matter and Scope of Compliance Auditing

Public servants are expected to safeguard all public resources entrusted to them. They need to safeguard all the resources all the times by complying with the rules that are laid for this purpose. This responsibility is as important as delivering the service efficiently. However, the activity of safeguard of resources (and so is book-keeping) run parallel to the service delivery activity. Service delivery is the very purpose for which any public sector entity exists.

| *Service Delivery Operations* | *Safeguard of Resources* | *Accounting* |
|---|---|---|
| Planning the Service Delivery<br>Aims, Objectives, Targets<br>Planning Supply Side<br>Planning Demand Side<br>Preparing Budget for the year | Compliance with<br>- the rules governing budget preparation,<br>- rules of proposals for new establishment, new service, new instruments of service (at all levels- Head of Offices, of Dept.) | Budget Estimates of the offices, of the department, demand for grants, their approval |
| Preparedness for the service delivery implementation<br>Organization structure<br>Manpower recruitment, training, deployment<br>Procurement - planning and execution (all inputs)<br>Procurement/acquisition of assets/ infrastructure<br>Operations Pan- deployment of manpower, inputs, logistics | Compliance with Rules and Controls over<br>- drawl of money and handling cash<br>- pay, all types of allowances,<br>- deductions<br>- establishment, contingency expenditure<br>- procurement of goods, material services, equipment, vehicles<br>- receipt, storage, issue of stores<br>- acquisition or creation of assets and infrastructure<br>- safe custody, maintenance of assets | Posting each amount of each voucher in the books of accounts (registers, ledgers, broadsheet)<br>Correctly with correct classification etc., |
| Implementation<br>Carrying out service delivery operations/activities, optimum use of inputs, efficiency in operations, maximum output<br>Delivering to the recipient | Controls over<br>- of inputs (consumables) consumed<br>- use of , equipment, infrastructure during the implementation, execution<br>- safeguard of resources when not in use<br>- safeguard of service delivery output | Adjustment accounts<br>reconciliation<br>periodical compilation |
| Reporting<br>Reporting on results of service delivery different levels (implies supervision and monitoring) | Reporting<br>- reporting of instances of non-compliance, fixing responsibility, penal action, improving controls | Appropriation account for the Demand |

Imagine a newly created department mandated to deliver a service say, health, education, internal security (policing) etc. It starts it activities with financial resources, its annual budget. Through its financial resources it acquires all other resources that are necessary for it functioning. They include manpower, material, services, equipment, assets, infrastructure etc. It uses these resources as inputs during the course of its service delivery during the year. Broadly we can identify four stages in the annual service delivery activities of any department; planning, preparedness, implementation and reporting. The responsibility of safeguard of resources by complying with rules (and also book-keeping and financial reporting) runs parallel to the service delivery activity (see the table in the previous page).

There are other associated activities. They can be broadly grouped into activities resulting in resource-inflow and resource-outflow. These activities can be treated as incidental to core service delivery activity.

Apart from regular spending, there are different forms of resource out-flow from the government and government entities like giving grants, loans, investment, annuity, cash benefits, subsidies etc. Certain rules exist that seek to safeguard these resources from the risk of loss...

| *Service Delivery Operations* | *Safeguard of Resources* | *Accounting* |
|---|---|---|
| Resource outflow<br>Giving grants, giving loans, paying back loans taken, interest on loans taken, interest payment of on types of borrowings, repayments, investments made in various forms including joint ventures, PPPs, its annuities, cash benefit transfer, subsidies | Compliance with Rules governing<br>Issues and release of loans, grants, interest payments, repayment of loans/ borrowing investments in JVS, PPP, other investments, annuity to PPPs, cash benefits transfers, cash transfers, subsidies. | Accounting of loans, grants released, various types of investments cash transfers, subsidies, Govt. guarantees |

In addition to legislative budget, there can be other forms of resource-inflows to the entities. Certain rules exist that seek to safeguard the resources from the risk of loss.

| *Service Delivery Operations* | *Safeguard of Resources* | *Accounting* |
|---|---|---|
| Resource inflow<br>Raising loans, receiving grants, receiving interest or dividends from investment, disinvestment, privatization, sale, issue of bonds, shares, other market instruments, Revenue sharing, production sharing arrangements | Compliance with Rules governing<br>raising loans, other forms of borrowing, investments made, receiving grants, disinvestment, privatisation, sale, revenue sharing arrangement, production sharing arrangement etc. | Accounting of loans raised, grants, interest received, revenue from sale, disinvestment |

Activities of entities engaged primarily in resource mobilization also have four stages. Revenue Departments make tax payers comply with Tax Laws and Rules. They enforce tax compliance. Tax Departments are expected to comply with the laid down procedures that seek to ensure that its tax administration and enforcement is able to safeguard tax resources from the risk of being not collected or short collected and excess collection is returned. These procedures are meant to safeguard loss of revenue from probable acts of omission or commission of tax authorities.

| *Tax Administration* | *Safeguard of Tax Resources* | *Accounting* |
|---|---|---|
| Planning (tax base, tax rate, elasticity) Preparedness to implement tax policy and Execution (Tax Administration) by way of identifying tax payers, tax assessment, levy and collection of and reporting. Income Tax, Central Excise, Service Tax, Customs Duties- Union; Sales Tax (VAT), State Excise, Motor Vehicle Tax, Stamp Duty etc. | Controls (over assessment, levy and collection of tax revenue) that seek to ensure that enforcement of tax payer's compliance (across the tax base) with the tax laws is consistent, uniform and correct. Seeking to safeguard the money that is due to government. | Accounting of receipts in the concerned books of accounts, their compilation, their consolidation |

Several departments levy and collect non tax resources. Certain rules exist that seek to safeguard the resources from the risk of loss.

| *Management of Non-Tax Revenue* | *Safeguard of non-tax revenue* | *Accounting* |
|---|---|---|
| Similarly for non-tax revenue (fee, charges, royalty, rent, receipt etc.) by entities that charge for its services (electricity), which trade (warehouse) which sell (mineral), which regulate (pollution control) or all other entities where revenue receipts are incidental | Compliance of entities with rules and procedures on assessment, collection and remittance (tax revenue and revenue receipts) Also how the entities enforced compliance applicable to those who should pay and who pay | Accounting of receipts in the concerned books of accounts, their compilation, their consolidation |

Natural resources are perhaps the most important public resources. They need to be safeguarded from not only possible loss due to unauthorised, unsustainable extraction but also from pollution, degradation, destruction and extinction.

| *Management of Natural Resources* | *Safeguard of Resources* | *Accounting* |
|---|---|---|
| Sustainable exploitation or use of mines, minerals, land, water, air, forest, flora and fauna. Prevention and control of pollution of air, water, land, food, flora, fauna, humans, climate change. Disaster Management Sustainable development | Compliance with the environment laws and rules by those who need to comply that seek to safeguard all these natural resources mentioned Enforcing authorities/ entities comply with the procedures that seek to provide assurance that they are enforcing the laws & rules. | Accounting of expenditure on safeguard of resources Environmental Accounting |

All the above resources are public resources. All the activities of the government are for the people of the country, the citizens. Healthy, educated (formal, informal), knowledgeable (explicit, tacit, embedded) citizens are the resources and assets of a nation. Their health and education depends on their livelihood. Providing opportunities and access available for livelihood is the very purpose for which a government exists.

In accountancy if the asset is the one that generates constant stream of revenue, the regular stream of revenue that comes as tax from the citizens makes them the most important assets of any government. In the private sector, people are only inputs in the production process as men in addition to machines, material and capital. In the economy people are consumers and suppliers in an ever ending cycle of demand and supply in search of equilibrium. The company that uses the most industrial robots, Toyota, now, says it is becoming more efficient by replacing robots with humans.

Public sector is different. Democracy is founded on the principles of fundamental rights expressed in the constitution of the country. Foremost of the responsibilities of any government is to safeguard the rights of the citizens. Guarding their rights is not favour extended by the government to the citizens. This is perhaps, the most important reason a democratic government exists. The concept of safeguard of resources thus extends to the safeguard of citizens, which means safeguard of their rights. It is difficult to argue that this is not the subject-matter of compliance audit in the public sector auditing.

| *Fundamental Rights* | *Safeguard of Citizens Rights* | *Accounting* |
|---|---|---|
| Right to Equality, Freedom, Against Exploitation, Cultural Rights, Educational Rights, Rights to Constitutional Remedies | Compliance with a number of laws that seek to guarantee these rights:<br>Right to work, right to shelter, right to health, right to education, right to water, environment, consumer protection | National Accounts of Well-being |

It was explained in the earlier chapters that entity can be the department, an office of the department, an entity under the administrative control of the department such as for-profit commercial entities (a government company, statutory corporation), not-for-profit entities (autonomous bodies, or a board, or a body or authority).

Depending on the type of service delivery involved, the entity uses its budget, financial resources to acquire other resources that will be used as inputs in the process of service delivery. Entities keep procuring the resources such as manpower, material, electricity, water and various kinds of services at shorter intervals on ongoing basis as when required. Entities acquire or create the resources such as equipment, machinery, vehicles, land, buildings and other infrastructure which are used in the service delivery activity over a longer period of time.

There are different stages in the management of resources. Entities need to safeguard resources at all the stages.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Financial Resources – Budget** Already existing assets, infrastructure created earlier financial resources | **While Spending for acquisition of resources** | *Manpower (own)* | **While resources are being consumed or used - in service delivery process** | **When they are in not in immediate use** | their physical safety<br>their upkeep<br>their maintenance<br>their obligations | **While delivering the output to the intended recipients** | **Disposing off the assets, material, output with residuary value** |
| | | *Manpower (hired)* | | | | | |
| | | *Material* | | | | | |
| | | *Equipment* | | | | | |
| | | *Assets* | | | | | |
| | | *Infrastructure* | | | | | |
| | | *Services* | | | | | |
| | | *Logistics* | | | | | |

The first stage is safeguard of financial resources, when they are yet to be used or waiting to be used. The second stage is safeguarding the financial resources when used for procuring or acquiring all other resources, inputs. The third stage is safeguard of quantity and quality of resources that are being procured or acquired. The fourth stage is safeguarding these resources while they are waiting to be used in the service delivery process. This stage includes their proper storage, physical safety, their maintenance and upkeep. The fifth stage is while these resources are consumed or utilized in the service delivery process.

We can identify two more stages after the completion of service delivery operations. Entities need to safeguard the service delivery output till it reaches the intended recipients or beneficiaries. Service delivery output can be tangible like food grains, water, cash benefits etc. They may be stored for some time, before delivered to the beneficiaries. Service delivery output can also be intangible like law & order, education, health.

Occasionally entities dispose of surplus stores or material or depreciated assets etc.. that have residuary value. It can also be surplus output. Entities need to safeguard them while they are being disposed of from the possible risk of not realizing their value. Disposal may also take the form of sale of public assets, leasing out, sharing arrangements with private entities and various form of privatization etc.

The rules that are in place to safeguard resources can be grouped into those dealing different resources and various stages they go through. There exist government rules and instructions of general kind that are applicable to all resources at all stages. They include administrative approvals and financial sanctions of competent authorities for each transaction,

spending not to exceed amount authorised by legislature mode of presentation of claims against Government, withdrawing money, handling of cash and cheques, disbursing etc.

All payment and all receipts of all the government entities constitute transactions of the Government. Activities of an entity get reflected and documented in its transactions. That is how compliance audit is also called transaction audit.

Audit of compliance with rules is usually referred to as regularity audit. However, we know that transactions can be regular, as per rules, but may be improper. This is about the propriety of the transaction. Regularity and propriety are two aspects and together they seek to safeguard of resources. No precise rules are laid down by government for this purpose. They are recognised standards. The expenditure should not prima facie be more than what the occasion demands. Public moneys should not be utilised for the benefit of a particular individual or section of the community unless the expenditure is in pursuance of a recognised policy or custom. No authority should exercise its powers directly or indirectly, to its own advantage or as favour to someone.

Each type of spending is governed by a set of laws and rules apart from being governed by general rules and principles. All forms of public spending from the point of view of 'safeguard of resources' from the risk of loss, waste, misuse, abuse, theft etc., is the subject matter for compliance audit.

Acts of omission or commission by the tax officials or the tax payers result in loss of revenue to the government. Elaborate rules, instructions and procedures exist to mitigate these risks. Tax administration and other forms of resource mobilisation from point of view of safeguard of resources is also subject matter for compliance audit.

Acts and rules governing the safeguard of natural resources is also a subject matter for compliance audit. Each natural resource and the activities that have an impact on that natural resource is a subject matter. And finally safeguard of rights of the citizens is also a subject matter for compliance audit.

Subject matter of compliance audit is vast and diverse. Subject matter of compliance audit of union government can be listed as follows.

**General principles relating to expenditure and receipts**

Budget as an instrument of expenditure control

Control of expenditure against budget

General principles relating to expenditure and payment of money

General principles relating to revenue and receipts

Delegation of Financial Powers

**Establishment Expenditure and Service Matters**

General Conditions of Service

Pay and additions to pay, government accommodation

Allowances- Travel, Transport, House Rent, Others and LTC

Leave and Joining Time

Deputation and Foreign Service

Loans and Advances, Provident Fund

Retirement and Pension

Conduct of Government Servants

Suspension/Dismissal/Removal

**Procurement of goods, services, equipment**

Procurement of goods, equipment and services

Inventory Management

Contract Management

Provision of goods and services through private sector/NGOs/Societies

**Acquisition/ creation of assets/infrastructure**

Creation of infrastructure through Public Works Department

Creation of infrastructure through private sector participation in various forms

**Grants, Loans, Deposits, Investment**

(a) Grants and Loan - States, UTs, LBs Bodies, ABs, Societies

(b) Government Investments, Disinvestment, Sale

**Pension, subsidies, cash benefits (direct benefit transfer)**

**Levy and collection of tax revenue and non-tax revenue**

Union (Income Tax, Central Excise, Service Tax, Customs); State (Sales Tax, GST); Non-Tax Revenue– Union and States

Production/Revenue Sharing Arrangements with private sector

**Natural Resources**

Rules governing safeguard of natural resources: land, water, air, forest, wildlife, environment, biodiversity etc.

**Economic and social and political rights of the citizens**

Enforcement of and compliance with rights based legislation

## CHAPTER -3

# Audit Objectives in Compliance Auditing

Audit of an entity, it transactions and the activities resulting in those transactions from point of safeguard of resources can be viewed as a compliance audit assignment. Such audit assignments are carried out by Audit Teams. Possessing requisite auditing skills, adherence to ethical standards, being independent and objective are prerequisites for auditors. They are expected to exercise professional scepticism and professional care.

Audit assignment is a process carried out broadly in three stages; planning the audit assignment, executing or conducting the audit assignment and reporting the audit findings. Planning an audit assignment involves understanding the entity, identifying the sub-matter for audit and formulating audit objectives. There cannot be an audit assignment without an audit objective or audit objectives. It is advisable that audit objectives are in the nature of audit questions that can be answered at the end of the audit assignment. Each audit objective or question needs suitable set criteria against which subject matter is examined.

During the execution or conduct of audit, the subject matter is examined with reference to a set of audit criteria to get an answer to the audit question. This examination involves application of audit procedures. Substantive testing is the procedure extensively used while carrying out compliance audits and financial audits. Substantive testing involves examination of a sample of transactions (of the subject matter) with reference to the audit criteria. Such examination throws up mistakes or deviations which may be significant or may not be. This is the audit evidence that supports the audit findings. Evidence should be sufficient and appropriate. These audit findings answer the audit objective or question. Audit report (either a local audit report/inspection report or a CAG report) can be in the form of an assurance that the particular resource or resource of the entity are reasonable well safeguarded and extent of significant deviations and irregularities and also what more needs to be done. Audit findings and arguments in the audit reports are supported by the audit evidence gathered while conducting the audit.

To repeat, audit findings are the answers to audit objectives/questions. There cannot be an audit assignment without audit objective or objectives, whether compliance audit, financial audit or performance audit. The overall objective of the performance auditing is whether operational activities of the entity can be more efficient and effective. Assignment is carried out with a view to provide recommendations on possible improvements in the operational performance. It can be the overall operational performance of the entity, an activity, a scheme, a program etc.

The overall objective of the financial audit is to give an opinion on whether the financial statements are free from material misstatement. Specific financial audit objectives are whether the financial position of the entity at the year as depicted in the balance sheet is free from material misstatement; whether the financial performance during the year as depicted in the profit and loss account is free from material misstatement and the reported cash flow statement is reliable. An audit assignment can also be limited in scope, only to examine one component of the financial statements, or an aspect of the financial reporting.

It is not possible for an entity to perfectly safeguard all the resources at all the times. The cost of doing so may outweigh the benefits. Hence the overall objective of the compliance audit could be to what extent the entity could safeguard it resources. To what extent each resource is safeguarded at different stages translates into a separate audit objective. Examples are to what extent the entity could safeguard the expenditure (financial resources) on pay and allowances of employees, on procurement of material, procurement of services, procurement of equipment, creation of assets, given in the form of grants or loans etc. The scope of compliance audit assignments may be a particular resource, a particular stage or all of them for the entity as a whole.

Some examples of audit objectives in compliance audit are given below.

To what extent preparation and submission of the budget leading to demand for grant is in compliance the applicable rules and procedures

To what extent the entity is in compliance with rules and procedures applicable over drawal of money, remittance of receipts and handling of cash and cheques?

To what extent the entity could safeguard the financial resources used towards pay and allowances of the employees in compliance with applicable rules.

To what extent the entity is compliance with the rules and procedures applicable to the expenditure on contingencies

To what extent the entity could safeguard its financial resources on procurement of material inputs and equipment in compliance with the applicable rules. Material is to be purchased as per requirement; to be procured in economic fair transparent manner by attracting best possible bids; contract conditions safeguard the interests of the government; contract conditions are effectively implementation and enforced

To what extent the received material and equipment is safeguarded in compliance with the applicable rules when received, on their storage and safe custody, on their issue from stores to users and their use for the intended purpose.

To what extent financial resources of the entity are safeguarded on procurement of service inputs in compliance with the rules applicable. Services are purchased as per requirement; procured in economic, fair, transparent manner; contract conditions safeguard the

interests of the government; contract conditions are effectively implemented / enforced particularly with reference to quality of service.

To what extent the entity could safeguard its financial resources while creating infrastructure or assets in compliance with the applicable rules and procedures on estimating the requirement of infrastructure for current and future needs; identifying the 'works' and their technical, environmental and financial feasibility; administrative approvals and expenditure sanction; bidding process to identify the most economic and suitable contractor; tender evaluation and award of contract; execution of contract to complete the work; on financial transactions and their accounting throughout the execution.

To what extent the created infrastructure/asset is safeguarded with regard to it its safety, upkeep and maintenance

Audit objectives of PPP project include: whether adequate systems and processes were in place to ensure that the decision to use the PPP model was suitably supported by a competent analysis of alternatives; whether the enforcement of public sector's interests and roles was fulfilled appropriately, effectively and with low risk; whether all significant risks and issues were considered and addressed appropriately in the final agreement; efficiency in transfer associated risks supposed to be borne by the private entity; ability of the PPP to meet program objectives; ability to accrue the benefits of the program to the poor people; financial sustainability or financial viability of the model; whether designing, building and operating (by private partner) was effective, economic and efficient;

What is the extent of compliance with rules and procedures applicable for sanction, approval and release of grants, loans, equity, and other forms of disbursements?

Compliance audit objective in respect of taxes broadly is whether tax laws and regulations have been properly applied, and no items are improperly excluded in the determination of taxes estimated to be payable and the amount due is collected.

The overall objective of environmental auditing from compliance point of view is to determine the extent of compliance with the relevant national, local or other laws and regulations with regard to health and safety of employees; preventing damage to surrounding environment (air, water, soil, flora, fauna, food chain); adverse impact on the health of neighbourhood population; sustainable and authorised exploitation of natural resources etc. Each of the natural resource, each eco system, each industry, products for human use and consumption etc., can be subject matter for compliance audit.

Compliance audit objective in respect of citizens' rights is to what extent civil, political, social and economic rights bases (legislation) Acts have been implemented.

Depending on the scope of the audit and the subject matter, each audit objective may have sub-objectives. Acts, Rules, regulations, procedures, instructions governing that set of transactions/activities are the criteria. As explained elsewhere compliance involves not only examination of compliance with the rules but also adequacy of rules for safeguard of resources. For various reasons some of the rules may have become redundant or not able to adequately safeguard the resource. Audit findings and report should try to address these issues also. There can be situation where rules are seemingly complied in letter but not in spirit. Construction contract was awarded to the lowest bidder but circumstantial evidence indicates that even that bid value is much higher. Compliance audit assignment should also examine such issues to the extent possible and comment on such pseudo-compliance.

Fundamental principles of auditing are same for any of the audit assignment including compliance audit. In brief they are as follows.

Auditors-Skills, ethics, independence, objectivity, professional behaviour

Exercising professional care, professional scepticism, adhering to quality standards

Audit involves three parties – auditor, auditee and user- terms of engagement

Subject matter to be audited, understanding the entity, identifying the risks,

Planning the audit assignment

Setting the audit objectives, sub-objectives

Identifying the audit criteria

Application of audit procedures

(review of controls, analytical procedures, substantive testing)

Materiality, significant deviations

Sufficient appropriate audit evidence

Audit findings, audit conclusions

Documentation of entire audit process and evidence

Reporting (reasonable assurance/exception reporting), long/short report,

Follow up of implementation of recommendations, improvement in compliance

Compliance audit guidelines of IA&AD explain the general principles for compliance audits in detail. These general principles are applicable not only for compliance auditing but also for financial auditing and performance auditing.

# CHAPTER -4

# Review of Controls and Substantive Testing

The procedures that govern the activities and resultant transactions can be viewed as internal controls. Controls are the devices that regulate the activities. Traffic signals are controls that regulate the traffic to safeguard people from possible accidents. These devices by way of controlling and regulating are also directing the traffic in the desired way and discouraging the flow in the undesired way.

In the private sector financial auditing, historically it was assumed that a well-designed system of internal controls for accounting can provide a reasonable assurance that the financial statements are reliable. Auditor initially obtains an understanding of internal control system and its components. If the controls are found to be reliable, auditor reduces the extent of detailed substantive testing. Otherwise the volume of detailed substantive testing would be high. This is how the private sector financial auditing literature and private sector financial auditing standards developed over the period. Private sector financial audit thus, includes (a) review of controls, test of controls and then (b) substantive testing.

Literature on internal controls grew rapidly resulting in developing of internal control standards culminating in the integrated internal control framework developed by Committee of Sponsoring Organisations (COSO). It became mandatory for the private sector auditors to comment on the effectiveness of internal controls over financial reporting in addition to certifying accounts. CEO and CFO of listed companies in USA under the provisions of Sarbanes Oxley Act (2002), have to submit report of their assessment of internal control over financial reporting. Auditors, under Auditing Standard No. 5 of PCAOB (Public Company Accounting Oversight Board) in addition to an opinion on the financial statements, must also express an opinion on the *effectiveness* of a company's *internal control* over financial reporting. There is a similar requirement for Federal Agencies to certify the internal controls. This also became a requirement under International Standards on Auditing (ISA 400).

## Internal controls relating to safeguard of resources

The concept of internal controls is not limited to the activity of financial reporting. Internal controls (system) is defined as a process, (designed by the higher management) to provide reasonable assurance regarding the achievement of objectives of the entity which are (a) efficiency and effectiveness of service delivery operations, (b) reliability of financial

reporting and (c) safeguard of resources by complying with applicable rules and regulations. It means that internal control system in an entity has three streams, one set of controls for financial reporting, another set of controls for service delivery operations and one more set of controls that safeguard resources. These three streams at certain places may overlap.

The above concept is extremely useful for compliance auditing in public sector. The rules in place to safeguard resources can be viewed as controls. For example, rules laid down for public procurement seek to minimise the risk of loss by regulating and directing the procurement activity in a particular way. All the rules governing expenditure, revenue and resources of the government are controls. Audit findings on loss, waste resulting from substantive testing in compliance audit are indicative of controls not being exercised, or controls are weak etc.

Compliance auditing in a way includes review of controls that seek to safeguard the resources and test of those controls. All the rules imposed on the departments by the financial ministry (general financial rules, delegation of financial powers) and detailed instructions and procedures within the departments can be viewed as controls. Departments would also be governed by rules imposed by other ministries like Ministry of Environment, Mines etc., which seek to safeguard natural resources.

A control system consists of five sets of controls. The first set is operating procedures that seek to direct and regulate the activity like for example how a procurement activity should be carried out. The second set is the information and communication procedures that coordinate (regulate/direct) the actions of individuals, sections and units for each activity. The third set is reporting and monitoring procedures.

Resources are always exposed to the risk of loss. This risk exists within the entity (procurement procedures violated) and also arises from the external environment (bidder attempts to influence procurement activity of the entity). The management of the entity is supposed to anticipate the possible risks and put in place controls to address those risks. They can be additional controls or modification of existing controls. Policy and procedures for risk assessment and mitigation constitute the fourth set of controls.

Lack of integrity and lack of ethical values in the organisation is perhaps the biggest risk leading to loss of resources. Management's commitment to promote and develop the culture of integrity and ethical values is considered as the foundation. Management is expected to set standards of conduct, competence, ethical values, integrity etc. If the tone set by managers upholds ethics and integrity, employees will be more inclined to uphold those same values. Corporate greed at the executive level has destroyed hundreds of companies, drained stockholders of their investments, and left innocent employees without work. So is in government entities. Creating and maintaining an ethical environment where management sets the tone at the top is called 'control environment'. It is the fifth component of the entity's internal control system. They are referred to as soft controls.

This control system also acts as an accountability mechanism to secure accountability of the head of the department to the legislature on how he or she ensured safeguard of public resources. MSO, in the chapter on Integrated Audit of Departments (3.9.19), says that audit should examine and comment upon the arrangements for securing and enforcing accountability at different levels of the department with particular reference to the availability of appropriate internal control.

Auditor obtains an understanding of internal control and its components and evaluates them. Outcome of the evaluation is assurance on the existence of controls. Then, the auditor tests of controls, the outcome of which is assurance on the working of the controls. From controls point of view the subject matter for compliance audit can be viewed as follows.

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| Controls over preparation, submission for annual budget and use of budget approved by the legislature (financial resources) |
| Controls over use of budget, over cash, cheques, general controls over disbursement and receipts |
| Controls over pay, allowance |
| Controls over establishment and contingencies |
| Controls over procurements of goods (material and equipment) |
| Controls over procurement of services |
| Controls over creation of infrastructure through public works department |
| Controls over creation of infrastructure through private participation |
| Controls over other forms of resource outflow- grants, giving loans, repayment of loans taken & interest on loans taken, annuities, subsidies, cash benefits, cash transfers, various forms of investment |
| Controls over resource inflows - Raising loans, receiving grants, issue of bonds, shares, other market instruments, revenue sharing, production sharing arrangements, disinvestment, privatization, sale of public assets/resources |
| Controls over assessment, levy and collection of tax revenue |
| Controls over assessment, levy and collection of non-tax revenue and revenue receipts like fee, charges, royalty, rent. |
| Controls over safeguard of natural resources |

## Substantive testing in Compliance Auditing

Activities of an entity are captured and recorded in the financial transactions and related documents. Payments including other forms of outflows, receipts including other forms of inflows are transactions. An account is a group of similar transactions, for example pay, contingencies, stores, assets, grants etc.

Substantive testing involves detailed examination of selected sample of transactions from each account. It includes examination of the activities that resulted in transaction. For example a purchase transaction is the result of a purchase activity that consists of estimating the requirement, having budget provision, approvals, sanctions, bidding, selection of bidder, award of contract, entering into agreement, receipt of the ordered material or equipment, its storage, issue for use, termination of contract etc.

Substantive testing is the audit procedure by which subject matter is examined with reference to the audit criteria to answer the audit question or audit objective. Criteria for financial audit objectives are the accounting standards. They set the standards for recognition, measurement, occurrence, completeness etc., of revenue, expenses, assets and liabilities. Substantive testing of selected transactions is carried out with reference these criteria to answer whether the financial statements of the entity are prepared in compliance with accounting standards and free from material misstatement. It is implied that adherence to accounting standards leads to preparation of reliable financial statements.

Substantive testing of selected transactions in compliance audit is with reference to rules and procedures that were laid down to safeguard the resources. It is implied that compliance with the related rules and procedures helps to safeguard resources from loss due to negligence, misuse, theft etc.

This activity of substantive testing of transactions and the activity of review of internal controls governing those transactions/activities are closely linked to each other. Review of internal controls involves evaluation of internal controls system and testing of controls. This evaluation involves auditor obtains an understanding of internal control system and its components and investigating its design. This evaluation is an exercise to have an assurance about the existence of internal controls. It is only about their existence, whether they are in place.

The next step is to have an assurance on operation of controls. It is about whether the controls were exercised and whether the controls are effective? This needs detailed testing of controls.

Traditional private sector financial auditing literature for long held the view if the controls are found to be reliable, auditor can reduce the extent of detailed substantive testing. Otherwise the volume of detailed substantive testing should be high. If controls can be relied upon, the sample for substantive testing can be small. It assumed that usually the controls are in place and are generally reliable. This activity of review of controls consists of evaluation of the control system and test of controls. Procedures the auditor performs to test design effectiveness of control system include a mix of inquiry of appropriate personnel, observation of the company's operations, inspection of relevant documentation and walkthroughs. Test of controls would involve examining the working of control with reference to earlier transactions and current transactions. After this activity, auditor carries out substantive testing of transactions. This is detail substantive test of selected sample of transactions.

Somewhere from 2009 auditors started realizing that 'test of controls' and 'substantive testing' can be carried out concurrently, together. Financial audit literature grew around this idea. Auditing Standard No. 13 of PCAOB, ISA 330 etc., say that in some situations, the auditor may design the dual-purpose test to achieve the objectives of both the test of the control and the substantive test. Financial audit assignment that certifies the financial statements and also reviews the internal controls over financial reporting is sometimes referred to as integrated audit.

This entire activity is one composite whole. Evaluation of control system would only give assurance about existence of controls. Test of controls gives assurance of the working of controls, their effectives. Substantive testing is nothing but testing of past transactions with reference to criteria. Since the controls are built around the criteria, the entire activity is one whole. Substantive testing of selected sample of transactions (and related activities) is nothing but test of controls. Having an assurance of existence of control needs to be supplemented through testing to see whether controls have worked in the case of past transactions. Simple existence of controls without being exercised would not serve the purpose.

This concept is relevant and very useful for compliance auditing in the public sector. The rules to be complied are controls. Instances of deviations found in the substantive testing indicate that control was not effective or control is not exercised. Weak control that could not detect and prevent mistakes, deviations, irregularities is an indication that probability of happening again and again in future. Compliance audit report can have recommendations to improve the existing control or institute additional control. Instances of deliberate override of control (or not exercising) would call recommendations to initiate investigation to fix the responsibility leading to disciplinary proceedings resulting in punitive action.

Substantive testing is post-mortem of transactions/activities that already took place whereas controls continue to exist. Exercising controls is an ongoing activity. Results of substantive testing provide assurance about how well the resources were safeguarded during in the case of past transactions. Review of working of controls provides assurance that entity would continue to safeguard resources, at least for the current financial year. The most effective way of conducting compliance auditing is to understand the control system, it design, evaluate them and carry out substantive testing with view to test the controls.

The remaining chapters in the text book are organized in such a way that each chapter briefly explains the controls governing a resource and the stages it goes through. Attempt is made to be as comprehensive as possible and also as concise as possible. Audit findings in the Audit Reports of Union and State Governments are given as illustrations.

## CHAPTER -5

# Controls over preparation and use of Annual Budget

Ability to realistically estimate the budget-needs before seeking the approval of the legislature contributes to safeguard of resources. Union Government seeks to achieve this objective by complying with related provisions in General Financial Rules (GFR Rule 42 and 51 their appendices, annexures) and Budget Manual. State Governments also exercise control over preparation of annual budget through similar rules like those in the Budget Manual of Jammu & Kashmir Government.

No Expenditure out of the Consolidated Fund can be incurred without presentation of budget documents to the Legislature and its approval. Presentation of budget has to be strictly in the prescribed format up to detailed head level separately under Voted, Charged, Capital and Revenue. Reasonably accurate forecast of budget is critical to an entity's operational and financial performance. It applies to the department as a whole and also to each of its subordinate entity. Revenue earning entities are required to forecast the estimated revenue.

Inability to realistically estimate the financial resources required by the entity to meet its service delivery targets can result in entity falling short of funds and consequently falling short of delivery targets. Such failure can also result in savings depriving other entities that are in need of such funds. Such savings often get parked in deposits amounting to blockade of funds. Such parking leads to incorrect reflection of government cash balances and avoidable borrowing costs for the government. Improper budgeting results in unplanned implementation of schemes, activities by the entities. Noncompliance with the detailed procedures laid for preparation of budget estimates results in delays and difficulties in implementation. Meeting expenditure out of poorly planned budget can result in poor selection of activities, poor implementation and thus idle investment or waste of public money.

Absence of annual service delivery plan results in poor budgeting. Service delivery plan that does not reflect the mandate of the department and that is not aligned to achieve the performance objectives of the department results in poor budgeting.

Budget rules and related instructions seek to safeguard resources. The rules and the budget related activities of the department/entity fall into four groups.

- Budget estimates should be based on proper planning on demand and supply side.
- Adequate controls should be exercised over preparation of budget estimates with reference to costs, items of expenditure, heads of expenditure, budget format etc.

- Adequate controls should be exercised over release of budget
- Adequate controls should be exercised over spending from the budget.

*Audit Objective* can be framed as 'to what extent the entity was able to safeguard the resources by complying with the budget rules while preparing its annual budget estimate and spending from it'. It can have the following sub-objectives.

*Audit Sub-Objective 1*: Whether budget estimates for the year were based on demand-side planning and supply-side planning?

*Audit Sub-Objective 2*: Whether adequate controls were exercised over preparation of budget in compliance with rules prescribing the preparation and submission of budget/ demand for grant.

*Audit Sub-Objective 3*: Whether adequate controls were exercised over release of budget to the entities.

*Audit Sub-Objective 4*: Whether adequate controls were exercised to ensure that annual spending is within the budget/grant/heads of expenditure and is in phased manner?

Each sub-objective is with reference to a set of rules and procedures. Such rules and procedures are the audit criteria. Extent of non-compliance is a reflection of the inability of the entity to safeguard the resources. Significant, pervasive and persistent instances of non-compliance are the evidence of the entity's failure. The following list of sub-objectives and criteria.

| *Audit Sub-Objective 1*: Whether budget estimates for the year were based on demand-side planning and supply-side planning? |
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| *to examine whether*: |
| Department's mandate is unambiguous and flows from allocation of business rules? Whether the aims, objectives of the department well-articulated to reflect its service delivery mandate? Do short-term performance targets contribute to medium and long term performance objectives? |
| Entity identified the factors that can adversely affect its service delivery operations (risks) which can arise within the entity and from outside? If it has identified, how are they proposed to be contained/ mitigated? |
| The annual service delivery plan of the entity for the ensuring year contributes to achieving annual performance targets? |
| The planning on the demand side identified the intended target group/ beneficiaries, extent of coverage, duration, place, quantity and quality of service etc. to whom the service will be delivered etc.? |

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| Demand side planning was based on validated and verifiable data? |
| Supply-side planning was based on prioritization of target groups, number of beneficiaries, scope, extent, quantity, quality and cost of service, past trend of budget made available to the entity etc.? |
| It is recurring annual service at the same levels as last year? Does it involve expansion of existing levels of service, addition of a new service or? Does it result in additional budget due to need for additional inputs like more manpower or additional equipment or assets or infrastructure etc.? |
| Detailed budget estimates reflect the costs of the annual service delivery planned? |

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| *Audit Sub-Objective 2:* Whether adequate controls were exercised over preparation of budget complying with the related rules and procedure. |
| *to examine whether:* |
| Controls related to budget preparation were exercised by the Head of Office (HoO) of entities? |
| Controls related to budget preparation were exercised by the Controlling Officer (CO) of the Department and the Head of the Department (HoD). |
| Budget calendar as issued by the Finance Department from time to time has strictly been adhered to? |
| The items of expenditure included in the estimates are in conformity with the standing instructions, existing laws, rules/orders etc., particularly for the proposed new services |
| The budget documents prepared strictly as per the prescribed accounting structure. |
| Budget format which required recording of previous year's actuals, that of first six months of the current year, revised budget sought for and budget estimate for the ensuing year with details up to primary head of account is strictly followed? |
| The distribution between voted estimates and charged appropriations has been made correctly as per prescribed norms for such classification. |
| Correct distribution between Capital and Revenue expenditure has been made as per prescribed accounting principles. |
| Provision has been made for discharging the past liabilities against the Govt. expected to be met during the ensuing Budget year |
| The controlling officers (CO) have exercised necessary check, on the provisions made by the disbursing officers in respect of fluctuating grants as compared with previous year's grants/actual. |

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| *Audit Sub-Objective 3*: Whether adequate controls were exercised over release of budget to the entities. |
| *to examine whether:* |
| HoD/CO was communicated the budget allotments by the Finance Department immediately after the Budget is passed and placed the funds at their disposal? |
| HoD/CO taken note of variations between the proposed and approved budget, particularly about new items of work/service/new posts etc. Variations factored into the annual service delivery plan? |
| HoD/CO communicated the budget allotment to the Head of the Offices (HoO)/Drawing Disbursing Officers (DDO) without delay and explaining the variations (if any) to the budget proposed by them? |
| HoD/CO issued separate orders regarding new items of expenditure provided for in the budget? |
| Subsequent increase or reduction made in the grant or any part of it by the legislature (Revised Estimates/Supplementary Demand/Grant) was communicated in time by the Finance Department to the HoD/CO and in turn to the HoO/DDOs. |
| Funds were released regularly in monthly/quarterly by the HoD/CO. |

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| *Audit Sub-Objective 4*: Whether adequate controls were exercised to ensure that annual spending is within the budget/grant/heads of expenditure and is in phased manner? |
| *to examine whether:* |
| HoD/CO maintained a register of grants and appropriations in the prescribed form noting therein original grant, its distribution amongst subordinate officers, modifications made therein from time to time with full accounting classification viz. Major head, Minor head, sub-head and unit of Appropriation. |
| Head of the Office (HoO)/DDO maintained the similar register? |
| Expenditure was regulated to ensure that it is within the limits for each of the units of Appropriation (unit level/department level? |
| DDO at whose disposal lump sum allotments were placed for fluctuating charges under a unit of appropriation e.g. travelling allowances and who are authorised to distribute the lump sum allotment over specific items or group of items falling under that unit, has restricted the expenditure on each item to the allocation made for it. |
| Redistribution of allotment to cover extra expenditure on one item by reducing or abandoning another item did not exceed the total allotment placed at the disposal of competent authority under the concerned unit of appropriation. |
| The expenditure during the year was in a phased manner. |

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| Savings in budget were surrendered well in time? Not parked in deposits etc.? |
| Excess expenditure under different units of Appropriation explained? Were the re-appropriations valid and approved by competent authorities? |
| Whether the service delivery achievements are in proportion to the budget spent? |

### *Examples*

Government of Jharkhand at the end of the financial year 2013-14, surrendered 30 per cent of its budget of ₹ 43,000 crore for which it initially sought approval from the Legislature. On the other hand it incurred expenditure of ₹ 694 crore without seeking the approval of the Legislature. During the year on 45 occasion it had drawn advances from Contingency Fund to meet expenditure that was neither urgent nor can be foreseen.

Budget of the Government of Chhattisgarh in 2013-14 was ₹ 50,000 crore of which expenditure was ₹ 40,000 crore.

Government of Meghalaya (2013-14) sought Legislative approval for ₹ 10,052 crore of which it could incur an expenditure of ₹ 6,973 crore (30 per cent savings).

Government of Assam (2013-14) incurred an expenditure of ₹ 37,208 crore against the budget of ₹ 53,017 crore. On the other hand there was excess expenditure of ₹ 1,524 crore without legislative approval.

Government of Mizoram sought budget approval for ₹ 8,056 crore for the year 2013-14 of which by the end of the year it could spend ₹ 6,613 crore. For 62 schemes there was budget provision for ₹ 1,794 crore of which it spent ₹ 141 crore and surrendered 92 per cent of the grants. In 32 of those 62 schemes it did not spend anything and surrendered the entire amount under the grants.

Government of Bihar in the year 2013-14 obtained the approval of the Legislature for supplementary budget of ₹ 14,217 crore in addition to the original budget of ₹ 62,554 crore. Its actual expenditure for the year was ₹ 51,628 crore.

As per Rule 17.20 of the Punjab Financial Rules, the spending departments are required to surrender the Grants/ Appropriations or portion thereof to the Finance Department as and when the savings are anticipated. Several departments (total of ₹ 2,876 crore) did not surrender such anticipated savings. (PB SFR 2014)

The entire Supplementary provision (₹ 11,436 crore) of Andhra Pradesh in 2013-14 budget proved unnecessary as the actual expenditure (₹ 1,38,612 crore) incurred was less than the original budget provision (₹ 1,62,148 crore). There were savings for the fourth consecutive year which stood at ₹ 34,973 crore (20 per cent) during the year. On the other hand there was excess expenditure of ₹ 530 crore in some heads during 2013-14 without legislative authorisation.

During the year 2013-14, Government of Jammu & Kashmir spent ₹ 4,470 crore without the approval of its Legislature.

As per provisions of Supplementary Rules 297 to 299 of Madhya Pradesh Treasury Code, every head of office is required to maintain expenditure control register and send Monthly Expenditure Statement to budget controlling officer. Test check of records in nine field DDOs in the Labour Department revealed that these registers were not maintained in proper form. The monthly expenditure in these offices was not recorded sub-head and scheme wise making it difficult to monitor the excesses and savings under each sub-head.

Paragraph 110 of Madhya Pradesh Budget Manual, envisages that in order to avoid incorrect booking of expenditure and potential fraud and misappropriation, the departmental expenditure should be regularly reconciled with the figures booked by the office of the Accountant General (A&E). Scrutiny of records of offices of LC, Director ESIS and the Registrar Industrial Court revealed that differences in these two sets of figures were significant. (MP AR 2010-11 Chapter 4)

Re-appropriation is transfer of funds within a grant from one unit of appropriation, where savings are anticipated, to another unit where additional funds are needed. Government of Punjab during the year issued 28 re-appropriation orders for ₹ 6,163 crore. Out of them 25 were issued on 31st March. Several of these re-appropriation orders proved to be unnecessary because of the expenditure did not come up to the budget. Under 12 Demands the government spent ₹ 22,440 against budget provision of ₹ 32,000 crore. Savings of the Departments of Health and Family Welfare, Rural Development and Industries were more than 50%. Government sought supplementary provision for ₹ 3,838 crore under some of the Grants but the final expenditure was less than the original budget. (PB SFR 2014)

Report on State Finances of Kerala (2013-14) commented that without assessing the requirement of funds and the capacity of the implementing agency to utilise budget allocation, the Kerala Government provided substantial funds (central sector schemes) in the budget. Only 13 schemes were implemented out of 40 announced (2013-14). Departments surrendered more than 90% of the budget allocation in 185 sub-heads. Surrender was 100% in 62 of them.

Government of Haryana sought the approval of the Legislature for budget provision of ₹ 4,284 crore for 116 schemes in the year 2013-14. It reduced the outlay to ₹ 3,065 in the revised estimates. Finally it spent ₹ 2,240 crore. Similarly ₹ 2,117 crore was provided for 151 schemes but the actual expenditure was 962 crore. It withdrew 59 schemes for which it earlier took the approval for ₹ 615 at BE stage. It reduced BE of ₹ 589 crore to ₹ 157 crore for 23 schemes in RE. (HR SFR 2014)

Public Works department and Irrigation Department in Himachal Pradesh persistently exceeded the approved budget by 20 per cent from 2008-09 to 2012-13. In 15 cases the Government incurred expenditure of ₹ 37 crore on new services without budgetary provision. (HP SFR 2013)

According to the provisions of the Tamil Nadu Budget Manual, expenditure on a scheme/ service not contemplated in the budget estimate constitutes New Service or New Instrument of Service (NS or NIS). In such cases, expenditure can be incurred only after obtaining either an advance from the Contingency Fund pending authorisation of funds by the Legislature or provision of funds through the supplementary estimates. The powers of controlling officers to re-appropriate savings available under some sub-heads in a grant for meeting additional requirements under other sub-heads within the grant are, subject to the limits prescribed for NS or NIS. During 2012-13 some of the Government departments, through executive orders, accorded 30 sanctions for ₹ 2,356 crore by departments under NS or NIS. Some of them had concurrence of the Finance Ministry. (TN SFR 2013)

In terms of instructions contained in the Karnataka Budget Manual, 1975, the estimates for salaries are required to be framed with reference to the officers and staff likely to be on duty and with reference to the particulars of pay drawn by each irrespective of the sanctioned strength. In the original budget for the year 2012-13, a provision of ₹ 3,500 crore had been made in Grant No. 3 to take care of the impact of the Pay Commission's report. The inclusion of provision on salary expenses under only one demand by the Finance Ministry was inappropriate as the complete details for the amount were not available, decision on implementation of the recommendations of Sixth Pay Commission were yet to be made known. (KA SFR 2013)

Rule 56 of the General Financial Rules of Government of Haryana provides that expenditure should be evenly spread throughout the year and rush of expenditure in the closing month is regarded as a breach of financial propriety. In respect of 17 heads under 12 grants more than 50 per cent of the total expenditure (₹ 8906 crore) was incurred during the last quarter of the year. Out of this ₹ 3,289 crore (37 per cent) was spent during the month of March 2014 (HR SFR 2014). The expenditure of UP Government in March 2014 was ₹ 28,437 crore out of the annual expenditure of ₹ 99,785 crore (UP SFR 2014). Chhattisgarh Government during spent 65% of the expenditure 36 Major Heads during the last period January to March 2014 (CG SFR 2014). In Meghalaya expenditure under 9 Major Heads during March 2014 was 90 per cent (ML SFR 2014). In Bihar expenditure under 11 Major Heads during March 2014 was 70 per cent (BR SFR 2014). In Kerala 27 per cent of plan funds were drawn during March (KL SFR 2014). In Rajasthan under 70 sub heads the expenditure in March was 62 per cent (RJ SFR 2014). In West Bengal ₹ 2684 crore was spent on the last day of March 2014 (WB SFR 2014).

While conducting audit of Bihar Bihar Rajya Pul Nirman Nigam Limited (Company) in 2010, Audit observed that forty five bridges it built during 2006 to 2010 at the cost of ₹ 107 crores were not yet put to use (in 2010) because the work on approach roads were yet to be laid.

The Petroleum and Explosives Safety Organization (PESO), a subordinate office under the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry in 2003 proposed to set up with Fire Works Research and Development Centre (FRDC) at Sivakasi, to carry out research on development of environment friendly fire works to address safety of personnel involved in manufacture and environmental aspects. This was at the instance of Supreme Court directions on the safety in this sector. The building with equipment and instruments with a total expenditure of 6.59 crore was inaugurated in July 2011. Audit observed in 2013 that the Complex was being used to conduct seminars, training, testing, examinations and enquiries because the proposal of 2006 for creating posts of technical/administrative/supporting staff aggregating to 80 numbers was pending for approval in DIPP. It was found working with 3 technical persons of PESO. (UN AR 19 of 2013 Para 4.1)

National AIDS Control Organisation (NACO) is a division of the Ministry of Health and Family Welfare. In 2005, it initiated a plan to install 21,650 Condom Vending Machines in 120 identified districts. It projected sale of 5 condoms per machine per day. The revenue generated was expected to meet operational and maintenance cost. HLL Lifecare Ltd. (formerly Hindustan Latex Limited) a PSU and Hindustan Latex Family Planning Promotion Trust (HLFPPD, a Trust under HLL are the operating agencies for this scheme. NACO spent ₹ 21 crore and installed 11,000 machines in 2005-06 and another 10,000 during 2008 to 2010. Audit observed that out of 21,000 machines, 10,021 were missing or not traceable. Among others, 2680 were damaged and not working, some were not installed. 6500 were functioning but average of take per machine per day was less than one. NACO in August 2011 took a decision to discontinue this service. (Union Civil 19 of 2013 Para 6.1)

Andaman and Nicobar Administration, Directorate of Shipping Services (DSS) proposed (May 2005) to construct two 100-passenger-cum-vehicle ferries (Vessels) under Inland Vessels Act, 1917 (I.V. Act) and accordingly, wrote to Ministry of Shipping (MoS), GOI for necessary approval and sanction of expenditure. These vessels were to ply in the tidal creeks separating Baratang and Middle Strait on one hand and Gandhi Ghat and Uttara Jetty on the other. When the Standing Finance Committee (SFC) sought clarification whether the proposed areas of operation had been declared as inland waterways or not, A&N Administration (Feb 2006) clarified that the creek waters were not covered under inland vessels limit. SFC recommended that a report may be sought from Directorate General of Shipping (DGS) about the safety of operation of the vessels in the creek

waters. MoS accordingly conveyed (Mar 2006) to the Administration that construction under the I.V. Class could be carried out subject to prior safety clearance by DGS only. Without resolving the issue of safety clearance from DGS, the DSS entered into agreement (October 2006) with *M/s* Garden Reach Shipbuilders and Engineers Limited, Kolkata (Builder) for construction and delivery of vessels under Inland Vessels Act at a total cost of ₹ 15.50 crore. National Ship Design and Research Centre, Visakhapatnam (NSDRC), Technical Consultant prepared the drawings, design & specification of the vessel with electrical motor driven HRP hydrogets with 200 KW capacity motors to operate within I.V. limits. The built vessels were received in Jan 2009 at a cost of ₹ 16.35 crore and named as MV Afra Bay and MV Kannatang. Trials of the vessels (January 2009) revealed that the wind and current factors of the operational area were not taken into account while designing the crafts. The 200 KW electric driven motors were not effective enough to counter the effect of wind and tidal force on these vessels and thus they could not be put into operation during high wind/current condition which prevailed at Port Blair for seven to eight months in a year. (14.2 Union Civil 19 of 2013)

The Union Territory of Lakshadweep (UTL) Administration uses helicopters as medical ambulance to evacuate critically ill patients from various islands of Lakshadweep to the main land (Koehl) for urgent and specialized medical treatment. In order to enhance to air safety of the helicopters and ensure navigational support for helicopter pilots in locating the islands/destination even in turbulent weather conditions, UTL sanctioned (Jul 2005) ₹ 1.52 crore for procurement of five Radar Transponders for the five islands (Billa, Chetalatgh Kavaratti, Kiltan and Minicoy). The Airports Authority of India (AAI) was entrusted with the procurement of Transponders by UTL without entering into any formal agreement. Airport Authority of India (AAI) in Sep 2006 and the Department of Telecommunications (DoT), Ministry of Communications (MoC) in May 2007 clarified to UTL that the Transponders could be commissioned for operation only after obtaining a Wireless Operating Licence (WOL) from the DoT. The pre-conditions for grant of WOL were site clearance and advance payment of licence fee and spectrum charges, calculated from the date of issue of DoT's decision letter. It was therefore, imperative on the part of UTL to ensure that WOL was obtained in time. UTL had to pay licence fee of 5000/- and Spectrum charges of ₹ 36.00 lakh per year. All the five transponders were received in May 2008 and were installed and were made ready for operation between March 2009 and May 2009. Due to non-receipt of WOL from DoT transponders could not be used and the objective of evacuating critically ill patients by helicopters as medical ambulance could not be achieved. Warranty period of transponders valuing ₹ 1.52 crore expired in July 2009. UTL applied for licence/spectrum only in September 2009 and paid DoT ₹ 1.17 crore till date (March 2013). (14.8 Union Civil 19 of 2013).

# CHAPTER -6

# Controls over drawal of money from Government Account and general controls over disbursement, receipts and remittance

Governments seeks to safeguard resources by having controls over drawl of money by the entities from the government account, handling of cash and cheques, having general controls over disbursement, receipts and remittance. Union Government seeks to achieve it through related provisions in General Financial Rules (GFR 21 to 41), Receipt and Payment Rules 1983, DDO Manual (Para 1 and 2), Government Accounting Rules (Chapter 4) and related instructions. All the State Governments have similar Rules, for example Chapter-2 of Jammu & Kashmir Financial Code.

All receipts due to the Government are credited into the government account and the entire public expenditure is met from it. Government account means the account relating to the Consolidated Fund the Contingency Fund and the Public Account. Apart from specific rules for each type of tax and non-tax revenue there are rules that serve as general controls to safeguard receipts and their remittance into government account. Similarly disbursements and payments are safeguarded. DDO and Head of the Office are responsible for application of these rules. Controlling Officer of the Department has the overall responsibility to guard public money against loss and waste. Head of the Department who is the Chief Accounting Officer is responsible and accountable for the department as a whole. The activity broadly consists of the following six components.

Adequate controls should be exercised in handling cash and cash book

Adequate controls should be exercised over presentation of bills, drawal of money from government account (treasury/ bank) and disbursement

Adequate controls should be exercised over receipts due to the government and their remittance into government account

Adequate controls should be exercised over handling the cheques and maintaining cheque book and payment through cheques

Adequate controls should be exercised over imprest and temporary advances

Adequate controls should be exercised over instances of losses and defalcation

To what extent the entity was able to safeguard resources by complying with the general rules governing expenditure and receipts can be examined by framing the Audit objective and sub-objectives as follows.

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| Audit Objective<br>Whether adequate controls were exercised by the head of the office over presenting claims, drawal of money from government account, disbursement , payment, handling of cash and cheques, receipts and their remittance into government account. | |
| Sub-objectives: | |
| Whether adequate controls were exercised by the Head of the Office and his Drawing and Disbursing Officer: | |
| | in handling the cash and maintaining the cash and cash book |
| | over presentation of bills for payment, drawal from government account and disbursement/ payment |
| | in handling cheques and maintaining cheque book and payments through cheques |
| | over receipts and remittances into government account |
| | over imprest and temporary advances |
| | over instances of losses and defalcation |

Rules and procedures regulating the activity referred to in each of the sub-objective would be audit criteria. Selected number of transactions for the purpose of examination is the sample. Instances of non-compliance that are significant and pervasive form the audit evidence to substantiate the argument that entity did not comply with or partially complied with and thus was unable to safeguard resources. The following is the criteria for each of the sub-objective. In entities where these activities are automated auditors would be required to design the test accordingly.

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| Audit sub-objective<br>Whether adequate controls were exercised by the Head of the Office/ Drawing and Disbursing Officer in handling the cash and maintaining the cash book? | |
| | To examine whether:<br>- There is only one cash book (CB) and one DDO is responsible for cash and maintaining the cash book (CB).<br>- CB has been maintained in the prescribed form and pages machine numbered and page count certificate recorded on its first page under signatures of DDO or an authorised officer?<br>- CB has been closed daily under the attestation of the DDO?<br>- All the monetary transactions (all entries of receipts and payments) have been entered in CB as soon as they occur and attested by DDO |

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| | - Full essential particulars of each transaction have been recorded in the cashbook to identify these individually<br>- Corrections interpolations have been cancelled in red ink, correct entry inserted and authenticated by DDO, corrections are not frequent<br>- For every payment, there is a proper voucher with full particulars of the claim and all information necessary for its identification and are supported by payees 'receipts duly numbered.<br>- All payments for sums exceeding prescribed amount are stamped; receipt signed by a responsible official who should satisfy himself at the time of signing of receipt that the amount has been entered in the CB.<br>- Acquittance are signed and authenticated by the disbursing Officer, all purchases made can be traced into the respective stores ledgers.<br>- Money received as revenue remitted in full on the same day or the next day into the bank for credit to government account<br>- Payments into government account are supported by proper challans, and they are genuine, payments entered in the CB as remittances to government account are verifiable with reference to the records maintained in the PAO/Treasury<br>- 'Account Payee' cheques in favour of government servants and third parties issued (after pre-check) by PAO/Treasury to DDOs are watched (delivery, acknowledgement) through a separate register (not entered in the CB)<br>- Money drawn as advance in anticipation of demands is in excess of requirement and such advances unadjusted within prescribed period<br>- Expenditure is not incurred by diverting departmental receipts<br>- Bank accounts were opened under the orders of the competent authority. Bank reconciliation statement is properly prepared and the balance as per bank pass book agrees with the balance as shown in the CB.<br>- Government and private money are not mixed up. Transactions relating to non-Government money are accounted for in a separate set of books and kept entirely out of Government account.<br>- Physical verification of the cash balance is done at the close of each month and a cash count certificate has been recorded at the close of each month<br>- Closing balance lying in the cash chest is given at the close of CB for each month. It does not include more than three months old un-disbursed balances.<br>- Government money is to be kept in strong cash box secured by two locks of different patterns. The keys of one lock should are kept apart from the keys of the other lock and in a different person's custody. The cash chest not opened without both the custodians of the keys being present. |

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| | - Cash/personal security at prescribed scale in prescribed form was obtained from the person handling the cash?<br>- the cash has been properly handed/taken over at the time of transfer of person handling cash and opening/closing balances are properly carried forward? |

| Sub-objective | |
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| Whether adequate controls were exercised by the Head of the Office and his Drawing and Disbursing Officer over presentation of bills for payment, drawal of money from government account and disbursement/ payment | |
| | To examine whether:<br>- Withdrawal of money is made from the government account only by presentation of bill in support of relevant claim for the purpose.<br>A bill is a statement of claims against the government containing specification of the nature and amount of the claim, either in gross or by items, and includes such a statement presented in the form of a simple receipt. A bill becomes a voucher only when it is receipted and stamped 'PAID'.<br>- Bill contains all the particulars such as nature of claim, amount claimed, period of claim, expenditure sanction, any deduction etc. DDO obtained sufficient information as to the nature of every payment he is making<br>- Sanction of competent authority exists for expenditure; the powers exercised are within those delegated to him; expenditure is within sanction for which funds were provided<br>- Bills for payment towards suppliers are examined by the HoO or a responsible official, another Gazetted officer designated as DDO<br>- Bill is prepared in the prescribed form (Pay bill, TA bill, contingency bill etc. Charges related to two or more major heads not included in one bill<br>- Full accounts classification is recorded on the bill by the DDO<br>- Corrections in the money column/ total are attested, no erasures or overwriting, spaces left blank in the money column/ other columns covered by oblique lines.<br>- If bill prepared on special orders, the copy of the sanction is attached such as appointment/ pay fixation/ loans/ advances etc.<br>- DDO transferred any money for investment or deposit from Government account irregularly unless expressly sanctioned by competent authority<br>- If any bill prepared in duplicate or triplicate, only one copy is signed or counter-signed in full and the others only initialled; Original copy sent for payment.<br>- Office copies of bills (except regular monthly pay and allowances bills) are retained by Drawing Officer bearing only his initials (and not full signatures) and the words 'office copy' prominently written thereon. |

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| | - An acknowledgement of the payment signed by the person by whom or on whose behalf the claim is put forward is invariably attached to the voucher<br>- For every payment he makes, a voucher with full particulars of the claim and all information necessary for its identification, classification is obtained by DDO.<br>- If there is a single receipt for several payments or a lump sum payment, related vouchers are cross referenced<br>- Where it is not possible to support a payment by payee's receipt, a certificate of payment duly signed by the disbursing officer and counter-signed by his superior officer, together with a memorandum explaining the circumstances, is on record<br>- Every voucher bears a pay order signed or initialled by disbursing officer, specifying the amount payable both in words and figures<br>- All paid vouchers stamped 'paid' or so cancelled; all sub-vouchers to bills cancelled (cannot be used a second time).<br>- Rules for preservation of vouchers and sub-vouchers followed<br>- A bill register is maintained in the prescribed form and is periodically reviewed<br>- All the payments are preferred immediately and paid within six months, unless there are valid reasons recorded and brought to the notice of CO<br>- If claims were withheld valid reasons are recorded and brought to notice of CO<br>- Sanction for old claims was adequately justified |

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| Audit sub-objective<br>In case of DDO with cheque drawing powers, whether adequate controls were exercised by the Head of the Office/ Drawing and Disbursing Officer in handling the cheques and maintaining cheque book and payment through cheques |
| To examine whether:<br>- Cheque books are kept in the personal custody of the DDO and that each of them bears his endorsement that each one contains the correct number of cheque forms.<br>- An intimation of the number of cheque book and number of cheques it contains is sent to the banks as soon as a cheque book is brought into use.<br>- Cheques are not signed unless required for immediate encashment/ disbursement.<br>- The amounts are written in words and figures on the counterfoils and initialled<br>- All corrections and alterations attested by the DDO over his full signature.<br>- The amounts as shown in the counterfoil of cheque drawn agree with the entries on the payment side of the CB.<br>- All cancelled cheques are stamped 'cancelled' under the initials of the DDO and are preserved for scrutiny.<br>- Cheques were drawn in favour of the actual payees; made over to the payee by the disburser/cashier or any authorized representative; |

- The cheque issued was charged off on the date of issue
- All cheques towards payment or personal claims of government servants, pensioners, contractors, suppliers and public sector companies and corporation are drawn as payable to or order of the payee.
  There are a few exceptions; Cheque drawn in favour of Government offices or Departments or payment on account of inter- departmental or inter-Governmental are crossed and the words "for credit to Government account and not payable in cash" written between the lines. Cheques payable to Government officers to enable them to make disbursement in cash, such as of pay and allowances of establishments, of contingent expenditure issued in favour of the disbursing Government officer concerned by designation, the word "only" being added after the designation of the payee officer on the cheque with superscription on the top "not transferable"
- Time barred cheque received from the party cancelled by DDO, and treated as voucher for issuing new cheque in lieu thereof. Amount of time barred cheque classified as minus credit, fact of issuing & no. of new cheque noted on the counter foil of old cheque & in the schedule & register of cheques drawn
- In case of cheques cancelled before issue, particulars recorded in the counterfoil
- in case of cheques cancelled after issue , it is confirmed that it is not encashed, intimate to bank to stop payment After issue and obtain acknowledgement
- Procedures for issue of a fresh cheque in lieu of lost cheque are followed.
  The Party requesting for the issuance of a fresh cheque in lieu of the lost one executed an indemnity bond. In case of government entities a fresh cheque is issued only on receipt of a certificate that the cheque alleged to have been lost was not received by them or having received the same, it was lost and further that it will be returned to the Pay and Accounts Office if found afterwards.
- All the paid cheques are traceable in the bank scrolls. The cheques issued are reconciled monthly with the bank scroll and difference analyzed into actual outstanding, time-barred cheques being cancelled and fresh cheques issued in lieu.
- Stock account of cheque books is maintained in the prescribed form and that the physical verification of cheque books in stock is carried out at regular intervals.
- Every six months, stock taking is done by an officer other than in-charge (cheques) and a certificate of physical count is recorded by him in the stock register.
- The loss of a cheque book or a blank cheque notified promptly to the branch bank

With regard to maintenance of register of cheques it is to seen whether:

- The register of cheque is maintained in prescribed form
- All the cheques drawn are serially entered in the register chronological order and all entries are attested by cheque drawing officer.
- The totals of the amounts of cheques drawn are correctly struck and agree with those shown in the compiled accounts rendered to the accounting officer

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| | - The dates of encashment of the cheques are noted against the relevant entries and an abstract of un-cashed cheques to the end of the month is prepared.<br>- All self cheques shown to have been drawn have been taken to the receipts side of the Cash Book promptly.<br>- The register of ‘’cheques delivered is scrutinized to see that it is maintained properly and necessary balances of outstanding cheques are correctly worked out. |

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| Audit sub-objective<br>Whether adequate controls were exercised over receipts and their remittance into treasury/ government account | |
| | To examine whether:<br>- All the moneys to be received as dues to government as remittance or deposit etc. brought to government account without delay.<br>- Concerned officials ensured that receipts and dues are correctly and promptly assessed and duly credited to consolidated fund/ public account.<br>- There is demand register with demands falling due are noted to recovery watched<br>- The person or party paying money into the bank on Government account presented with it challan (in duplicate/triplicate or quadruplicate as specified) in the prescribed form showing distinctly the nature of the payment, the department or office on whose account it is made, particulars of the concerned Pay and Accounts Office, proper account classification of the credit.<br>- If the receipts are paid in cash all realisations entered in the cash book and remitted to the bank without delay<br>- All sums due are received and checked against demand, all receipts realized and paid into the treasury and entered in a register maintained by the DDO.<br>- Receipts in printed forms are issued in a consecutive order for all money received.<br>- All receipts written in figures and in words in the original and signed in full over the ‘Cash Received/| Received Payment’ stamps. Before the official signing the receipt and initialling its counterfoil, the amount is entered in the cash book.<br>- A stock register in the prescribed form is maintained to keep an account of receipt books, receipts. No Government officer may issue duplicates or copies of receipts granted for money received on the allegation that the originals have been lost.<br>- All the receipts books are kept under lock and key in the custody of a responsible officer and one book is issued to the concerned on receipt of the used- up-book.<br>- The challan bears the seal and signature of the bank in token of money having been deposited, proper classification is recorded, separate challans have been prepared when moneys are creditable to several heads of account |

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| | - The date of the remittance shown in the cashbook corroborates with the date of the remittance recorded by the treasury/bank on prescribed form<br>- the remittance made got verified from the treasury/bank at the close of the month<br>- If receipts are authorised to meet payments, the gross receipts and the payments made, are entered as receipts and expenditure in a record that is kept for the payments into and withdrawal from the Consolidated Fund or Public Account as the case may be, and accounted for as such to the Accounts Officer<br>- If a cheque or draft was dishonoured, the fact was reported at once to the tenderer with a demand for payment in cash and the dishonoured, cheque or draft returned to the tenderer on surrendering the preliminary acknowledgement of the receipt of the cheque or draft |

| Audit sub-objective<br>Whether adequate controls were exercised over imprest and temporary advances | |
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| | *To examine whether:*<br>- Imprest amount/ permanent advance are within the prescribed limit.<br>- Recouped every month, sub-vouchers submitted with account for recoupment of advance, were initialed with date by the Officer concerned?<br>- Each voucher can be traced to corresponding entries in stock/ store/ ledgers/ registers/ measurement books etc.<br>- The holder of a permanent advance or an imprest is able to produce the total amount of the money in vouchers or in cash at any point of time<br>- Unspent outstanding imprest/advance is recovered in cash in the cases where accounts were not rendered within a month<br>- A note of outstanding imprest was kept in the last pay certificate of the officials at the time of his/ her transfer |

| Audit sub-objective<br>Whether adequate controls were exercised over reporting losses and defalcation | |
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| | *To examine whether:*<br>- Instances of defalcation or loss of Government money made good by the person responsible for it and immediately reported to the concerned authorities (and to the Accountant General in the State)<br>- Loss due to honest error of judgment, negligence, fraud; held personally responsible for contributing to the loss by his own action or negligence.<br>- cases condoned by competent authority have evidence that loss the act of official was in good faith, done his best up to the limits of his ability and experience and it was honest error of judgment. |

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| | - Cases involving material loss or destruction due to suspected fire, theft, fraud exceeding the prescribed value reported to police for investigation<br>- After full enquiry as to the cause and the extent of the loss has been made, the detailed report sent to concerned authority (and a copy to the Accountant General).<br>- Loss is made good after the responsibility is fixed and disciplinary action is taken; remedial measures taken to strengthen the control system<br>- For write-off, remission of recovery the prescribed procedure was followed |

***Examples***

According to Rule 95 of Assam Financial Rules (AFR), the Head of office is personally responsible for accounting of all moneys received and disbursed and for the safe custody of cash. He is required to verify day to day transactions, attest each entry that appeared in the cash book and authenticate the analysis of daily/monthly closing balance. He should satisfy himself through periodical examination that the actual cash balance corresponds with the balance as per cash book. Rule 95 (5) of AFR provided that a bill register should be maintained in the prescribed form and all bills, to be assigned by the Head of office or the officer authorised on his behalf, should be entered in the bill register and put up to the officer along with the bills for attestation of the entries in the bill register while signing the bills. The actual monetary transaction should be entered in the cash book so that the balance of the cash book represents the actual cash balance. Every payment must be supported by a voucher (Rule 78) with clear particulars of the claim. Every voucher must bear a pay order signed or initialed and dated by the disbursing officer. In the case of fund received through cheque and transactions made through bank account, reconciliation with bank balance and actual bank balance indicated in the cash book should be done at regular intervals and a certificate to that effect recorded in the cash book.

Scrutiny (February 2012) of records of the Joint Director Health Services, Diphu, Karbi Anglong Autonomous Council revealed that he did not maintain the statutory records and did not carry out the prescribed procedures. Bill register was not maintained; serial number was not recorded in vouchers along with chronological maintenance of vouchers in voucher guard files; proof of bank reconciliation with the bank was not available; physical verification of cash balance along with analysis of closing cash balance was not done; bill-wise analysis of closing balance in cash book was not carried out showing bank balance and cash balance separately. Attempts were made cover up the misappropriation by entering fictitious figures collected through non-existent 'receipt books' and payment of corresponding amounts without supporting vouchers. The difference

in balances that could not reconciled indicating possible misappropriation was ₹ 18.45 lakh. (1.2.4 AS 2013)

According to Rule 92 (a) (ii) of Kerala Treasury Code (KTC), Volume I, all monetary transactions should be entered in the cash book as soon as they occur and got attested by the head of office in token of check. According to Rule 131(a), the contents of cash chest shall be counted by the head of the office or under his orders by the Subordinate Gazetted Officer at the close of business on each working day and verified with cash book balance. A memorandum of verification shall be signed and dated by the Government servant who counted the cash. Each entry of receipt and payment made in the cash book should have been checked by the officers during attestation with reference to the counter foils of cheque books, bills passed by the sanctioning authority, acquittance roll, etc., to prevent and detect any discrepancy. The drawing officers should invariably keep the cheque book supplied to him in his personal custody. When amounts were drawn through self-cheques, they should be entered on the receipt side of the cash book and corresponding entries for payment should be made on the payment side of the cash book.

In Government hospitals, separate accounts were to be maintained for Hospital Development Committee (HDC) funds and Rashtriya Swasthya Bima Yojana (RSBY) funds. During the course of audit (Jul 2012) of the accounts and register of HDC and RSBY in the Government General Hospital, Thiruvananthapuram for the period from Feb 2011 to July 2012, it was noticed in audit that the daily closing of HDC cash book and RSBY cash book were not checked and attested by the Superintendent. The physical verification of cash was not conducted. It was conducted on 28 Jul 2012 at the instance of Audit. The actual cash found was ₹ 39,000. The closing of the cash book on 27 July 2012 showed that there was cash balance of ₹ 7.93 lakh. There were temporary advance receipts amounting to ₹ 2.21 lakh for which final account was to be prepared. The shortage of cash was ₹ 5.33 lakh. Three self-cheques for ₹ 3.75 were drawn from the RSBY and transferred to the HDC as a stop gap arrangement. In the HDC cash book two of the cheques were shown as cash payment to the HDC bank account without making corresponding entries on the receipt side of the cash book for the amounts received from RSBY. (3.7 KL 2 of 2014)

As per provision of Rule 197 of Madhya Pradesh Treasury Code, the bill register should be reviewed monthly by the DDO and record a certificate to confirm that it is correctly maintained. Monthly abstract should be prepared at the end of each month giving details of number of bills submitted to the treasury, the total number of bills passed and total number of bills cancelled, bills pending etc. Scrutiny of bill registers of 21 test checked DDOs revealed that neither the review of bill registers was conducted by DDOs nor were monthly abstracts prepared in eight DDOs.

As per rule 282 of MP Financial Code (MPFC) every official handling cash or stores is required to deposit security. Records of ten DDOs out of 21 in the Labour Department revealed that nine officials handling cash and seven officials handling stores had not deposited any security. (4.1.7 MP 2010-11)

As per Rule 98 (2) (iv) of Maharashtra Treasury Rules, 1968, at the end of each month, the head of the office should verify the closing cash balance in the cash book with dated signature and record the balance in words and figures. Scrutiny of cash books maintained by 45 DDOs of Social Justice and Special Assistance Department in Maharashtra revealed that there were differences between cash books and bank pass books to the extent of ₹ 108.54 crore as of March 2013. Reconciliation of cash book balances with balances as per bank pass books was not done. In Kolhapur, Sholapur and Pune districts, the Assistant Commissioners did not verify the closing cash balance at the end of each month during the period 2008-10. (2.4 MH 4 of 2014)

Audit pointed out that 17 out of 34 test-checked Child Development Project Officers (CDPOs) did not prepare any abstract showing the bill number, date of drawal of the amount during the last five years to ascertain the cash balances lying undisbursed for long period. The CDPOs, the Deputy CEOs (ZP) and the Deputy Women Child Development Officers (DWCDOs) were discharging the duties of DDOs. Funds received by the DDOs on account of diet, honorarium, implementation of various schemes and disbursement of salaries to staff were drawn from Treasury through Electronic Clearance System (ECS) and directly credited to the bank account of the DDO concerned. Scrutiny of cash books in 1120 CDPOs, two DWCDOs (Mumbai Suburban and Yavatmal) and two Deputy CEOs (Beed and Osmanabad) revealed that the difference between the bank balances and cash book balances amounting to ₹ 17.41 crore were not reconciled. (MH 2011-12)

The closing balance of the cash book of Rajendra Institute of Medical Sciences (RIMS), Ranchi as on 25 November 2003 was ₹ 15.16 crore. The opening balance in the cash book on the next working day (27 November 2003) was, taken as ₹ 13.90 crore on the basis of the bank statement. The shortage of ₹ 1.26 crore was not reconciled (June 2010). Audit found that even after accounting the unaccounted available vouchers for payments/remittances the shortage of cash according to its cash book was ₹ 1.24 crore. (JH 2009-10 Para 1.2.7)

According to Rule 300 of the Jharkhand Treasury Code, no money should be withdrawn from the treasury unless it is required for immediate payment. It is not permissible to draw money from the treasury and place it in deposit in order to avoid lapse of allotment. Audit scrutiny of Department of Social Welfare, Women and Child

Development, Government of Jharkhand revealed that there were unspent balances with test-checked projects and DSWOs amounting to ₹ 52.22 crore as of March 2010. Out of this, ₹ 46.68 crore was parked in banks, ₹ 4.49 crore had been given as advances, and ₹ 44 lakh was in the form of unadjusted vouchers and ₹ 61 lakh as cash in hand. (JH 2009-10 Para 1.3.7.2)

While conducting the audit of Orissa University of Agriculture and Technology (OUAT) in July 2014, it was noticed that Main Cash Book of Comptroller was closed only up to March 2013. Reconciliations were not made with bank statements (five bank accounts) at the end of each week or each month. Discrepancies to the tune of 22.86 crore were noticed. (OD 1 of 2014)

Audit scrutiny (Jun-Jul 2013) of the records of Medical Superintendent (MS), Government Hospital Gandhi Nagar, Jammu, revealed that ₹ 10.63 lakh were drawn (Feb 2012 to Mar 2013) towards payment of diet charges on the basis of photocopies of bills for payment to the diet contractor. Audit found that diet charges pertaining to various periods (Mar to Jun 2009, Mar, Jun 2010 and Nov 2011 to Sep 2012) were already drawn during Aug 2009 to Mar 2013) on the basis of original bills. The Medical Superintendent had not maintained a bill register to keep a watch on the period(s) for which bills were preferred by the diet contractor and payments made to him from time to time against the bills preferred. (JK 4 of 2014 Para 3.11)

Rule 77 (ii) of Central Treasury Rules (CTR) stipulates that all monetary transactions should be entered in the Cash Book as soon as they occur and attested by the Head of the Office in token of check. Audit of the records (Aug 2013) of the Director, Relief and Disaster Management, Imphal, Manipur showed that a sum of ₹ 65.93 lakh for implementation of a scheme was withdrawn through 25 cheques from the bank between 5 June and 19 July 2013. The amounts withdrawn were neither reflected in the Cash book nor in the Cheque issue register. There was no Cash Book entry after 3 May 2013 where the closing cash balance was stated as ₹ 1.03 crore. Till date (Aug 2013) ₹ 65.93 lakh remained unaccounted. (1.4 MN 1 of 2014)

During Audit (Oct 2012) it was observed that the Directorate of Veterinary & Animal Husbandry Department, Kohima, Nagaland was maintaining a current bank account (A/c No.10277120294 at SBI, Lerie Branch, Kohima). Despite requisition and several reminders, the Department furnished (October 2012) only the Bank Account Statement for the year 2011-12. On test-check, only a few transactions in the Cash Book could be traced back to the Bank Account. The balance in the bank account was lower by amounts ranging from ₹ 5.56 crore to ₹ 8.79 crore than the monthly closing balance recorded in the Cash Book. The following is an illustration.

| | CB as per cash book ₹ in crore (main & subsidiary) | CB as per bank account ₹ in core | Difference ₹ in crore |
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| Jan 2012 | 10.75 | 2.66 | 8.09 |
| Feb 2012 | 11.64 | 2.85 | 8.79 |
| Ma 2012 | 26.10 | 20.54 | 5.5 |

Similar deficiencies were noticed between the Cash Book maintained by the EE, V&AH Division and Bank Account Statement (A/c No.10277120589 at SBI, Lerie, Kohima). For example, in August 2009, the total payments made as per the Cash Book was ₹ 78,000 while the total debits during the month in the Bank Account was ₹ 2.17 crore. Payments were made without recording them in the Cash Book. (2.3.9 NL 1 of 2013)

The guidelines of the Sarva Shiksha Abhiyan (SSA) envisaged that funds provided for implementation of the programme to the Vidyalaya Shiksha Samittees (VSS) were to be kept in nationalised or scheduled banks at the district level and in any nationalised or scheduled bank or post office at the block and village level. Audit of the accounts of the VSS were to be operated with the joint signature of the Secretary, VSS and Head Master of the school. Scrutiny of records of the District Superintendent of Education-Cum District Programme Co-ordinator (DSE-cum-DPC), SSA, Araria in Bihar disclosed (January 2009) that the DSE-cum-DPC had released ₹ 2.02 crore to 414 new primary schools through cheques during Mar 2007 to Feb 2008 for construction of school buildings, boundary walls and other purposes . However, instead of crediting to the accounts of the VSS as per the procedure, the cheques were collected personally by the DSE-cum-DPC, the Junior Engineer and the Assistant Executive Officer of the scheme. They did not deposit the cheques in the bank accounts of the concerned VSSs. The entire amount was transferred to the Primary Agriculture Credit Co-operative Society (PACCS), Dehati during November 2007 to June 2008 by opening new accounts in the names of the said schools. ₹ 52.74 lakh was provided to 20 schools and the remaining ₹ 1.49 crore was misappropriated by the DSE-cum DPC, SSA Araria and other officials in connivance with PACCS, Dehati. (BR 2008-09 Para 2.1.3)

Audit of records of the Director General of Police, Punjab (April2014) showed that an amount of ₹ 7.44 crore (including interest) collected (between December 2013 and August 2014) on account of receipts from traffic challans was kept lying in the bank accounts of the respective district police Headquarters, outside the Consolidated Fund of the State in contravention of the constitutional provisions ibid. (SFR 2014)

Rule 2.2 (iii) of the Punjab Financial Rules as also applicable to Haryana provides that a DDO should satisfy himself that all the monetary transactions are entered in the Cash Book as soon as they occur and the same are attested by him. In case an employee, who is not in

charge of the Cash Book, receives money on behalf of the Government, he is required to remit the same to the employee having a Cash Book or deposit the amount into the treasury/bank on the same day or in the morning of the next day.

Government of Haryana in 2001 entrusted the work of issue of registration certificates of vehicles to District Red Cross Societies (DRCS). The district administration fixed (July 2001) service charges for issuing registration certificate and driving licenses. DRCSs were required to collect the service charges and issue receipts in duplicate to the concerned persons. The amounts so collected were required to be deposited with the bank on the same day or the latest by the next day. The DRCSs were required to maintain district as well as tehsil-wise detailed records of service charges collected on daily, monthly and yearly basis. Audit (Sept 2011) of the records of DRCS, revealed that data entry operators (DEOs) were deployed at Sub-Divisional Office for collecting service charges on behalf of the DRCS and deposit the same with DRCS cashiers. DRCS never called for the details of amounts collected by DEO to ensure that all the amounts collected by DEO were regularly deposited. Test-check (Sep 2011) of service charges deposited by two Sub-Divisional Offices (Nuh and Ferozepur Jhirka) revealed that against ₹ 34.50 lakh collected as service charges, only ₹ 16 lakh was deposited with the DRCS, (HR 3 of 2013 Para 4.1.1)

## CHAPTER -7

# Controls over expenditure on pay and allowances of employees & their service matters

An office consisting of its employees is referred to as establishment. The expenditure on pay and allowance of the employees constitute very significant part of the expenditure of a department and its offices. In order to safeguard voluminous expenditure on pay and allowance from the risk of incorrect payments, excess payments arising out mistakes, mismanagement and fraud etc., several rules and procedures are put in place by the governments.

Rules governing employees and expenditure on employees of the Union Government are Fundamental Rules (FR), Supplementary Rules (SR) and Central Civil Service Rules (CCS) and General Financial Rules (GFR). There are 130 Fundamental Rules. Supplementary Rules are framed under various Fundamental Rules. CCS Rules regulate various aspects of service of the Central Government employees. Some of them are CCS (Conduct) Rules, 1964; CCS (Leave) Rules, 1972; CCS (Joining Time) Rules, 1979; CCS (CCA) Rules 195, CCS (Pension) Rules, 1972, CCS (LTC) Rules, 1988, CCS (Revised Pay) Rules, 2008 etc. The procedures are laid down Government Accounting Rules (GAR), 1990. There would special provisions in some departments like Railways, Defence, and Scientific Departments which would governed by related rules. There are Rules similar to Union Government in every State, governing the State Government employees like J&K Government Financial Code, J&K Civil Service Rules etc.

To what extent the drawing and disbursing officer could safeguard the financial resources on pay and allowances of the government servants and regulate their service matters by complying with the related rules is examined by framing the audit objective as follows.

Audit Objective: whether adequate controls were exercised by the HoO and HoD over pay, allowances, entitlements and claims of the employees and their service matters to safeguard the financial resources of the government from the risk of loss of waste due to incorrect, inadmissible payments etc.

| Sub-objectives: | |
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| Whether adequate controls were exercised by the HoO/DDO over: | |
| | estimating the annual budget for pay, allowances, entitlements and claims of employees (includes alternation to establishment, new establishment) |

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| | employees newly joining the office subsequent to their recruitment and on transfer posting from other offices |
| | upkeep of service record (service books) of each employee |
| | preparation of pay bill and drawal and disbursement of pay and fixed allowances |
| | release of increments to employees and fixation of pay on promotion, |
| | leave, leave salary, joining time, leave/ on deputation/ absent/ on suspension |
| | various allowances to the employees |
| | statutory and other deductions from the salary |
| | non-interest bearing advances and interest bearing loans and recoveries |
| | Preparation of pay bill for the establishment, pay acquittance, on un-disbursed pay |
| | travel claims on tour and transfer, LTC |

Rules governing the activity referred to in each sub-objective are the audit criteria. Number of the transactions selected for verification is the sample. Instances of non-compliance that are significant and pervasive are the audit evidence of the extent of the failure of the entity to safeguard the resources spent on employees. The following is generic and the auditor has to refer to the specific rules of the State Government or Union Government and the specific department/entity as applicable.

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| Sub-objective<br>Whether adequate controls are exercised on estimating the annual budget for pay, allowance, entitlements, and claims of the employees by the DDO/HoO | |
| | *To examine whether:*<br>Details of estimates under Salaries are worked out on budget forms, which are designed in a manner so as to bring out details of salary payable. The details are worked out systematically individual by individual.<br>Estimates are prepared in respect of the staff strength which stands sanctioned for the Department and on the approved rates of pay and allowances. No revision in such strength and rates was assumed even if the same is strongly expected<br>In case of vacant posts, the estimates were proposed at the minimum of the scale of pay attached to such posts.<br>Anticipated increases in the current level of salary by way of increments are worked out according to the prescribed parameters. Where increments have been stopped for a year or so affecting the budget year it has been ensured that no provision for increments against posts held by such incumbents have been made.<br>Provision for an employee working on a higher post but placed in a lower scale of pay was made in the lower scale only. |

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| | Provision for leave salary has been made separately |
| | Arrears of pay anticipated to be paid in the new financial year was provided for in the prescribed form/column with necessary explanation in the remarks column. |
| | Provision for pay and allowance of officers under suspension irrespective of the fact that they may be drawing only subsistence allowance has been made |
| | Appropriate approved accounting classification has been recorded and each item given the prescribed specific code. |
| | Alteration in the establishment (new posts) was budgeted as prescribed |

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| Sub-objective<br>Whether adequate controls were exercised by the head of the office/DDO over employees newly joining the office subsequent to their recruitment or on transfer posting from other offices | |
| | *In respect of newly recruited joining the office to examine whether:* |
| | Identity of the newly recruited person reported for joining is established |
| | Documents related to recruitment, qualifications and posting to this office are valid |
| | Documents related to the age of the person, fitness (health) are valid |
| | His/her joining pay and allowances are correctly fixed, required declarations from the employee are collected |
| | Service book opened and necessary entries are recorded in the service book at the appropriate place under the attestation of the head of the office |
| | Reference for verification of validity of documents related to identity, qualifications etc., was made with concerned authorities/agencies after his/her joining |
| | *In respect of employees joining on transfer posting examine whether:* |
| | Orders of posting and orders of relieving officer |
| | The last pay certificate (LPC) of the employee (in the prescribed form) received from the earlier office and available |
| | LPCs contain full details of the post held, scale of pay, last salary paid up to which date of the month, recoveries/deductions made from last pay bill and to be made from the pay in future |
| | Service book is received from earlier office, full particulars have been incorporated in the LPC with reference to entries in the Service |
| | Joining time availed is as per entitlement |
| | Similar controls were exercised over employee who has left the office on transfer posting to other office |

| Sub-objective<br>Whether adequate controls were exercised over upkeep of service | |
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| | *To examine whether:*<br>Service books in the prescribed form are maintained for all the employees<br>All the nominations in regard to the GPF/ Gratuity/ CGEIS and details of the family members, declaration of home town are recorded in the service books.<br>Alteration is made in the date of birth with the sanction of competent authority.<br>Each necessary detail like joining, changes in pay due to increment promotion etc., leave taken, transfer, joining time, deputation, LTC, suspension, interruption in service etc., have been recorded and the entries were attested by the competent authority<br>Leave accounts are maintained properly in the prescribed form; credits afforded to leave accounts are correct and the leave availed of by an official has been debited correctly and balances worked out under attestation.<br>Account of loans and advances taken , recovery/deduction made are maintained properly in the prescribed form<br>Periodic verification as prescribed was carried out and service verification certificates have been recorded and entries in the service book confirmed by the employees<br>All entries in the service book are verified and completed for retiring Government Servant to facilitate timely finalization of retirement benefits<br>Service books are kept in the safe custody of the Head of Office. |

| Sub-objective<br>Whether adequate controls were exercised on preparation of pay bill and drawal and disbursement of monthly pay and fixed allowances | |
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| | *Pay bills are examined to see whether:*<br>Bills for pay, fixed allowances (permanent travelling allowance, conveyance allowance etc.) and leave salary are prepared in the prescribed pay bill form.<br>Separate pay bills were prepared for establishments whose charges are debitable to different heads of account; for different classes of employees if required.<br>The total number of persons to whom pay and allowances are drawn do not exceed the sanctioned number of posts. In the pay bill the sanctioned strength of the permanent staff is indicated at the top of each section of posts. In the case of temporary posts, the number and date of the sanction letter shall also be indicated.<br>The name of every incumbent is shown against each post and the rates of pay and allowances claimed for each are shown. If not, a certificate is endorsed on the bill stating that all persons whose names are omitted from, but whose pay has been drawn in this bill, have actually been employed during the month, that full details of the emoluments drawn for them working up to the total included in this bill have been duly shown in the Pay Bill Register. |

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| | The actual period for which these payments are claimed when pay and allowances are drawn for a portion of a month only, and the fact was mentioned against the concerned Government servant in the body of the bill.<br>Pay of employee is correct with reference to the substantive post held, pay fixed as per the pay scale and fixed allowances are per the entitlement.<br>Increase in pay due to increase in dearness allowance is worked out correctly with reference to due date, unqualified period and rate of increment. Any impact of it on any of the allowances is worked out correctly.<br>Increase in pay due to increment was worked out correctly with reference to due date of increment, amount, with reference to entry in the service<br>Increase in pay due to promotion is correctly worked out with reference to date of promotion, taking charge and entitlement under the pay scale<br>Entries of pay fixation on promotion, increment, leave, loans taken, etc., are verifiable with reference to entries in service book.<br>Fixed allowances (house rent allowance, transport allowance etc.) were as per the entitlement, correctly worked out, supported by required certificates/information<br>Required monthly deductions on account of income tax, license fee for government accommodation, subscription towards pension/provident fund, recovery of principle/ interest on loans taken such as house building, vehicle, computer etc., advances such as festival advance etc., were incorporated in the pay bill correctly.<br>Entries in all the money columns of the bill are totalled separately under each section and part; totals are checked by DDO or responsible person other than the person preparing the bill.<br>The monthly bill is supported by an absentee statement in the prescribed form if a government servant was absent during the month. Absence could be due to leave, suspension, unauthorised absence etc., where amount of pay & allowances to each types is treated according to applicable rules |
| | *Pay Bill Register is examined to see whether:*<br>A Pay Bill Register is maintained in the prescribed form to record dues payable to and deductions made from pay and allowances of a Government servant.<br>All payments made/released to the individuals by way of salaries and other allowances are entered in to the relevant column.<br>Scale of pay, date of increment, date of birth etc., are noted in the column provided for in the register.<br>All the advances paid to the individual and the recovery thereof is entered in the register. Details of recoveries other than the regular nature clearly stated.<br>The payment of arrear claims are also noted in the month of payment.<br>A cross reference is given against the original entries to guard against double payment. |

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| | The entries made in the pay bill register are attested by a responsible officer in token of verification of their correctness. |
| | Abstract of Pay Bill is maintained in the prescribed form as an abstract of pay and allowance bills presented for payment. |
| | A Bill Check Register in prescribed form is maintained, which is made use of in preparing the section wise acquittance rolls in large establishments where pay is disbursed through Section Supervisors. |
| | Pay and allowances were disbursed to the employees entitled to receive them through their bank account or cheques or through acquittance. The Head of an Office is personally responsible for the amount drawn on a bill signed by him or on his behalf until he/she has paid it to the person entitled to receive it and has obtained a legal quittance. |
| | In respect of the payments made through acquittance rolls on the pay day, the disbursement certificate was signed by the disbursing officer in token of the total amount actually paid. The 'PAID' stamp, duly attested by the drawing officer, affixed against the total disbursed amount of the acquittance roll. In respect of undisbursed amount paid subsequently, the items are stamped 'PAID' individually and attested by the drawing officer while signing the Cash Book. |
| | If, for any reason, payment cannot be made within the course of the month, the amount drawn for the payee shall be refunded by short drawing in the next bill (refunded to treasury), and when the occasion for making the payment arises. |
| | Register of un-disbursed pay and allowance (in the prescribed form) was maintained and all the un-disbursed amounts recorded therein. |
| | Entries of the total and particular amount of undisbursed pay and allowances were made against each bill serially and subsequent payments thereof entered in the appropriate columns of the Register and the Cash book, each such entry being attested by a Gazetted Officer. From this Register, an abstract of amounts remaining undisbursed for three months should be prepared in order to ensure their refund either in cash or by short drawal from the next bill. |
| | Adequate arrangements made if undisbursed pay is retained up to three months in the cash chest and separately without mixing up the cash balance of the cash book. |
| | Arrears of pay, fixed allowances or leave salary not drawn in the ordinary monthly bill is drawn through a separate bill with a certificate by the DDO that no part of the amount claimed has been drawn previously; a note of the arrear claim is made in the office copy of the bills for the period to which claim pertains. |
| | In case of arrears of pay of an employee who came on transfer posting the DDO prepared a Due and Drawn Statement and sent to the earlier office for verification. The amount is drawn and paid to the employee after the earlier officer has made entries in their records returned to this DDO after their vetting. |

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| | In the case of Government servants transferred to foreign service/Public sector Undertakings/Government autonomous bodies the arrears are drawn by parent offices and paid to Government servant by cheque/Bank drafts. |

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| Sub-objective<br>Whether adequate controls were exercised over leave and leave salary paid to employees |
| *To examine whether:*<br>Government servant was entitled for such leave (earned leave, half pay leave, commuted leave, leave not due, extra ordinary leave, maternity leave, paternity leave, child care leave, study leave, casual leave, station leave etc.) and leave account is maintained in the service book.<br>Leave is sanctioned by the competent authority, required documents are attached<br>Necessary entries are made in the service book<br>Impact of leave on increment, promotion was taken into account<br>If leave can be en-cashed, whether worked out correctly<br>Whether reference to sanction of leave were recorded in leave salary bills and in respect of arrear bills, certificates to the effect that the payment drawn now were not drawn in any shape previously |

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| Sub-objective<br>Whether adequate controls were exercised over statutory deductions to be made from salary |
| *To examine whether:*<br>Income tax due on the income from salary for the financial year was worked out and deducted from the monthly salary<br>Other taxes due such as professional tax etc., were worked out correctly and deducted from salary<br>Minimum contribution to the pension, provident fund, state insurance were worked out correctly and deducted from the salary<br>License fee etc., with reference to the government accommodation provided were worked out correctly and deducted from the salary<br>The schedules of recoveries were maintained in the prescribed forms and appended with the monthly pay bills |

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| Sub-objective<br>Whether adequate controls were exercised over sanction of personal loans and advances to the employees and their recovery from them |
| *To examine whether:*<br>Non-interest bearing advances such as festival advance, salary advance on transfer, travel advance, LTC advance etc., were sanctioned by the competent authority, entitled amount was sanctioned, recovery affected regularly |

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| | Penalties for delay in repayment were levied |
| | Register for advances and recoveries maintained and watched regularly |
| | Interest bearing loans/advances such as house building advance, motor vehicle advance, computer advance were sanctioned by competent authority on fulfilment of required conditions such as submission of required documents and verification of facts, mortgaging the asset to government till loan is outstanding etc. |
| | Amount sanctioned was accordingly to entitlement and was correct |
| | Recovery of principal amount of loan/advance was affected regularly |
| | Interest was worked out correctly and recovery of interest was affected regularly |
| | Penalty for delays in repayment were levied |
| | Register for advances and recoveries maintained and watched regularly. The register is maintained in prescribed form, separate folios are earmarked for each type of advance, all payments made and recoveries effected are posted individual wise, non-recovery/non-posting of the recovery in any month/months are properly explained in the remarks column, opening balances are correctly carried forward from the previous year register, Interest accrued is correctly calculated and posted, particulars of original mortgage bond and insurance cover are noted in the remarks column, wherever necessary, and the dates of first insurance and subsequent renewals watched. The fact that the Government servant concerned has accepted the balance is cited in the remarks column. |

| Sub-objective<br>Whether adequate controls were exercised over travel of government servants | |
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| | *With regard to travel on tour, to examine whether:* |
| | The travel was approved by the competent authority. Was it in public interest? |
| | The travel was in the entitled/prescribed class/mode and travelled by the shortest possible route to the destination. |
| | Sanction of the competent authority was obtained for journey by mode of conveyance to which Govt. servant was not entitled. |
| | The rates of DA for halts and journey applied correctly with reference to entitlement of the employee, rates for the place travelled, the time of departure/arrival. |
| | The charges claimed in the bill are in accordance with the prescribed rates and journey undertaken in accordance with the approved program? |
| | Applicable supporting documents were provided for claiming daily allowance |
| | Deductions on account of free mode of transport & free boarding or lodging have been made wherever the employee has availed of such concessions? |

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| | *With regard travel on transfer, to examine whether:* |
| | Transfer was in public interest, stated to be so, transfer report is available |
| | Composite grant is worked out correctly |
| | Cost of transportation of personal effects from residence to residence worked out correctly |
| | Actual fare for self and family for journey by entitled class worked out correctly including for journey by road not connected by rail or air travel |
| | *With regard to travel on leave travel concession/ home travel:* |
| | The members of family of the Govt. servant for which transfer TA/ LTC has been claimed are as per family statement. Whether the son, daughter qualified to be dependent. Whether the mother, father qualify to be dependent |
| | The LTC bills were supported by rail/bus tickets in each case and were preferred within one month of completion of journey. |
| | If advances are availed the final adjustment was made timely and correctly. |
| | *With regard to TA on local journey, temporary transfer, on training... whether:* |
| | Local journey is beyond stipulated distance of 8 Km from duty point |
| | Mileage allowance correctly worked out, DA is correctly worked out (50% of DA) |
| | TA on temporary travel is regulated to a maximum of 180 days and no joining time is allowed |
| | *With regard to TA on retirement whether:* |
| | Transfer grant, actual cost of transport of personal effects and actual cost of self and family correctly worked out |
| | If new station is at a distance of less than 20 Km, entitlements are restricted |
| | With respect to all the above types of travel claims, examine whether |
| | The budget allocation existed at the time of drawal of claim/advance |
| | Travel allowance (TA) bills are prepared in the prescribed format |
| | TA bills were countersigned by the controlling officer and were preferred within the stipulated period. If preferred thereafter the reasons for entertaining it has been explained by the sanctioning authority? |

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| Sub-objective | |
| Whether adequate controls were exercised over reimbursement of medical claims of government servants | |
| | Employees of certain government, departments depending on the location of the office may be covered by any medical health scheme of the government. If covered by such schemes the compliance to such rules is examined in audit. In some cases it could be fixed medical allowance. In some cases employees may be covered under a medical insurance claim. |

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| | *With regard to instance where medical claims are reimbursed, to examine whether* |
| | The register in the prescribed form is to record full details of medical expenditure reimbursed to the each government servant. |
| | The cost of only admissible medicines and injections as per Rules, is reimbursed; |
| | The bills are countersigned by the Controlling Officer where DDO is not the HoO and is not exercising the powers of the Controlling Officer |
| | The medicines have been purchased only from the authorized sources as laid down in the medical attendance rules/ instructions issued from time to time failing which necessary relaxation has been accorded by the controlling authority and a certificate to this effect has been endorsed on the bill by that authority. |
| | That necessary sanction of the Head of the Department exists in relaxation of rules in emergent cases and that the charges in such cases have been regulated in accordance with the schedule of charges as laid down in the Rules. |
| | That necessary approval of the competent authority has been obtained in respect of treatments obtained outside the District/ State as per Rules. |
| | The traveling allowance claims to and from the place of treatment for journeys made by patient are in accordance with the instructions in Medical Attendance Rules. |
| | The person in respect of whom the medical charges are incurred falls within the definition of family of the Government servant as defined under the Rules. |

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| Sub-objective<br>Whether adequate controls were exercised over conduct of employees | |
| | *To examine whether:* |
| | Officer procedure manual explaining the rules and instructions governing the working of employees exists |
| | Committee and procedures to address sexual harassment at work place exist |
| | Attendance registers (in the prescribed form) are maintained and used, prescribed action is taken against habitual latecomers and absentees |
| | Duty register describing the allocation of duties to employee exists and is in use |
| | Officiating arrangements for persons who are on leave are made |
| | Due dates for completing annual performance appraisal reports are adhered to |
| | Due date for submission of annual property returns are adhered to, office is informed by the employee about his/her buying and selling of immovable property, he/she receiving gifts exceeding the prescribed ceiling |
| | Instances of violations of conduct rules were adequately addressed resulting in censure, other minor penalties, and major penalties. Monetary impact of these punishments correctly worked while preparing the pay bills |

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| Sub-objective<br>Whether adequate controls were exercised over retiring employees | |
| | *In retirement cases, to examine whether:*<br>Pension cases are finalised expeditiously without delay |
| | Preparation of pension papers initiated sufficiently (one or two years) before the retirement of the Government servant so that required information/records are ready a few months in advance of the date of retirement<br>The pension papers duly completed after determining the qualifying service, the average emoluments and the admissible pension and gratuity<br>The amount of pension, gratuity, commutation, leave salary, insurance etc., worked out correctly<br>All the dues are worked out correctly and deducted<br>Impact of the outcome of the disciplinary cases if any taken into account |

## *Examples*

Ministry of Human Resource Development (MHRD), Government of India issued (Jun 2004) instructions to all National Institutes of Technologies (NITs) to rationalise the pay scales of non-teaching employees of the Institutes with the identical scales of pay of GoI, as notified under Central Civil Services (CCS) (Revised Pay) Rules 1997 with effect from 1 April 2004. The Ministry also clarified to all NITs (April 2007) that matter relating to up-gradation and revision of pay scales of employees of NITs would require the specific approval of Government of India (GoI) in addition to the approval of the Board Of Governors (BOG).

When Government of Andhra Pradesh revised the pay scales of non-teaching staff of State Universities in October 2005, the NIT Warangal made a request to MHRD, GoI for extending that to its non-teaching staff. Ministry in Jan 2006 rejected the proposal. NIT Warangal was taken over by the GoI with effect from 1st April 2003 and it is fully funded by GoI.

Audit noted (/Feb 2013) that Board of Governors of NIT Warangal in its 19th meeting (Feb 2011) resolved to extend revised Government of Andhra Pradesh pay scale to non-teaching employees of the Institute with effect from 1 Jul 2003 to 31 Mar 2004 (notional fixation) and to re-rationalise the pay scales of the employees of the Institute, thereafter with Central Government CCS (Revised Pay) Rules 1997 scales. Institute implemented the decision and 320 non-teaching employees were paid arrears (Mar 2011) amounting to ₹ 2.89 crore for the period from 1 Apr 2005 to 28 Feb 2011. Audit objected stating that it was violation of Ministry's instructions. Audit was of the view that BOG facilitates functional autonomy but in financial matters even the BOG has to function within the Rules framed by the Government. (Union Civil 25 of 2014 Para 9.5)

The Ministry of Finance, Government of India (GoI) while extending the revised pay structure for Central Government employees (on the basis of recommendations of the Sixth Central Pay Commission), to the employees of Autonomous Bodies, clarified (September 2008) that the revised pay structure may be extended to the employees of Autonomous Bodies whose conditions of the service were exactly similar to those in Central Government departments. Further for employees of Autonomous Bodies whose pay structure was not similar to those of the Central Government, it was to be ensured that the final package of benefits is not more beneficial to the corresponding categories of the Central Government employees. As per General Financial Rule 209 (6) (iv) (a) also, all grantee institutions or organisations which receive more than fifty per cent of their recurring expenditure in the form of grants-in-aid, should ordinarily formulate terms and conditions of service of their employees which are, by and large, not higher than those applicable to similar categories of employees in Central Government. In exceptional cases relaxation may be made in consultation with the Ministry of Finance.

Modified Assured Career Progression Scheme (MACPS) for the employees of the Central Government departments, was implemented vide Department of Personnel and Training OM dated 19 May 2009. The Scheme provided for financial upgradation on completion of 10, 20 and 30 years of service. The pay of an employee shall be raised by three per cent of the total pay in the pay band and grade pay drawn before such up gradation with raise to next higher grade.

Audit observed that Asiatic Society, Kolkata while implementing recommendations of the Sixth Pay Commission, allowed pay of the Group D employees in the pay band of ₹ 5200- 20200 with grade pay off 1900 instead of grade pay off 1800. It fixed grade pay of all the eligible officials at higher levels than what was entitled under MACPS. In September 2010 it approved one additional increment to all its employees, reportedly for increased volume of work. The cumulative effect of irregular pay fixation, inappropriate implementation of MACPS and irregular grant of additional increment resulted in undue benefits off ₹ 3.09 crore to employees, of which ₹ 1.38 crore has already been paid (October 2012).

By-laws of the Society provide the retirement age of the officials of the Society as 60 years, but services can be extended one year at a time and total period of such extension should not exceed five years. The Ministry (October 2002) in response to an earlier reference directed that such extensions shall not be granted as a matter of routine and without prior approval of the Ministry. Audit Scrutiny revealed that services of all the 30 employees who had crossed the age of superannuation (60 years) during 2007-2012 were extended by the Society. Earlier also, the Society had granted extension of service to 33 employees who were to superannuate during 1998-2007. (3.1 Union Civil 23 of 2013)

Sub-clause 3 of Rule 66 of the Receipts and Payments Rules, 1983 stipulates that entries in all money columns of the pay bills are to be totalled separately under each section and part to arrive at the total entitlements as well as net payable after the statutory deductions in red ink. Section wise totalling of the pay bills must be checked by the Drawing Officer himself or by some responsible official other than the person preparing the bill. Treasury Rules further prescribe various checks to be exercised by the Treasury Officer before accepting the claim and to record the omission or correction and to limit the payment admissible in respect of each bill presented by the Drawing and Disbursing officers of the establishments.

Scrutiny (April 2012) of paid vouchers in respect of the Chief Medical Officer, Zunheboto, Nagaland for the period from November 2010 to October-2011 revealed that the establishment drew ₹ 509.56 lakh in 40 pay bills against the admissible net salary of ₹ 478.91 lakh by inflating the total of the pay bills resulting in fraudulent drawal of ₹ 30.65 lakh.

Scrutiny (November 2011 and April 2012) of the pay bill vouchers of the Deputy Inspector of Schools (DIS), Niuland for the period from 03/2010 to 06/2011 revealed that the DIS drew ₹ 764.83 lakh in 60 pay bills against the admissible net salary of ₹ 738.84 lakh by inflating the totals of the pay bills. This resulted in fraudulent drawal of ₹ 25.99 lakh. (1.4 & 1.8 NL 1 of 2013)

Ministry of Health and Family Welfare (Department of Health), GoI notified the Regulations for Post Graduate Institute of Medical Education and Research (PGIMER), Chandigarh, which came into force on the 21 April 1967. Rule 40 of Regulations states that in respect of matters not provided in these regulations, the rules as applicable to Central Government servants, such as general conditions of service, pay and salary, joining time and orders and decisions issued in this regard by the Central Government from time to time shall apply mutatis mutandis to the employees of the Institute.

Government of India, Directorate of Estates revised the flat rates of licence fee recoverable for the residential accommodation of the Government of India throughout the country and requested all the Ministries/Department (Apr 2011) to take action to recover the revised licence fee in accordance with these orders. The revised rates of licence fee were effective from 1 July 2010.

Audit pointed out (Nov 2012) that PGIMER, Chandigarh was recovering licence fee as per the rates prescribed by Chandigarh UT Administration, which were lower than the rates prescribed by the Director of Estate, GoI. Standing Finance Committee (SFC) and Governing Body of PGIMER decided to revise prospectively from July 2013. The delay in implementation of orders of increase in licence fee from July 2013 instead of 1 July 2010 resulted in loss of ₹ 1.57 crore to the public exchequer. (Union Civil 25 of 2014 Para 7.4)

Ministry of Human Resource Development (MHRD), GoI after consulting the Ministry of Finance, instructed (February 2004) all autonomous organisations under its jurisdiction, that interest on General Provident Fund (GPF) and Contributory Provident Fund (CPF) at a rate higher than the rate notified by the Government should not be paid. University Grants Commission (UGC) also reiterated (April 2004) these instructions.

Audit pointed out that the Punjab University had paid interest on GPF/CPF accumulations at the rate of nine per cent as against the notified rate of interest of eight per cent (Apr 2011- Nov 2011) and 8.60 per cent (Dec 2011 -Mar 2012) fixed by the Central Government. This resulted in overpayment of ₹ 4.49 crore to GPF and CPF subscribers as below. (Union Civil 25 of 2014 Para 9.4)

| | GPF | CPF | Total |
|---|---|---|---|
| Interest credited to subscribers | 2563.43 | 1730.83 | 42.67 |
| Interest to be credited to subscribers as per Government rates | 2269.93 | 1548.80 | 38.19 |
| Excess interest credited to subscribers | 266.50 | 182.03 | 4.49 |

As per Rule 50 of the CCS Pension Rules, 1972, government employees after completing five years of qualifying service become eligible for receiving retirement gratuity. Resignation from service entails forfeiture of past service. The Payment of Gratuity Act, 1972 provides for a scheme for payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments. As per Section 4 of the Act, gratuity is payable to an employee on termination of employment after rendering continuous service for not less than five years on superannuation, retirement, resignation or death. Under CCS Pension Rules, 1972, those employees who resign from service would not be eligible to receive gratuity, whereas under The Payment of Gratuity Act, 1972, employees who resign after rendering continuous service for not less than five years were eligible for payment of gratuity.

National Institute of Ocean Technology, Chennai (NIOT) is an autonomous institute under Ministry of Earth Sciences, MoES (formerly known as Department of Ocean Development) established in November 1993. The Staff Service Rules of NIOT stipulated that regular staff would be governed by CCS Pension Rules, 1972 for the purpose of payment of gratuity. However the contract staff would be covered under The Payment of Gratuity Act, 1972. NIOT placed (Aug 2008) a proposal before its Governing Council (GC) to amend the Staff Service Rules so as to bring staff appointed on regular basis also under the ambit of The Payment of Gratuity Act, 1972

retrospectively from September 2000. GC approved (Jan 2010) the proposal and an amount of ₹ 68.88 lakh was paid to 54 regular staff who had resigned from service between 2001 and 2013 and who were otherwise not eligible for gratuity under CCS Pension Rules, 1972.

Audit pointed out that this was in contravention to the provisions of CCS Pension Rules, 1972, because government employees become eligible for receiving retirement gratuity only after completing five years of qualifying service. It resulted in irregular payment of ₹ 68.88 lakh towards gratuity to regular staff of NIOT who had resigned from service. (Union Civil 27 of 2014 Para 5.2)

The Department of Public Enterprise (DPE) issued instructions (November 2008) for regulating pay and allowances perquisites and performance related pay (PRP) to executives and non-unionised supervisors of Central Public Sector Enterprises (CPSE). PRP is directly linked to the profits of the CPSEs and performance of Executives. Further instructions and clarifications dated November 2010 and July 2011 laid down following conditions for payment of PRP.

Each CPSE was required to adopt a 'Bell Curve Approach' in grading the officers so that not more than 10 to 15 per cent executives were graded as 'Outstanding/Excellent' and 10 per cent of executives should be graded as 'Below Par'. DPE further clarified (July 2011) that each CPSE has to follow 'Bell Curve Approach' strictly and ensure that 10 per cent of executives be graded as 'Below Par' and are not paid any PRP.

PRP by CPSEs to their executives was subject to twin ceilings viz. (a) grade-wise ceilings ranging from 40 per cent to 70 per cent of basic pay for executives below Board level and 100 per cent to 200 per cent of basic pay for Board level executives and (b) an overall ceiling of 5 per cent of profit before tax of an enterprise.

Profit Before Tax (PBT) for computation of PRP was expected to come out form the specified objectives and core activities of CPSEs and that extraordinary items like valuation of stock, grants/waiver by Government, sale of land, etc., (list of items is not exhaustive) was not to be included in calculation of PBT as far as PRP is concerned.

Audit observed that the following CPSEs deviated from the DPE guidelines and made irregular payment of ₹ 202.95 crore to their employees towards performance related payments

| | | | | |
|---|---|---|---|---|
| Ministry of Petroleum and Natural Gas | Oil and Natural Gas Corporation Limited (ONGC) | 2010-11 to 2012-13 | While the Company graded 10 per cent executives as below par, it paid PRP to all the executives except 2 per cent during 2010-11 and 0.132 per cent during 2011-12 out of executives with 'Below Par' grading. | 117.10 crore |
| Ministry of Steel | MECON Limited | 2009-10 to 2011-12 | Company did not follow 'Bell Curve' approach and considered only two per cent of its total executives as 'Below par'. Performance of 15% executives as graded as 'Excellent', 45 per cent as 'Very Good' and 30 per cent as 'Good' in line with the DPE guidelines. The Company modified the performance rating of 17 to 24 per cent executives as 'Excellent' and 57 to 64 executives as 'Very Good' and 14 to 17 per cent as 'Good'. | 9.12 crore |
| Ministry of Power | Rural Electrification Corporation Limited (REC) | 2009-10 to 2012-13 | Remuneration Committee of the Company observed (Dec 2011) that introduction of grade wise ceilings as per DPE instructions of Nov 2008 resulted in average reduction of 68 per cent in incentive payments to executives as compared to the then existing PRP scheme. It paid an additional component in the form of 'baseline compensation' to executives to subject to a maximum of 66 per cent of their basic pay and within overall ceiling of 5 per cent of profit of REC to partially compensate the fall in the PRP. | 51.68 crore |
| Ministry of Heavy Industries and Public Enterprises | Bharat Heavy Electricals Limited | 2008-09 | Remuneration Committee of the Company noted (January 2010) that advance payment of PRP for 2008-09 had already been made by the Company in excess of the PRP payable and recovery of excess amount already paid. Would demotivate the employees. The Company waived off excess payment already made to executives. | 15 crore |
| Ministry of Defence | Bharat Dynamics Limited (BDL) | 2007-08 to 2010-11 | PBT of ₹ 276.52 crore of the Company for 2007-08 to 2010-11 included interest income of ₹ 474 crore earned on short term deposits of funds, received mainly as advances from Ministry for various projects entrusted to the Company. If interest income is excluded payment of PRP would not have arisen as there was no profit during the period 2007-08 to 2010-11, for the purpose of payment of PRP. | 10.05* crore |
| | | | | **202.95** |

Thus, due to non-adherence to the DPE guidelines with respect to payment of 'performance related pay', the CPSEs made an irregular payment of ₹ 202.95 crore for the years 2008-09 to 2012-13. (13.2 Union Commercial 13 of 2014)

Rail Wheel Factory (RWF), Yelahanka comprises three shops namely Wheel shop, Axle Shop, Wheel set assembly shop. Railway Board fixes the annual targets for production based on the capacity of the plant, man-power available and requirements received from Production Units and Zonal Railways. Based on the yearly targets fixed, a monthly production programme is drawn by RWF. To sustain production levels, generally an Incentive Bonus is given to the staff. The Incentive Bonus paid to the staff of RWF is linked to the Standard Plant Capacity (SPC) fixed for it. At the request of the Railway Board the National Productivity Council conducted a detailed study in 1999 and fixed norms for the manpower required to operate the available machinery in a scientific manner. Thus, the SPC of the plant was fixed at 8300 wheels and 4200 axles per month. The SPC was subsequently revised to 8475 wheels and 4230 axles in 2003 due to augmentation of plant capacity. A Committee recommended upward revision of the SPC to 9860 wheels and 4800 axles per month with effect from December 2009.

RWF, however, did not accept the recommendations of the Committee and instead based on the negotiations with the Staff Council, fixed (March 2010) the SPC as 8899 wheels and 4442 axles per month. Incentive bonus was paid accordingly. SPC fixed in March 2010 based on negotiations with Staff Council was below the annual production capacity fixed by 2009 Committee. This resulted in payment of extra incentive bonus to the tune of ₹ 3.35 crore during three years ending March 2013.

Instructions of Railway Board stipulate that in RWF overtime booking in sections covered under Incentive Scheme should be eliminated completely (December 1999). Wheel Production, Wheel maintenance, Axle Forge Production, Axle Forge Maintenance, Axle Machine Shop Production, Axle Machine Shop Maintenance, General Maintenance are the units in RWF covered under the 'Incentive Scheme'. Examination of records by audit revealed that overtime booking continued in the sections covered under the Incentive Scheme and ₹ 5.47 crore was paid towards overtime allowance during three years ending Mar 2013. (5.1 Union Railway 26 of 2014)

According to Karnataka Government (Allotment of Government Quarters) Rules, 1999, a Government servant provided with rent free accommodation shall not be eligible for payment of House Rent Allowance (HRA). In disregard of these provisions, Superintendent of Police, Railways, Bangalore (SP) authorised payment of HRA to Government Railway Police (GRP) staff who had been provided with rent free accommodation in 18 stations. This resulted in an excess payment of ₹ 63.09 lakh to the GRP staff during March 2008 to April 2010. (13.1.4 KA 2011-12)

According to Sixth Central Pay Commission accepted by the Union Government, House Rent Allowance (HRA) is payable at the rate of 30, 20 and 10 per cent of Basic Pay

plus grade pay is admissible for cities/towns in X, Y and Z classification respectively. Ministry of Finance extended (September 2008) the orders issued by the Government of India (GoI) to implement the revised pay structure to the Autonomous Bodies, Statutory bodies etc., whose pattern of emolument structure are identical to those of the central government employees. In case the pay and allowance were not identical, a separate group of officers might be constituted to finalize the revision of pay scales etc. But the final benefit proposed should not be more beneficial than that admissible to the corresponding categories of central government employees.

Audit pointed out that National Institute of Fashion Technology (NIFT), an autonomous body of the Textile Ministry NIFT despite having emoluments structure identical to those of the central government employees decided (Oct 2008) to pay fixed amount of Housing Benefit Incentive (HBI) with effect from 16 June 2008 in lieu of HRA to its Administrative Officers/ Faculty. HBI so fixed ranged between ₹ 8000 to ₹ 20,000 per month in respect of employees in metropolitan cities and 75 per cent of the slabs in respect of employees in non-metropolitan cities. During the period June 2008 to December 2013 (up to February 2013 in respect to Delhi, Kangra, Shillong centres and Head Offices) a total of ₹ 19.59 crore was paid as compared to admissible amount of ₹ 14.49 crore. Benefit Incentive over and above the House Rent Allowance admissible to Central Government employees paid by NIFT to its employees was in violation of GoI orders. Irregular payment made amounted to ₹ 5.10 crore. (Union Civil 25 of 2014 Para 17.1)

In March 2006, the Government of Kerala revised scales of pay and allowances of Government employees/teachers of the State with effect from 1 July 2004. The Government (June 2006) extended the benefit to all the employees of universities (except Agricultural University) of the State.

Audit observed that headquarters of the Calicut University, Kannur University and Mahatma Gandhi University were situated in unclassified places. Against the Applicable rate of HRA of ₹ 150 per month, the Universities paid HRA at the rate ranging from ₹ 250 – ₹ 1200 (which was applicable for B class cities).

The issue was first pointed out by Audit between Jul 2007 and Jan 2008. Government issued (Jan 2008) orders directing the universities to pay HRA strictly as per Government rules and to recover HRA, if any, paid in excess. Kannur University started paying HRA at the admissible rates (₹ 150 per month) from March 2008 and Calicut University from April 2011. Both the universities kept the recovery in abeyance and said that they took up the issue with the government. Mahatma Gandhi University continued to pay HRA at inadmissible rates. The irregular HRA paid to the

employees of the three universities amounted to ₹ 2.70 crore.

| Name of the University | Excess HRA paid during | Amount paid ₹ in core |
|---|---|---|
| Calicut University | July 2008 to March 2010 | 1.07 |
| Kannur University | April 2005 to February 2008 | 0.18 |
| Mahatma Gandhi University | March 2006 to March 2010 | 1.45 |
| | | ₹ 2.7 crore |

(KL 2010-11 para 3.3.1)

In accordance with the rules prescribed for the grant of City Compensatory Allowance (CCA), the Government of India, Ministry of Defence in May 2005 Defence Civilians posted at 24 Equipment Depot (ED), Manauri located within 8 Kms. from the periphery of Municipal limits of Allahabad are entitled to CCA at the rates applicable to those working at Allahabad, for a period of three years with effect from 1 Jan, 2005. As per the CCA rules, the staff concerned have to reside within the qualified city out of necessity, that is, for want of accommodation nearer to their place of duty.

It was pointed in Audit that IAF sanctioned the payment of CCA to Air Force officers/ Personnel below Officer Ranks (PBORs) posted at 24 ED on the authority of above Government sanction applicable to Defence Civilians even though these officers and PBORs did not reside in the city and were provided accommodation at the ED. The amount paid during the period 2005 to 2008 was ₹ 18.85 lakh. (3.10 Union Defence 4 of 2014)

According to the Department of Public Enterprises (DPE) instructions of April 1987, an individual central public sector enterprise (CPSE) may frame leave rules for its employees keeping the broad parameters of the policy guidelines laid down in this regard by GOI. GOI allowed encashment of half ay leave (HPL) and earned leave (EL) put together within the overall ceiling of 300 days with effect from 1-1-2006, on superannuation, which was an enhancement to the earlier ceilings on encashment of EL up to 240 days. DPE's circular of 26 October 2010 clarified that CPSEs were not permitted to encash EL and HPL of retired employees beyond the overall ceiling of 300 days. In a further clarification of 17 July 2012, DPE reiterated that sick leave could not be encashed, though EL and HPL could be considered for encashment of leave on retirement subject to the overall limit of 300 days.

Audit pointed out that the following CPSEs deviated from the DPE guidelines and made irregular payment of ₹ 138.58 crore to their employees towards encashment of EL and HPL and Sick Leave over and above the ceiling of 300 days.

| | | | |
|---|---|---|---|
| Ministry of Mines | National Aluminium Company Limited (NALCO) | January 2006 to March 2013 | 25.67 |
| Ministry of Heavy Industries | Bharat Heavy Electricals Limited (BHEL) | April 2013 to October 2013 | 36.86 |
| Ministry of Housing and Urban Poverty Alleviation | Housing and Urban Development Corporation Limited (HUDCO) | January 2006 to October 2012 | 2.16 |
| Ministry of Petroleum and Natural Gas | GAIL (India) Limited | April 2008 to March 2013 | 2.51 |
| Ministry of Petroleum and Natural Gas | Indian Oil Corporation Limited (IOCL) | April 2008 to March 2013 | 71.38 |
| | | | **138.58 crore** |

The encashment of EL/HPL/SL to its employees by the CPSUs in exceeding 300 days amount to ₹ 138.58 crore was in violation of DPE guidelines and was, thus, irregular. (7.1 Union Commercial 14 of 2014)

Leave Rules 1967 and 1988 of Hindustan Aeronautic Limited stipulated that the Company's supervisory staff and non- supervisory staff would be entitled to 7 and 12 days casual leave (CL) respectively in a calendar year to meet urgent/unforeseen circumstances or in the event of minor indisposition. The CL shall lapse at the end of the calendar year. In August 1988, the company amended the 1967 Rules allowing an attendance bonus of one day's basic pay for each unutilized day of CL subject to it being not less than 4 and up to a maximum of 10 days in a year. The company amended the 1988 Rules in May 2010 to allow the attendance bonus to all other employees from the calendar year 2010. Thus, the Company had allowed encashment of Casual Leave. In October 2010, Department of public Enterprises (DEP) clarified that CL should not be encashed and would lapse at the end of the calendar year. Even after receipt of DEP's clarifications, the Company did not revise its Rules. It paid ₹ 9.06 crore was paid during 2010 and 2011 as pay attendance bonus to its employees. After Audit pointed out in July 2012, the Ministry directed the Company to follow DPE guidelines and not to allow encashment of CL. The Company continued to make requests to the Ministry for allowing continuance of the scheme in the interest of the Company's work as a special case and continued with the scheme. The Company made a total payment of ₹ 12.43 crore during 2010- 11, 2011-12 and 2012- 13 as attendance bonus to its employees (for un-utilised CL) in contravention of the DPE guidelines and in contravention of the directions of the Ministry. (7.1 Union Commercial 13 of 2014)

The Bhakra Beas Management Board (BBMB) in July 1991 decided to adopt the Punjab State Electricity Board (PSEB) pay scales as revised from time to time and also allowances/ concession sanctioned by PSEB from time to time to its employees. PSEB in October sanctioned Hydel Allowance equivalent two increments to its staff with effect from

18th October 2006 at Hydel Projects of Shahpur Kandi, Anandpur Sahib Hydel project, UBDC Madhopur & MHP Talwara under Hydel Organization. It has not sanctioned this allowance for Joginder Nagar Hydel Project because the staff there was already getting hardship allowance. Punjab State Power Corporation Limited clarified that hydel allowance was not admissible to the employees who were already receiving the hardship allowance in PSEB. During the course of audit of BBMB, it was noticed that Board took a decision in April 2007 to grant Hydel Allowance equivalent to increments on the pattern of PSEB. Board also decided that the Hydel allowance shall not be adjusted against any hardship/ any other allowance which was in vogue in projects. Thus, the BBMB Employees, who were already getting Hardship Allowance equivalent to six increments prior to 18th October 2006 were also granted Hydel Allowance equivalent to two increments. Audit pointed out that ₹ 4.95 crore paid from 18 October to 31 December 2012 as Hydel Allowance in addition to the Hardship Allowance was irregular.

(Union Civil 25 of 2014 Para 14.1)

All India Institute of Medical Sciences (the Institute) was reimbursing learning resource allowance (LRA) up to ₹ 20,000 per annum to its faculty since April 2000 reportedly aimed to help faculty members for enrolling in scientific societies and purchase of books, journals and other learning resource material. In December 2002 it send a proposal approved by its Governing Board to the Ministry to increase the LRA to faculty to ₹ 24,000 and to extend the benefit (₹ 10,000) of LRA to its Group A Officers.

The Ministry after consulting the Ministry of Finance asked (July 2004) the Institute to stop this scheme of reimbursement of LRA suggested that required books, journals may be purchased for its Library. The Institute repeatedly taken up with the Ministry once in December 2004 and again in September 2005 with a proposal to further enhance the LRA limit of the faculty members to ₹ 36,000 per annum and allow LRA to Group A officers. The proposal was not agreed to (December 2005) by the Ministry. However, the Institute continued payment of LRA. Irregular expenditure incurred on LRA during Mar 2009 to Dec 2011 was ₹ 3.22 crore.

(Union Civil 23 of 2013 Para 4.1)

All qualified divers of the Indian Navy, belong to a specialised cadre, and are entitled to Diving Allowance (fixed monthly remuneration) and Dip Money (based on actual duration of diving (including practice diving) at actual depth achieved in the water. All divers are required to remain current in diving as long as they are in the diving cadre. The Indian Navy divers posted in Delhi Area are attached with Indian Naval Diving Team (Delhi) for diving practice. INDT (D) has one Re-Compressed Chamber (RCC) to facilitate practice diving under control conditions for work up of divers, as also for conduct of deeper dives. The capacity of this RCC is 8 divers only at a time.

Audit pointed out (Apr-Jul 2012) that of ₹ 10 lakh Dip Money paid to 196 divers was payment for fictitious dives stated to have been performed between 01 Sep 2008 and 25 Jul. 2011. INDT (D) has one RCC, with a capacity of 8 divers. Master Log Books indicated that between on more than one occasion, more than 8 divers (ranging from 9 to 65), simultaneously dived in this RCC. Only one Master Log Book was to be maintained but three were maintained. Entries were neither signed by diving officers every week nor were countersigned by the Officer-in-Charge INDT (D) every month, even though, the extant orders make it mandatory to do so. Audit further stated that IHQ MoD (Navy) needs to review the functioning of the system at the remaining locations. (Union Defence 4 of 2014 Para 4.9)

The Government of India, Ministry of Finance introduced (May 1989) an Island Special Duty Allowance (ISDA) in lieu of the Special (Duty) Allowance to civilian employees, who had an all India transfer liability posted in the Andaman, Nicobar and Lakshadweep Islands. ISDA was to be restricted in the same manner as Special Duty Allowance and therefore not admissible during leave / training beyond 15 days at a time and beyond 30 days in a year and during suspension and joining time. Based on the recommendations of Vth Pay Commission, ISDA was extended (February 2000) to Defence Service Personnel (DSP) as well. The terms and conditions and the rates of ISDA applicable to civilian employees was applicable mutatis mutandis, to the DSP also. The rate of ISDA ranged between 12.5% and 25% of the basic pay depending on the area of posting within the Islands.

Based on the details made available by the HQ ANC, of leave/ training availed of by the Naval Personnel since the implementation of VI$^{th}$ Pay Commission i.e. w.e.f. 01 Sep 2008, Audit computed the overpayment restricting to just one aspect i.e. the period of absence on leave and training period exceeding 15 days at a time, in respect of officers and sailors posted at 14 Naval Units at A & N Islands. The pay scale for computing the excess was adopted by us at the midrange and the percentage of ISDA was adopted at 12.5 per cent i.e. the lowest of the three ranges of ISDA. The excess payment based on this conservative computation worked out to ₹ 3.29 crore. (Union Defence 4 of 2014 Para 4.9)

Rule 3(2) of the Medical Attendant Rules states – 'provided that the Controlling Officer shall reject any medical claim, if he is not satisfied with its genuineness on facts and circumstances of each case after giving an opportunity of being heard in the matter.' Rule 5 of Appendix-II of the rules further provides that all bills for charges on account of medical attendance and treatment should be countersigned by the controlling authority.

Scrutiny of Treasury Vouchers/Bills for the month of March 2009 pertaining to the Office of Commissioner, Secretariat General Services Department, ltanagar, in June 2011, revealed that medical reimbursement claims totalling ₹ 44.31 lakh in 16 bills preferred by 11 staff attached to the Commissioner's office, Itanagar, for themselves/ family members were passed for payment in the month of March 2009 against the claims preferred by these staff between April 2008 and December 2008. The claims were manipulated by inflating the prices of medicines (in 15 bills ₹ 36.73 lakh), preferring reimbursement claims for medicines not prescribed by a doctor (in 3 bills- ₹ 2.15 lakh), laboratory charges not supported by cash memos nor prescribed by a doctor (in 5 bills- ₹ 1.77 lakh) and making claims without supporting cash memos (in 4 bills- ₹ 2.07 lakh). The actual admissible amount, duly supported by doctors' prescriptions and cash memos of the medical store/pharmacy or laboratory worked out to only ₹ 1.59 lakh in respect of the 11 employees. Failure on the part of CO/DDO to exercise the prescribed checks while passing the medical reimbursement bills, resulted in fraudulent drawal of excess medical claims amounting to ₹ 42.72 lakh. (AR 1 of 2013 Para 3.2)

In the Andhra Pradesh Government powers were delegated to all the district level officers of all the departments in the State to sanction medical reimbursement claims up to a value of ₹ 25,000 subject to scrutiny by the District Medical Board/ District Hospital Superintendent/ Superintendent of Teaching Hospitals. Where the claim exceeded ₹ 25,000 it was to be referred by the district officers concerned to the Director of Medical Education (DME) for scrutiny. As Per provisions of AP Integrated Medical Attendance Rules, 1972, detailed checks are to be exercised by the DDOs/Controlling Officers while passing the medical claims of employees. During the course of test-check of vouchers relating to reimbursement of medical claims by audit, 162 cases of officials belonging to the School Education Department covering nine districts during the period April 2009 – March 2010 were referred to the hospitals for confirmation of the bonafides of the claims. The cases in which the claims exceeded ₹ 25,000 were referred to the DME for confirmation with regard to scrutiny having been conducted. Total fraudulent claims amounted to ₹ 2.29 crore. All the 162 cases which were referred to the hospitals were found to be fake/fabricated/forged as confirmed by the hospital authorities. (AP 2009-10 Para 3.1.1)

Scrutiny (Jan 2010) of LTC vouchers for the period Sep 2008 to Dec 2009 pertaining to School Education and Tribal Welfare Departments in Adilabad District, Andhra Pradesh revealed payment of LTC claims amounting to ₹ 84.91 lakh in 994 cases were in violation of AP Travelling Allowance Rules. All of them were found to be fraudulent

claims where DDO and Treasury Officer failed to verify them before admitting the bills. The types of frauds involved in these claims are (a) fabrication of the computerised railway tickets by producing manipulated Xerox copies thereof, interpolation of figures and particulars of journey (b) submission of claims with cancelled tickets (c) Submission of fake printed tickets.

Audit observed that (a) in 611 out of 994 cases, there was repetition of Passenger Name Record (PNR – a unique ten digit number printed on the railway reservation ticket) in the tickets produced by the claimants, (b) in 348 cases, the claims were submitted with same ticket numbers, (c) in 28 cases, the claims were submitted with cancelled tickets, (d) in seven cases, the claims were submitted with fake printed tickets. Service Registers did not contain the entries of (a) declaration of family members, (b) permission from competent authority for availing LTC, (c) declaration of home town/place of visit, (d) evidence of availing any kind of leave and corresponding debit in the leave account and (e) amount of LTC claimed and date of payment. (AP 2009-10 Para 3.1.2)

Karnataka Government's (Family Pension) Rules, 1964 provide that when a Government servant dies while in service, his/her family is entitled to Family Pension at the enhanced rate of double the normal rate or fifty per cent of the last pay drawn by the deceased Government servant whichever is less, for a period of seven years from the date following the date of death or till the date on which the Government Servant would have attained the age of sixty five years had he/she remained alive, whichever is earlier.

Failure on the part of the Public Sector Banks to monitor and adhere to the cut-off date for payment of Family Pension at enhanced rates resulted in excess payment of ₹ 2.36 crore in 772 cases by 30 District Treasuries during 2009-10, which were noticed in audit during 2010-11. In respect of 20 treasuries, further excess payment of ₹ 92.57 lakh was noticed in 255 cases, in spite of the excess having been pointed out in earlier years, resulting in continued excess payment of ₹ 1.61 crore. These are only illustrative cases. (KA 2010-11 Civil 3.3.1)

# CHAPTER -8

# Controls over office expenses or the expenditure on contingencies

Expenditure on management of office is called contingent charges or contingencies. This expenditure is distinct form the expenditure on core service delivery. For example, the expenditure of the police department on its main functions like vehicles used in the field, fuel for those vehicles, equipment used in the field etc., is not office expenses. The expenditure related to incidentals like administration of the department and its offices is the office expenditure. We can find this distinction in the object class, object head classification of expenditure.

There are 44 Object Heads of expenditure which are grouped into 7 object classes.

| Object Class | Object Heads/Object Code |
|---|---|
| Personnel Services and Benefits | 01. Salaries, 02. Wages, 03. Overtime Allowance, 04. Pensionary charges, 05. Rewards, 06 Medical Treatment |
| Administrative Expenses | 11. Domestic travel expenses, 12. Foreign travel expenses, 13. Office expenses, 14. Rents, Rates, Taxes, 15. Royalty, 16. Publications, 20. Other Administrative expenses |
| Contractual Services and Supplies | 21. Supplies and Materials, 22. Arms and Ammunition, 23. Cost of ration, 24. POL (fuel), 25. Clothing and Tentage, 26. Advertising and Publicity, 27. Minor works, 28. Professional services, 30. Other contractual services |
| Grants, etc. | 31. Grants-in-aid General, 32. Contributions, 33. Subsidies, 34. Scholarships/Stipend, 35. Grants for capital assets, 36. Grants-in-aid-Salaries |
| Other Expenditure | 41. Secret service expenditure, 42. Lumpsum provision, 43. Suspense, 44. Exchange variations, 45. Interest, 46. Share of taxes/duties, 50. Other charges |
| Acquisition of capital assets etc. | 51. Motor vehicles, 52. Machinery and equipment, 53. Major works, 54. Investments, 55. Loans and advances, 56. Repayment of borrowings, 60. Other capital expenditure |
| Accounting Adjustments | 61. Depreciation, 62. Reserves, 63. Inter-Account transfer, 64. Write-off/ losses, 70. Deduct recoveries |

We can see that Object Class- Administrative Expenses has 7 Object Codes/Heads in which Object Code 13 (*Office Expenses*) includes all contingent expenses for running an office such as furniture, postage, purchases and maintenance of office machines and equipment, liveries, hot and cold weather charges, telephones, electricity, water charges, stationary, printing of forms, purchase and maintenance of staff cars and vehicles for office use, fuel for those vehicles. Object-Code Head 20 *Other Administrative Expenses* (under Object Class

Administrative Expenses) include expenditure on office canteen, hospitality, entertainment expenses, gifts and expenses on conducted tours, expenditure on conferences, seminars, workshops and expenditure on other training programmes.

The expenditure on vehicle purchased for administrative/office use and fuel for it would fall under Object Head 13 Office Expenses whereas the expenditure on vehicles engaged in the service delivery and their fuel costs would fall under Object Code 51 Motor Vehicles under Object Class 6 –Acquisition of Capital Assets. Similarly the equipment for office/ administrative use would fall under Object Head 13, but the expenditure on equipment for service delivery would fall under Object Code 52 Machinery and Equipment under Object Class 6- Acquisition of Capital Assets. Similarly professional charges for services rendered for office purpose would fall under Object Code 13, whereas professional services for service delivery would fall under Object Code 28. However, pay and allowance of all the employees fall under Object Class 1- Personnel Services and Benefits.

Expenditure on managing the office (or the office expenses) is referred to as contingent expenses. It mainly consists of purchase of goods/services like electricity, water, and telephone etc., listed under Object Codes 13 to 20 of Object Class 2 (Administrative Expenses). Controls over procurement of goods and services are dealt in the next chapter. This chapter deals only with the issues related to the contingent expenditure or contingencies.

Contingencies are theoretically categorised into contract contingencies, scale-regulated contingencies, special contingencies etc. For certain goods and services the head of the office or the department enter into annual contracts. Examples are electricity, water, telephone and office building rent etc. DDO can draw the amount from the PAO/Treasury without further sanction of the Head of the Office/Department to meet this expenditure. They are called *contract contingencies*. Spending on certain items is regulated by prescribing a scale, how much can be paid like for example liveries, police guard etc. They are called *scale-regulated contingencies*. DDO can spend within the powers delegated to him and would seek approval if expenditure exceeds his power. *Special contingencies* like for example purchase of a photocopier or vehicle for the office, require the previous sanction of superior authority.

Certain payments on items like electricity bill, water bill are made on receipt of the last month's bill. They are called *fully vouched contingent bills*. Expenditure on certain miscellaneous items is met by the DDO but would require the counter-signature of the controlling authority. They are categorized as counter-signed contingencies.

The above types are not mutually exclusive. A particular contingency may fall into more than one type. Some of the special contingencies may be scale-regulated and again a few of them may require counter signature. All these contingencies ultimately fall into one of the following three modes of payment.

(a) Payment for some of them is initially met from permanent advance at the disposal of the DDO which is meant to meet day to day contingent and emergent expenditure. Subsequently the detailed bill (in the prescribed form – fully vouched contingency bill) with supporting vouchers is sent for clearance by PAO/Treasury/AG. Short fall in the prescribed limit of permanent advance is periodically recouped. The type of contingency that fall under this mode of payment could be scale regulated, contract or miscellaneous.

(b) In certain cases the goods or services are already provided and bills are received. Examples are electricity bill, water bill, telephone bill, and office rent payable of/ for the previous month. They are considered as credit bills and a detailed bill of contingent charges is prepared and presented to PAO/Treasury for drawal of that much money and then payment is made. Similarly amount is drawn for purchases like stationary, other material for office by presenting a detailed bill with pre-receipt bills. When these purchases are made, the goods are received but the payment is not made. Detailed bill of contingent charges prepared on the basis of above mentioned credit bills and pre-receipted bills are also called fully vouched contingent bills. Types of contingencies paid through mode could be scale regulated, contract and special contingencies.

(c) The amount of expenditure on some of the items would be higher and can't be met from the permanent advance. Further, the normal system of procurement where payment is made after the supply could not be followed in certain cases and certain limitations like urgency. To meet such expenditure, the Head of the Office sanctions advances to a Government Servant. Such advance is drawn as abstract contingency bill (in the prescribed form). It is known as AC Bill (in J&K White DC Bill). Since the amount is drawn it is a voucher. After the goods and services are acquired and payments are made, a detailed contingent bill (in the prescribed form) with supporting sub-vouchers is prepared for the counter-signature of the controlling officer. This is known as DC Bill (in J&K Red DC Bill). These DC Bills supported by sub-vouchers with the counter-signature of the controlling officer is sent to the PAO/AG/Treasury. It is obvious that Detailed Contingency bill is not for payment. Types of contingencies paid through this mode could be special contingencies or miscellaneous.

Rules governing contingency expenditure in the Union Government are Rules 290 to 293 in GFR, Rule 96 to 123 of Receipt and Payment Rules, Para 2.44 to 2.50 of Manual for DDOs and instruction issued by the Government, Heads of the Departments and Heads of the Offices from time to time. There would be special provisions in some departments like Railways, Defence, and Scientific Departments which would be governed by related rules. There are Rules similar to Union Government in every State, like for example Chapter-7 of the J&K Financial Code.

To what extent the drawing and disbursing officer could safeguard the financial resources of the entity on contingencies by complying with the related rules is examined by framing the audit objective as follows.

Audit Objective: whether adequate controls were exercised by the drawing and disbursing officer/ head of the office, the controlling officer/head of the department over contingencies to safeguard the resources from the risk of loss or waste.

Rules governing different modes of spending on contingencies are the criteria and accordingly audit sub-objectives can be framed. Controls to be exercised over different types of items on which expenditure is incurred can also be basis for framing the audit criteria and accordingly sub-objectives can be framed. Number of transactions selected for the purpose of examination is the audit sample. Instances of non-compliance that are significant and pervasive are the examples of extent of failure of the entity to safeguard resources on this account. This is the audit evidence. The entity can be partially compliant, compliant or non-compliant.

| Sub-objectives:<br>Whether adequate controls were exercised | |
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| | In accurately estimating the annual budget for contingencies |
| | On drawal of advance through Abstract Contingent Bill (AC Bill) |
| | On submission of Detailed Contingent Bill (DC Bill) for the advance drawn through corresponding AC Bill – referred to countersigned contingency bill |
| | On contingent bills for prepaid bill (from permanent advance), pre-receipted bills (where payments to me made after drawal of money)- referred to as fully vouched contingency bill |
| | Over contingent register |
| | Over vouchers that are retained in the office and sent to PAO/AG |
| | Over contingent register |
| | By the head of the office |
| | By the controlling officer |

| Sub-objective<br>Whether adequate controls are exercised on accurately estimating the annual budget for contingencies | |
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| | *To examine whether:*<br>Details of estimates under contingencies (office expenses) are worked out on budget forms, which are designed in a manner so as to bring out the required details.<br>Contingencies in the Budget Estimates of the department or office concerned are classified according to detailed head |

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| | Anticipated increases in the current level are worked out according to the prescribed parameters.<br>Provision for replacement of equipment, furniture is correctly worked out<br>Provision for replacement of office vehicle is correctly worked out<br>Appropriate approved accounting classification has been recorded and each item given the prescribed specific code. |

| Sub-objective<br>Whether adequate controls are exercised over drawal of advance through AC bill | |
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| | To examine whether:<br>Charges relating to two or more major heads included in one bill<br>Amount was drawn through AC bill after ensuring that the existing amount of permanent advance can't meet the proposed expenditure, and purchases can't be managed under the normal procurement system (where the payment is made after receipt of goods/services)<br>Amount of advance is the minimum required for the purpose<br>The amount of advance is within the powers delegated to the head of the office<br>No pay of any kind and no additions to pay was drawn on bills for contingent expenditure.<br>The adjustment bill is submitted by the government servant to whom the advance is given with the prescribed number of days (usually 15 days to 30 days)<br>Advance or balance is recovered from the government servant if he/she failed to submit the adjustment bill within the prescribed number of days<br>Another advance through AC bill is not drawn unless the AC bill of previous month is settled. A certificate should attached to every abstract contingent bill to the effect that the detailed contingent bills have been submitted to the controlling officer in respect of abstract contingent bill drawn during the month previous to that in which the bill in question is presented for payment.<br>In Treasuries where the system of payment by cheque is available the DDO obtained cheques in favour of the party (for amount in excess of certain limit) through requisition enclosed to the bill (discharge on the bill) instead of resorting to AC Bill. The cheques will be crossed and will be delivered to the Drawing Officer or his messenger. The Drawing Officer on receipt of crossed cheques from Treasury accounts for the same in his office cash book and delivers to the concerned party by the Drawing Officer after obtaining the proper receipt / acknowledgement.<br>A control register is used to watch monitory the timely clearance of AC bills<br>Whether large amounts are drawn from the budget through AC bills are drawn and kept in bank account outside the government account. Several offices do this during the month of March to avoid the lapse of annual budget. Rules prohibit such practice of drawal of money through AC bill and parking in the bank account. |

| Sub-objective<br>Whether adequate controls are exercised on DC Bills corresponding the AC Bills |
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| *To examine whether:*<br>Every bill includes a certificate stating 'expenditure could not be avoided, the payments entered in this bill have been duly made to the parties entitled to receive them, vouchers for all sums above the prescribed amount are attached to this bill'<br>It is in the prescribed form, shows monthly total of each column with description of each charge requiring explanation. The number assigned to the sub-vouchers entered in detail against each time. The number and date of abstract bill cashed and sub-vouchers included in each shown at foot. The amount shown in the bill agrees with that of abstract bill. Difference if any between the amounts is explained.<br>Detailed bill is signed by the Head of the Office and submitted to Controlling Officer with all sub-vouchers exceeding the prescribed ceiling and with a certificate endorsed on the bill for amounts below the ceiling.<br>Prescribed scale was adhered to in the case of scale regulated contingencies. If it is in excess of the scale whether countersigned before payment. There are no instances of splitting of purchases to avoid countersignature.<br>The corresponding contract documents are available for the contract contingencies and amounts paid are in accordance with the contract conditions.<br>In case of purchase of stores, the bills include a certificate stating that prescribed procurement rules were followed, goods services received were of correct quantity in good quality, rates paid were not in excess of the accepted rates/market rates, note of payment recorded against original indents and invoices<br>Bills presented in support of payments for purchase of stores are accompanied by a certificate that the articles detailed in the vouchers, and their quantities are correct, their quality good and according to specifications, that the rates paid are not in excess of accepted or market rates, and that suitable notes of payment have been made in the indents, supply orders and invoices,<br>Charges paid to daily wage labourers are supported by certificate signed by disbursing officer confirming that they were paid. Do amounts tally with supporting documents?<br>With regard to charges relating to hire buildings, it is certified that no portion was used for residential or other than office purposes, if used they were recovered.<br>If tax like sales tax was paid, there is a certificate stating the goods or services were not exempted from the tax and amount paid was correct and the vouchers are attached to bill or retained in the office<br>If light refreshments are arranged at formal meetings and conferences, there is certificate stating that expenditure on entertainment charges included in this bill was incurred in accordance with the terms and conditions laid down by the Government, from time to time, and is within the prescribed monetary limits |

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| | Controlling officer received the bills from the Head of the Office in prescribed form with required details and documents. Exercised his checks, disallowed any amounts, countersigned and sent to PAO/Treasury/AG. Monitors the bills through contingent register kept in his officer. |
| | Heads of Offices authorized to draw on Abstract Contingent Bills have sent their Detailed Contingent Bill to their countersigning officers within the prescribed time, so that all the DC Bills can be sent to the Accountant General by the prescribed time. In some States, the Rules provide that Accountant General intimates the Treasuries the details of the DDO who have not sent their DC bill in time and Treasury has the power to stop the payment of further AC bills. If such cases are anticipated by the Head of the Office he may seek extension of time from AG and inform the Treasury. |
| | Any amount drawn on any of the bill cashed during the month has been refunded into the Treasury, the date of refund was stated in the bill. |

| Sub-objective<br>Whether adequate controls are exercised over contingent bills for prepaid bills (from permanent advance), credit bill, pre-receipted bills (where payments to me made after drawal of money)- referred to as fully vouched contingency bill | |
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| | *To examine whether:* |
| | The charges relating to one major head is included in one bill |
| | No pay of any kind and no additions to pay was drawn on bills for contingent expenditure. |
| | All payments which can be made from the permanent advance are made from it and the same recouped by drawing the money from the treasury on bills supported by necessary sub-vouchers. |
| | The date of payment and the amount paid is recorded on each sub voucher at the time of payment. |
| | Sub-vouchers are included for all charges that are in excess of the prescribed amount. Sub-vouchers below the ceiling are retained and cancelled by DDO/CO to prevent their possible misuse (re-use). |
| | The amount required in excess of permanent advance, for payment, drawn on this types of bill without supporting sub-vouchers under this rule, only if the services have been rendered or the supplies received, but the payment is pending merely for want of sub-vouchers or payee's acknowledgement. In such cases credit bill or pre-receipt bill is enclosed. |
| | Bill is in the prescribed form showing monthly total of each column with description of each charge requiring explanation. The number assigned to the sub-vouchers (for payments made from permanent advance) and credit bill/ pre-receipted bill (for payment to be made) entered in detail against each time. |

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| | Every bill includes a certificate stating that expenditure could not be avoided, the payments entered in this bill have been duly made to the parties entitled to receive them (if paid from temporary advance/AC bill) or will be paid on receipt of money drawn on bill (if it is credit bill or pre-receipted bill), vouchers for all sums above the prescribed amount are attached to this bill (will be sent immediately after the amount is paid if credit/ pre-receipted) |
| | The bills includes a certificate stating that prescribed procurement rules were followed, goods services received were of correct quantity in good quality…. |
| | Bills presented in support of payments for purchase of stores are accompanied by a certificate that the articles detailed in the vouchers, their quantities are correct… |
| | Charges paid to daily wage labourers at monthly rates are supported by certificate signed by disbursing officer confirming that they were paid…. |
| | If tax like sales tax was paid, there is a certificate stating the goods or services … |
| | If light refreshments are arranged at formal meetings, conferences, there is … |
| | In cases of payment of rewards to informers, or in cases where it is not desirable to disclose the names of payees, a certificate in the handwriting of the disbursing officer to the effect that the payment has been duly made. This certificate is in lieu of the payee's receipt ordinarily required. |

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| Sub-objective<br>Whether adequate controls are exercised over contingent register | |
| | *To examine whether:* |
| | Contingent register in the prescribed form, provides for entering all the details such as amount, date, name of payee, sub-voucher number, sub-heads, detailed heads. |
| | Separate registers have been maintained for each class of contingent charges (if required) and period of such payments is linked. |
| | The budget allotments sanctioned for each head of expenditure entered in the register. The expenditure is worked out progressively, and regulated carefully in accordance with the altered grants. |
| | All bills of contingent expenditure have been included in this register. Entry is made for each payment with details; date of payment, the name of payee and the number of sub-voucher, the amount, description if needed in the prescribed columns. |
| | Initials of the HoO, or of a gazetted officer to whom this duty has been delegated, entered against the date of payment of each item in the contingent register. If any charge requires any explanation, DDO made necessary entry in the column under the heading Description and obtain the initials of the Government servant who incurred the charges, against the entry. |

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| | If during the absence of the HoO or GO to whom the duty of maintenance of contingent register has been delegated, the entries in the contingent register have been initialled by a non-gazetted Government officer, the register were reviewed and the entries re-initialled by the HoO/GO on return to duty at the headquarters. |
| | Every item paid from the permanent advance no matter on what account, must is at once entered in the contingent register in its proper column. An advance made from the permanent advance is recorded and watched till adjusted |
| | The totals of all bills so entered in the register have been worked out correctly and the balance of the Budget provision available worked out and recorded? |
| | The contingent register should show the expenditure classified in detail under the several items falling under a detailed account head and facilitate preparation of contingent bills, their verification and as control over expenditure and help to prepare estimates in the next year. The expenditure on the less important items shown as a whole is one column without accounting charge under each of these items. |
| | The excess if any over the available budget provisions have been got regularized by way of proper re appropriation order/demand of supplementary funds? |
| | A note to the effect of sub-vouchers which should accompany a contingent bill has been made in the 'remarks' column of the contingent register |
| | Proper sub-vouchers and stock entry certificate support expenditure & pass orders is recorded thereon. |
| | The entries made in the register correspond with the details recorded in the cash book, drawal register, acquaintance roll, stock register? |
| | Countersigned contingency bill with sub-vouchers submitted to the AG and necessary note kept in the contingency register. |
| | As soon as the monthly Detailed Contingent Bill is received in the office of the countersigning authority, the figures should be transcribed from it into a register in the same form as the DDO's register, together with a full same form as the disburser's register, together with a full description of any item that requires explanation. The countersigning authority should review the bill with the sub-vouchers. There are thus be two registers of the same form in the offices of the DDO and the Controlling Officer. The register in the Controlling Officer would be similar with certain differences. In the one with DDO, a single line is given to each sub-voucher; in the one with Controlling Officer a single line is given to each monthly bill, except that each disbursement which is unusual or special will have an extra line. The column used by DDO to record of the numbers of sub- vouchers would be kept blank by the Controlling Officer. The column that shows the date of despatch is used as date of receipt by the Controlling Officer in Controlling Office. |

| Sub-objective<br>Whether adequate controls are exercised on the supporting sub-vouchers |
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| *To examine whether:*<br>Sub-vouchers for all amounts in excess of the prescribed limit are enclosed to the fully voucher contingent bills sent to Treasury/PAO<br>Sub-vouchers for all amounts in excess of the prescribed limit are enclosed to the counter-signed detailed contingent bills sent to AG/PAO.<br>In all cases in which sub-vouchers (below the prescribed monetary limit) are not required to be forwarded to the Accountant General or the Controlling Officer, the Drawing Officer should certify in the bill that sub-vouchers other than these attached to the bill have been so defaced and retained in the office. They are cancelled by means of a rubber stamp or by an endorsement in –red -ink across the voucher and initialed by the Government Servant authorised to draw the contingent bills of the office. The cancellation is made at the time when the contingent bill in which the sub-vouchers or sub-vouchers are included is actually signed.<br>Sub-vouchers below the prescribed limit prescribed limit are to be sent by the DDO along with the bill for counter signature.<br>Controlling officer after verification and counter signature of bill cancels (the vouchers that need not be sent to AG) and certifies that about the retained vouchers.<br>Sub-vouchers which are required to be sent to the Accountant General are not be cancelled either by the Drawing Officer or by the Controlling Officer, as the duty of cancelling these sub-vouchers and keeping them in proper custody to prevent their fraudulent use devolves on the Accountant General.<br>Sub-vouchers submitted to a Controlling Officer which he is not required to forward to the Accountant General, are duly cancelled by him after check and the cancellation should be attested by the Controlling Officer at the time of counter signature of the bill.<br>If the amount of the sub-voucher exceeds the permanent advance, the cancellation should be made as soon as the payment is made and entered in the contingent register.<br>Retained sub-vouchers are preserved for the prescribed number of years. |

| Sub-objective<br>Whether adequate controls by the DDO/Head of the Office |
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| *To examine whether:*<br>The rules regarding the preparation of bills are observed,<br>The money is either required for immediate disbursement or has already been paid from the permanent advance,<br>The expenditure is within the available allotment of funds, |

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| All steps have been taken with a view to obtaining an additional allotment of fund if the original allotment of fund has either been exceeded or is likely to be exceeded, and in the case of contract contingencies, the proposed expenditure does not cause any excess over the allotted funds. |
| DDO furnished the monthly statement of actual expenditure in the prescribed form to his Controlling Officer by the prescribed date of the following month. |
| Drawing officer demonstrated his/her responsibility by ensuing that money was spent as a person of ordinary prudence may be expected to exercise in spending his own money, |

| Sub-objective<br>Whether adequate controls are exercised by the Controlling Officer |
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| *To examine whether:* |
| The items of expenditure included in a contingent bill are of obvious necessity and are at fair and reasonable rates, |
| The previous sanction required for any item is attached, |
| The relevant vouchers are all received and in order, the relevant vouchers are all received and in order, |
| The calculations are correct, and especially the allotment of funds has not been exceeded nor are these likely to be exceeded, and |
| AG/PAO has been informed either by a remarks on the bill or otherwise of the reason for any excess over the monthly proportion of the allotment of funds. |
| If expenditure is progressing too rapidly, alerts the DDO for appropriate action |
| Verify the figure of actual expenditure as reported by the DDOs with reference to the Allotment Register maintained by him and shall reconcile these figures with those of AG |
| Controlling authority/counter-signing authority demonstrated his/her responsibility by ensuring items of expenditure included in a contingent bill are of obvious necessity and are necessary, obtained at fair and reasonable rates, that previous sanction for any item requiring it is attached, that the requisite vouchers are all received and are in order, that the calculations are correct. |
| As regards the contingent charges which do not come up for countersignature, the Controlling Officer should scrutinize the contingent register during local inspections and satisfy himself generally, as regards the necessity for the charges, the correctness of rates, competency of sanction etc. |

### *Examples*

Rule 290 of the Jharkhand Treasury Code (JTC) defines contingent charges as 'all incidental and other expenses which are incurred for management of an office as an office or for technical working of the departments'. Under Rule 318 of Jharkhand Treasury Code (JTC), contingent charges requiring countersignature by the Controlling Officers after payments can be drawn as an advance from the Treasury in an AC Bill (Form T.C. 38) without any supporting voucher. The expenditure is debited under the relevant service head. Subsequently, under Rule 320 and Rule 322, the corresponding DC Bill (in Form T.C. 39) supported with sub-vouchers and countersigned by the Controlling Officers is required to be submitted to the Accountant General (A&E) not later than 25th of the following month. Another fresh withdrawal through AC bill is permitted after submission of corresponding DC bill. Under Rule 391, a certificate to the effect that the detailed bills for AC bills drawn in the previous month have been submitted for countersignature to the CO shall be attached to the first AC bill presented for payment after the 10$^{th}$ of each month. While submitting a contingent bill to the Treasury in the last week of a financial year, the Drawing and Disbursing Officer (DDO) under Rule 300 of JTC is required to certify that payment of the bill amount will be made within the financial year and undisbursed amount, if any, will be deposited into the Treasury by 31 March of the financial year. On receipt of the DC bills in office of the Accountant General (A&E), the same are adjusted, after scrutiny of sub-vouchers, against the concerned AC bills and the differences or disallowances are noted for recovery, and adjustments are made in case of misclassification. However, the responsibility for the effective control of contingent expenditure rests primarily upon the heads of offices and with the countersigning authorities in case of AC bills.

In Jharkhand, Audit observed that funds amounting to ₹ 3,192 crore were drawn through AC bills during the period 2011-14. Corresponding DC Bills for several of these drawls were pending at the end of June 2014. The Health, Medical Education and Family Welfare Department issued a sanction order allotting ₹ 9.46 crore under Asadhya Rog for BPL family to be drawn in AC bills. Four offices have withdrawn a sum of ₹ 298 crore from Treasury through bills prepared in Form T.C 37 and 76 (used for drawal of fully vouched contingent bill and drawal of Loans and Advances respectively) instead of prescribed Form T.C. 38. Thus drawal of funds in Form T.C. 37 and Form T.C. 76 was irregular as the funds drawn were neither fully vouched contingent bills nor an advance and it also bypassed a procedural requirement under Rule 318, thereby making the system vulnerable to misappropriation as there was no requirement to submit detailed contingent bills supported with sub-vouchers countersigned by Controlling Officers against the funds drawn on Form T.C.37 and T.C. 76. (JH Report on State Finances 2013-14)

Rule 177 of Bihar Treasury Code (BTC) 2011 provides that a certificate shall be furnished by the DDO to the effect that money withdrawn on the contingent bill shall be spent within the same financial year and that the unspent amount shall be remitted to the Treasury before 31 March of the year. As per Rule 194 of the BTC 2011, countersigned DC bill shall be submitted within six months following that in which the abstract bill was drawn and no abstract bill shall be cashed after the end of this period of six months unless detailed bill has submitted.

In 2012 Audit pointed out that at the end of March 2011 against ₹ 25,331 crore drawn on 83542 AC bills during 2002-03 to 2010-11, DC bills for ₹ 2,755 crore were submitted. That would mean 74,117 DC bills for ₹ 22,575 crore were due.

According to Bihar Public Works Departmental (BPWD) Code Rule 212, clarified in Bihar Public Works Account (BPWA) Code rule 5 of Appendix 4, expenditure on establishment of a works department should not exceed 12 per cent of works expenditure. Establishment expenditure against works expenditure of department ranged between 18 and 40 per cent during 2007-11 (BR 2013 Para 2.1.7.2)

As per sub-rules 11 (ii) and 14 of Rule 27 of the Delegation of Financial Powers Rules, Tripura, 2007, drawal of the amount in AC Bills should be adjusted in DC Bills by submitting to countersigning officer within 60 (sixty) days from the date of the drawal of the amount and the HoD shall countersign all DC Bills and forward them to the Accountant General (Accounts & Entitlement), Tripura within 90 (ninety) days from the date of the drawal of the AC Bill. Total number of unadjusted AC bills as on 31 March 2012 was 13,548 involving ₹ 148.69 crore which increased to ₹ 150.72 crore in respect of 17,433 bills as on 31 March 2013.(TR Report on State Finances 2012-13)

In Sikkim, a certificate has to be given on the AC Bill Form clearly mentioning that the detailed contingent bills for all the contingents for advance drawn more than 3 months before have been submitted which is to be certified by the DDO at the time of drawing the AC Bill. Audit observed that DDO certified all AC Bills without ascertaining unsettled advances. In 18 cases ₹ 1.71 crore already shown as adjusted in the records of the Department is lying unadjusted in the Office of the Senior DAG (A&E). (SK Report on State Finances 2013-14)

The Contingency Manual of the Government of Assam stipulates that detailed bills for the charges drawn in AC bills in a month should be submitted to the Controlling Officer by the 2$^{nd}$ of the following month. The CO shall despatch all DC bills to the AG (A&E) by 25$^{th}$ of the following month. The Treasury Officers should ensure that no payment is made after the 10$^{th}$ of a month on any AC bill unless it is certified by the drawing officer that all DC bills for sums drawn on AC bills in the previous month have been forwarded to the Controlling Officer. The total amount of DC bills received was only ₹ 1,285 crore against the amount of AC bills of ₹ 2,834 crore leading to an outstanding balance

of ₹ 1,549 crore (5,329 DC bills) as on 31 March 2014. Secretariat Administration, the Home Department contribute to 50 per cent of it. (AS Report on State Finances 2013-14)

According to the Meghalaya Treasury Rules, 1985, the COs are to submit DC bills against the drawals on AC bills to the AG (A&E) within a month from the date of receipt of such bills in his office. The total amount of DC bills received up to 2011-12 and during 2012-14 was only ₹ 33.84 crore against the amount of AC bills of ₹ 71.20 crore leading to an outstanding balance of DC bills of ₹ 37.36 crore as on March 2014. (ML Report on State Finances 2013-14)

The West Bengal Treasury Rules 2005 provides for a maximum period of 60 days for the submission of DC Bills against the AC bills drawn. If at all there is a delay beyond this period it has to be with the permission of the Administrative Department with concurrence of the Finance Department. There also exists a mechanism of reporting of submission of DC bills on time to the PAG of the state.

By 2012-13 there are 10,862 DC bills pending worth ₹ 799 crore. Scrutiny of the records of Advance Check Register of different treasuries revealed that pending adjustment of earlier DC bills, treasury officers of 40 treasuries entertained further claims through AC bills, in contravention of the provisions of WBTR. Further, bills relating to advances on TA, LTC, GPF, Salary, etc. were included as AC Bills in six treasuries. The purpose of drawal of advances was not mentioned in the Advance Check Register of 11 treasuries. Register of AC Bills was not closed at the end of each financial year and the details of un-adjusted advances were not brought forwarded to the next financial year as required under Rule 4.138(5) of WBTR in five treasuries. Test-check of the records of DDOs revealed several instances of significant deviations. An amount of ₹ 2.82 crore was drawn (Jan 2012) in AC bill by the Commandant, SAP 2nd Battalion towards procurement of 63 vehicles. The entire amount was paid to the automobile company in Feb 2012. However, the automobile company supplied 36 vehicles valuing ₹ 1.72 crore and refunded the residual balance after period ranging between eight and 13 months from the date of receipt of fund. In another instance ₹ 5 lakh was drawn by SP, Howrah by AC bill towards payment of Bye Election Allowances to Police, NVF, and miscellaneous expenditure that included farewell function, meeting, seminar, purchase of wood violating the norms of financial propriety. (WB Report State Finances 2012-13)

As per Punjab Treasury Rules read with Punjab Financial Rules Volume-I, amount drawn on AC Bills should be settled by submitting DC bills to the AG (A&E) for the expenditure incurred along with supporting vouchers within one month. However, out of total 2621 AC bills for ₹ 3,099 crore drawn during the period 2011-14 by different departments from various treasuries of the state, 1946 DC bills amounting to ₹ 1,327 crore were

sent to AG (A&E), Punjab. As many as 675 AC bills mounting to ₹ 1772 crore were awaiting adjustment as on 31 March 2014. (PB Report on State Finances)

DC bills should be prepared for the amount drawn on AC bills in any month and should be headed as pertaining to the month in which payment was actually made from the treasury. Scrutiny of records in the office of the Director Animal Husbandry revealed that six AC bills for ₹ 8.03 crore were drawn during 2010-11 (July 2010 to March 2011) but no records were maintained to watch timely submission of the DC bills. DC bills for this amount were not sent to (AG (A&E) as of January 2012. (PB Report on State Finances)

As per Rule 211 of Gujarat Treasury Rules, 2000, the drawing officers are required to furnish the DC Bills in respect of all AC Bills within three months from the date of drawal of Abstract Contingent Bills to AG (A&E). However, 8,708 AC bills amounting to ₹ 281.53 crore were drawn up to March 2014 by 21 Departments for which DC bills were not furnished (March 2014). The Education Department had a pendency of 3,708 bills of ₹ 123.02 crore and the Home Department had 1,197 bills pending of ₹ 84.21 crore. (GJ Report on State Finances)

In Andhra Pradesh a review of working of Treasuries and PAO, Hyderabad during 2012-13 revealed the following.

Joint Director of Agriculture (JDA), Mahabubnagar drew ₹ 227 crore on 60 AC bills during 2009-13 of which DC bills were yet to be submitted for an amount of ₹ 101 crore as of June 2013. JDA Ananthapur (₹ 187.26 crore), Srikakulam (₹ 106 crore) and Assistant Director of Agriculture (ADA) Srikakulam (₹ 71 lakh) drew (Jun 2011 to Nov 2012) money on AC bills for payment of input subsidy to farmers on account of natural calamities. The related DC bills were not submitted as of 31 March 2013.Out of ₹ 115.53 crore released (May & Jun 2011, and Apr 2012) by the Commissioner and Director of Agriculture (CDA), an amount of ₹ 4.32 crore being unspent balance was deposited in Banks by JDA, Srikakulam instead of remitting to Government. (AP Report on State Finances 2012-13)

According to Government of Kerala order (July 2000), advance drawn should be adjusted within time, failure of which would entail recovery in lump sum along with penal interest at current bank rates. Government, subsequently prescribed (Oct 2011) a period of three months for presentation of final bills and the penal interest was fixed at 18 per cent per annum on the unutilized portion of advance. In Directorate of Public Instruction, 89 contingent advances for ₹ 58 crore were lying unadjusted (Apr 2012) as the payees of the advances did not submit the final bills. It included 21 advances amounting to ₹ 0.55 crore (21.31 per cent) which were more than three years old and 25 advances amounting to ₹ 0.60 crore (23.25 per cent) more than two years old. Maintenance of an advance register and its periodic monitoring by the supervising officer was missing. (KL 2012 Para 4.1.12)

# CHAPTER -9
# Controls over inputs for service delivery

Delivery of service by a department is a process. This process consumes inputs in the form of manpower, material, equipment and services. This chapter deals with controls over these inputs. The financial resources that are used for procurement of inputs need to be safeguarded from the risk of loss or waste due to inappropriate procurement procedures and practices. The procured material need to be safeguarded till consumed in the service delivery process from the risk of loss due to theft, degradation/loss due to improper storage or negligence. Procured equipment need to be safeguarded from the risk of loss due to theft, degradation/premature depreciation/loss due to improper maintenance. Material and equipment need to be safeguarded from loss while being used/consumed in service delivery process from the risk of improper handling. Inputs in the form of services should be similarly safeguarded from loss or waste as they are consumed while being provided.

These inputs with Object Codes/Heads 13 to 21 and 33 and 34 that fall under Object Class 3: Supplies and Services and under Object Class 6- Capital Assets respectively. Accounting Rules describe them as 'stores'. This term is used to indicate all articles and material required for service delivery, budgeted for and classifiable under heads of expenditure such as tools and plant, machinery, equipment, material and supply. Material, equipment and services are procured for service delivery purpose (program) and also for the administrative functions (program-support). The later fall under Object Class-2 Administrative Expenditure. Controls over those procured for administrative function as office expenses or contingencies were discussed in the previous chapter. The present chapter deals with those inputs that are procured and consumed in the service delivery. These controls are equally applicable for inputs purchased and used for the administrative purpose. Controls over creation of infrastructure that are used in service delivery over longer period are dealt in the next chapter.

Rules governing the procurement of material, equipment and services of the Union Government are General Financial Rules (GFR), Delegation of Financial Powers (DFPR) and instructions issued by the Finance Ministry, Central Vigilance Commission from time to time. Every department is expected to have laid down procurement procedures (Procurement Manual) that are in conformity with the above and also have procedures for the safe storage, upkeep and usage of the material and equipment. International best practices can be found incorporated in the draft procurement bill. There would be special provisions in some departments like Railways (Indian Railway Financial Code, the Indian Railway Code for

the Stores Department), Defence (Defence Procurement Procedure, Defence Procurement Manual) and Scientific Departments which would be governed by related rules. Defence Ministry has Rules similar to Union Government exist in every State Government incorporated in their Financial Code, Financial Rules, Accounting Code, Accounting Rules etc. States like Karnataka, Tamil Nadu and Rajasthan have Public Procurement Act.

To what extent the head of the office/department could safeguard the financial resources of the government on procurement, storage, upkeep and usage of material, equipment and services from the risk of loss or waste by complying with the related rules is examined by framing the audit objectives as follows.

Audit Objective-1: Whether adequate controls were exercised over procurement of material and equipment (by the procurement official/head of the office/ Department)?

Audit Objective-2: Whether adequate controls were exercised over storage, upkeep and usage of the procured material and equipment on (by the procurement official/head of the office/ Department)?

Audit Objective-3: Whether adequate controls were exercised over procurement and use of contracted services

## Controls over procurement of material and equipment

Five fundamental principles of good procurement process are open tendering, effective advertisement, non-discriminatory conditions and specifications in the tender documents, opening the tender in public, award to the most eligible bidder. However, these five principles work when the market is non imperfect and it can discover the correct price. Procurement is prone to risk of corrupt practices from the procuring officials as well as bidders. Public resources are also prone to waste due to procurement of material and equipment that is not required for use in near future, not required at all, far in excess of the requirement, of much higher specification that required either due to negligence or corrupt practices. One can identify the following stages in procurement. The entity is required to document all these of procurement.

Estimating the requirement and budget
Identification of specifications of material and equipment
Selecting the purchasing method
Preparation of bid documents and invitation of bids
Evaluation of offers
Selection of successful bidder
Entering into agreement or contract for delivery of supplies
Monitoring the contract for receipt/maintenance of supplies

Each of the above stage and the rules governing them would be sub-objectives and audit criteria. Selected number of procurements that is representative of the total is the audit sample. Instances of non-compliance that are significant and pervasive are the audit evidence of the extent of the failure of the entity to safeguard the resources spent on procurement. The following is not an exhaustive check list and auditor has to refer to the specific rules of the State Government or Union Government and of the specific department if required. The following check list makes a reference to the GFRs and other Rules of Union Government,

Audit Objective: Whether adequate controls were exercised over procurement of material and equipment (by the procurement official/head of the office/ Department)?

| Sub-objectives: | |
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| Whether adequate controls were exercised over: | |
| | Estimating the requirement and budget |
| | Identification of specifications of material and equipment |
| | Selecting the purchasing method |
| | Preparation of bid documents |
| | Invitation of bids/attracting the best bids |
| | Evaluation of offers and selection of successful bidder |
| | Entering into agreement or contract for delivery of supplies |
| | Monitoring the contract for receipt of supplies |

| Sub-objective<br>Whether adequate controls were exercised over estimating the requirement of material, equipment and services | |
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| | *To examine whether:*<br>The quantities of material/equipment estimated were far in excess of requirement or conversely in short of requirement<br>Cost material/equipment was reasonably estimated and included in the budget |

| Sub-objective<br>Whether adequate controls were exercised over identification of specifications | |
|---|---|
| | *To examine whether:*<br>Material/equipment with non-essential specifications and superfluous specifications and features were selected and purchased with resultant extra cost<br>The quality of the material/equipment identified/purchased was much high than the basic needs with resultant extra cost |

| Sub-objective<br>Whether adequate controls were exercised to ensure that the prescribed method of procurement was followed | |
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| | *To examine whether:*<br>Material/equipment locally purchased without inviting quotations did not exceed the prescribed money ceiling (for example ₹ 15,000)<br>Procurement was done through local purchase committee for material/equipment/ valuing the prescribed monetary limits (more than ₹ 15,000 and less than ₹ 1 lakh).<br>Rate contract was used for items of standard type<br>All the purchases valuing more than the prescribed monetary limit (₹ 25 lakh) were done through open tender enquiry<br>Two bid open tender enquiry was adopted for high value technical contracts as prescribed by the Rules<br>Limited tender was used for purchases of prescribed monetary value ( less than that prescribed for open tender-₹ 25 lakh) and at least 3 bidders participated<br>Discretion to adopt limited enquiry even for higher value purchased was justified in the terms of urgency, savings on advertisement, possibility of no new supplier etc. Reasons for using the discretion and grounds on which the method was elected were explained in writing and were convincing<br>Decision to purchase through single tender enquiry fulfilled the prescribed criteria such as only a particular manufacturer prepares/produces it (propriety article certificate is enclosed), only particular /spares/ material is compatible etc.<br>If single tender is adopted for urgency reasons, decision maker has recorded the reasons. The reasons are valid and convincing and subsequent events have justified it. |

| Sub-objective<br>Whether adequate controls were exercised over preparation of bid documents and invitation of bids | |
|---|---|
| | *To examine whether:*<br>Standard bid documents are prescribed for each method (open tender, two-bid open tender, limited tender, single tender, rate contract, local purchase)<br>Appropriate bid document for the prescribe method (open, limited, single) was used<br>All the essential information a bidder needs for sending responsive bid is clearly spelt out in the bidding document in a language that is understandable<br>Bid document contains instructions to bidders, conditions of Contract, schedule of requirements, specifications and allied technical details, price schedule (to be utilised |

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| | by the bidders for quoting their prices), contract form and other standard forms, if any, to be utilised by bidders |
| | Due date and time of submission and location are clear in the bid documents |
| | Provided reasonable time to send their bids, |
| | High value contracts provided for pre-bid conference for clarifying issues |
| | Bid document clearly specified the date, time and place of opening of the bid. |
| | Bid documents contained suitable provision to enable a bidder to question the bidding conditions, bidding process and/ or rejection of its bid. |
| | Bid document contained provision for settlement of disputes, if any, emanating from the resultant contract. |
| | Criteria for determining responsiveness of bids, criteria/ factors to be taken into account for evaluating bids on a common platform and criteria for awarding to the responsive lowest bidder are clearly indicated in the bidding documents |
| | Bid document provided for earnest money/bid security as deposit or demand draft to be returned within stipulated number of days after finalisation of tender to all the bidders who are not selected |
| | Before inviting bids, budget provision was available, administrative approval was available and financial sanction was available |

| Sub-objective<br>Whether adequate controls were exercised to attract the best bids | |
|---|---|
| | *To examine whether:* |
| | Necessary publicity was given to the attract a number of bidder with due regard to the value of the contract, availability of suppliers/providers, cost of publicity |
| | For an open tender prescribed minimum advertisement like publishing in one national daily at least, department web-site etc., were followed. |
| | Entity maintained its own register of suppliers? |
| | The terms and conditions for registration such as manufacturing/delivering capacity, quality, past performance, financial back-ground etc., are clearly defined |
| | Registered suppliers have fulfilled the terms and conditions for registration |
| | Performance of the registered suppliers watched and if-necessary de-registered |
| | Efforts are made to identify further sources of supply at better rates |
| | At least three bidders responded to limited tenders |
| | Minimum number of competitive bidders available in the market, the market is competitive enough to offer competitive bids, if the market is not competitive how does the entity discover the correct price |

| Sub-objective<br>Whether adequate controls were exercised over evaluation of received bids and selection of most successful bidder | |
|---|---|
| | *To examine whether:*<br>The process of receiving the bids was transparent and they are stored safely<br>Bids were opened in the presence of bidders or their representatives at the specified location at the specified time<br>The evaluation was carried out by competent and authorised persons, individually or as a committee<br>Bids received are evaluated in terms of the conditions already incorporated in the bidding documents.<br>Comparison was thorough and well documented and convincing<br>Ranking was strictly according to predetermined criteria without any subjectivity<br>No new condition/consideration which was not incorporated in the bidding documents were brought in for evaluation of the bids.<br>Determination of a bid's responsiveness was based on the contents of the bid itself without recourse to extrinsic evidence.<br>Bidders were not permitted or encouraged to alter or modify their bids after expiry of the deadline for receipt of bids.<br>The procuring authority satisfied that the price of the selected offer is reasonable and consistent with the quality required<br>Contract is awarded to the lowest evaluated bidder whose bid has been found to be responsive and who is eligible and qualified to perform the contract satisfactorily as per the terms and conditions of contract<br>If awarded to the next highest bidder the reasons for taking that decision properly documented and were convincing enough.<br>If negotiation were held, was it compliant with conditions prescribed for negotiation and process and outcome was well documented<br>In two-bid procurements, techno-commercial bids are opened first and evaluated. Financial bids of only those bids which were technically accepted and shortlisted are opened.<br>Most successful bidder is selected and also found to be suitable<br>Successful bidder provided performance security in the form of a Demand Draft, Fixed Deposit Receipt or Bank Guarantee for the prescribed amount (5 to 10% of contract amount), for the prescribed validity period. |

| Sub-objective<br>Whether adequate controls were exercised over entering into agreement/contract with the contractor/supplier for supply goods/material etc. |
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|---|---|
| | *To examine whether:* |
| | After completion of bidding process a formal contract was signed with the successful bidder within the prescribed time period |
| | It was standard format of contract, and was suitable for the procurement under examination. If necessary modification were made, legal advice was obtained |
| | The terms of contracts were given either within the body of contract or as annex. They clearly specified secure supply of agreed material/equipment at agreed price within the stipulated dates/time within the body of the contract or as an annexure. |
| | The terms of contract are precise, definite and without any ambiguities that might create indefinite liability on the part of the entity. |
| | Contract stipulates that contractor would pay all applicable taxes, responsible to remit them to tax authorities, or deducted by the entity and remitted |
| | Terms of contract clearly indicate the mode of transport, liability for damage during transport/transit |
| | Terms of contract provide for the right to reject the items that do not meet specifications and contractor to provide for or replace such items |
| | Terms of contract provide liabilities and penalties for failure to fulfil any conditions by the contractor |
| | Performance guarantee and warranty clause were incorporated |
| | Provides for dispute resolution |
| | Contract document, performance guarantee instruments were under safe custody. |

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| Sub-objective<br>Whether adequate controls were exercised over supplier's adherence to contract conditions | |
| | *To examine whether:* |
| | Terms of contracts relating to time schedule of delivery, quantity, quality were strictly enforced, timely payments were made |
| | Any deviations to the contract conditions. If any, the reasons are well documented and found to be convincing. Were they made through amendments to contract |
| | Terms of payment were strictly followed. Were reasons for deviation well documented and found convincing |
| | Performance guarantee instruments were periodically reviewed |
| | Suppliers adhered to all the conditions, if not notices were issued and the related contract conditions were invoked, liquidated damages, penalties levied |
| | Any disputes during the contract implementation, if any resolved according to the related contract conditions |

## Controls over procured material/equipment for its storage, upkeep and use

Audit Objective-2: Whether adequate controls were exercised over storage, upkeep and usage of the procured material and equipment (by the procurement official/head of the office/ Department)?

| Sub-objectives: | |
|---|---|
| Whether adequate controls were exercised over: | |
| | receipt of procured material/equipment |
| | over storage and issue material/equipment for use |
| | over the stores |
| | over equipment available for use by employees |
| | over disposal of depreciated, unserviceable and obsolete equipment/material |

| Sub-objective<br>Adequate controls were exercised over receipt of procured material/equipment | |
|---|---|
| | *To examine whether:*<br>Supplied material/equipment was inspected, verified, measured, received and accounted for by the designated officials<br>Quantities are correct, quality was in accordance with required specifications, and there was no deficiency or damage<br>Inspection if required to be done by a qualified person/agency and it was done |

| Sub-objective<br>Adequate controls were exercised over storage and issue material/equipment for use | |
|---|---|
| | *To examine whether:*<br>Receive material/equipment taken into the store<br>Details of the material/equipment, description, make, quantity, monetary value (not exceeding market value) are entered into the register in the prescribed form (stock register/asset register) by the official in charge of the store<br>Storage arrangements are adequate and suitable particularly for valuable items and items with special characteristics (temperature, dust free etc.)<br>Arrangements for physical safety are adequate<br>Issued to users only on receipt of written request in the prescribed form<br>Obtained the written acknowledgement of the user who indented and received<br>Necessary entries of issue are made in the stock register |

| Sub-objective<br>Adequate controls are exercised over the stores | |
|---|---|
| | *To examine whether:*<br>The Officer-in-charge of stores maintained an account of material/equipment in the prescribed form. The form of store accounts depends on the nature of goods & material and frequency of transactions. There could be separate accounts for fixed assets like equipment, consumable etc.<br>Store account depicts item wise list of how much is available in the store on a given day, how much is received from the suppliers that day, how much issued to the indenters and what is the balance available in store<br>Physical verification was carried out once in a year by an independent official in the presence of officer in charge of the store.<br>Results of physical inspection proved that actual numbers available at that time was same as the numbers in the store accounts.<br>Discrepancy between the results of physical count and store accounts if any noticed during physical verification was recorded in the stock register.<br>Discrepancy was brought to the notice of competent authority. Differences are reconciled if they were due to errors in accounting.<br>Appropriate action was taken for proven shortages due to acts of omission or commission<br>Any damages, unserviceable goods were identified and recorded during the physical verification and brought to the notice of competent authority.<br>Reasons for damage, premature deprecation are identified and if necessary responsibility is fixed for negligence in store keeping, procuring quantities far in excess of requirement<br>Steps are taken to dispose of items declared as non-moving, unserviceable and obsoleted<br>In the event of transfer of Officer-in-charge a statement giving all relevant details of the materials etc., in question was signed with date by the relieving officer and the relieved officer. Each of these officers retained a copy of the signed statement |

| Sub-objective<br>Adequate controls are exercised over fixed assets (equipment, machinery, computers, furniture, vehicles etc., other than land and buildings) available for official use | |
|---|---|
| | *To examine whether:*<br>All assets are promptly tagged to enable easy identification<br>Location of each of the asset is recorded<br>Custodian of each of the asset/all the assets/group of assets is identified<br>Arrangements are available to prevent unauthorised access and report if any<br>All fixed asset movements are approved in accordance with the authority limits. |

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| | Movement of fixed asset is recorded and acknowledged by the receiving branch |
| | Account of fixed assets such as plant, machinery, equipment, furniture, fixtures etc., are maintained in the prescribed format. Assets of historical/artistic value held by museum/government departments are maintained separately. |
| | Fixed assets were verified periodically (once in a year) and the outcome of the verification recorded in the corresponding register. Discrepancies, if any, were promptly investigated and brought to account. |
| | Wherever required log books are maintained to monitor the use or misuse of asset |
| | Adequate arrangements are made for their upkeep and maintenance |

| Sub-objective<br>Whether adequate controls were exercised over vehicles | |
|---|---|
| | To examine whether: |
| | Stock account of all the vehicles in use (together with their spare parts) is maintained and periodically checked |
| | History sheet of each Vehicle is maintained |
| | Average running mileage per litre of each vehicle have been worked out and compared across the months and a norm fixed |
| | Log books are scrutinized periodically by a senior official to get an assurance that there is no misuse |
| | Entries of petrol and repairs have been made in the Log Book |
| | Entries of journeys are entered in the log book and all the journey were admissible under the rules |
| | In case of non-duty journey, all such journeys are properly billed for, recoveries made promptly and the amount credited to Government Account |
| | Proper accounts are maintained for tyres replaced / retreated, petrol oil and lubricant and the quantity shown as having been purchased on the purchases vouchers / issue slips tally with the quantity shown as received in petrol accounts etc., of the vehicles i.e. log books |

| Adequate controls were exercised over disposal of depreciated, unserviceable and obsolete equipment and material | |
|---|---|
| | *To examine whether:* |
| | Any such items were declared so with recorded reasons by the competent authority. |
| | Approved for their disposal through auction, if value is more than prescribed amount (₹ 2 lakh) disposal is through open advertisement. |
| | Their book value was calculated basing on purchase price, depreciation or by other mean and reserve price is fixed |

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| | Disposal through an advertised tender was through bidding, selection and award to the highest responsive bidder. |
| | The process was transparent, competitive, and fair and there was no discretion. |
| | Payment by the successful bidder was secure and payment is received before releasing the goods |
| | If it was through auction it was done through approved auctioneers or directly. |
| | The goods material was handed over only after receiving the payment. |
| | Only those items that could not sold after best attempts were sold as scrap. |
| | Items such as receipt books, security press items, etc., that involves security concerns were disposed of/ destroyed in an appropriate manner. |

Audit Objective 3: Whether adequate controls were exercised over procurement and use of contracted services

| Sub-objective<br>Whether adequate controls were exercised over outsourcing the office functions | |
|---|---|
| | *To examine whether:* |
| | Entity has prescribed detailed instructions and procedures for outsourcing the services such as cleaning the office premises, transport, watch and ward, clerical duties, secretarial duties etc. They are in conformity with the principles in the Financial Rules of Government |
| | Services are purchased through an open tender if the value of the service above the prescribed monetary value (for the year/moth) and limited tender for lesser value |
| | The tender enquiry explains the nature of service required; expected expertise, qualification, eligibility from the contractor; statutory obligations like minimum wages, taxes, etc., of the contractor |
| | Bidding process is followed; responsive bids are evaluated, segregated, and ranked. The best bid should be selected and awarded |
| | Formal contract explaining all the conditions, service levels, performance measures was signed and enforced |
| | The performance of the contractor continuously monitored. |

| Sub-objective<br>Whether adequate controls were exercised over consultancy contracts | |
|---|---|
| | *To examine whether:* |
| | Entity laid down detailed instruction for engaging consultants and they are in conformity with the principles laid down in Government Financial Rules |
| | Consultants are engaged only when there is requirement of high quality work for which Department does not have expertise. |

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| | Prior approval of the Competent Authority was obtained |
| | Requirements, objectives, scope of the assignment, pre-qualification criteria and eligibility conditions were prepared |
| | Organisations engaged in the similar activity were consulted and a reasonable estimate of the expenditure is made, list of consultants in the market is prepared |
| | If the estimate is more than the prescribed monetary value (₹ 25 lakh) broad scope of the service and inputs that will be provided by the department, eligibility criteria to be met by the consultants was prepared and tender enquiry seeking expression of interest (EOI) was floated (at least in one national daily) |
| | In the EOI bidder are asked to send their comments on the objectives and scope of the proposed work and explain their past experience in the similar work |
| | Eligible bidders were shorted listed to receive request for proposal (RFP). |
| | RFP contains Terms of Reference (OTR) with statement of objectives, outline of tasks to be carried out, time schedule, inputs available with Department and inputs required form consultant. |
| | RFP contains a letter of invitation, procedure for submission of proposal, TOR, formats for technical & financial proposals, contract terms including midterm review and monitoring by the department, bid evaluation criteria, final selection and award procedure for technical and financial bids separately. |
| | There is a Consultancy Evaluation Committee (CEC) to analyse and evaluate the technical proposal. It recorded detailed reasons for acceptance or rejection of each case. Financial bids of only those declared qualified by CEC were opened. |
| | Bids are ranked basing on financial proposal and thus selected. |
| | Single source selection on nomination basis can be done in special circumstances with recorded justification and approval of competent authority |
| | Performance of the consultant was systematically and continuously monitored. |

Rules governing procurement in Defence Ministry and India Railways is given briefly in the next chapter while dealing with creation of infrastructure.

### *Examples*

The Procurement Manual of Bharat Sanchar Nigam Limited (BSNL) stipulates that the starting point of the procurement process for any item should be the estimation or forecast of its requirement. In BSNL, the Optical Fibre cable (OFC) network works are executed by Telecom Project Circles and the assets are transferred to the Territorial Circles (who are end users) after completion of the works.

In order to firm up the plan for implementation of FTTH (Fibre to the Home) service by having state of the art fibre based access network, BSNL Corporate Office placed orders for the procurement of 3,000 km of 288F cable on five vendors in August and

September 2008 and the cable was allotted to five Project Circles in 2010. Audit observed that as on October 2012 cables valuing ₹ 41 crore were lying idle. It was 52% of the total cable purchased at the cost of ₹ 79 crore. This issue of its demand ability to implement was not discussed in the meeting of Board of Directors of Management Committee. (Union Civil 17 of 2014 Para 5.2)

ISRO Satellite Centre (ISAC), a unit of Department of Space (DOS), raised (November 2007) a purchase indent for procurement of Si2-124 Solid State Switches from Si2 Microsystems Limited, Bengaluru on proprietary basis with the purpose of developing alternate vendor to meet increasing demand of the switches in Indian Regional Navigational Satellite System (IRNSS) project.

The purchase order was placed (October 2008) on a firm for design and development of 50 solid state switches including 30 numbers of 42 Voltage and 20 numbers of 70 Voltage devices at a total cost of ₹ 1.60 crore. The firm was required to supply prototypes within four to five months for clearance by ISAC followed by production units within six to eight months from the purchase order date (by April/June 2009). In February 2010 ISAC cleared two prototypes. Vendor supplied 23 switches of 42 Voltage and 19 switches of 70 Voltage in July 2010 and sought extension of time to supply the remaining. Audit found that ISAC in Aug 2010 paid ₹ 1.47 crore and short closed the order because it was decided that these sold state switches would not be used for IRNSS project. Instead ISAC would conventional packages. As on that date (May 2014) these switches were not put to any use. (Union 27 of 2014 Para 4.4)

Due to progressive gauge conversion, a number of Metre Gauge (MG) sections over North Western Railway was closed and converted into Broad Gauge (BG) section. Consequently, the utilization of MG coaches declined and some of these coaches were rendered surplus. Scrutiny in audit revealed that 146 coaches were sent to Bikaner Workshop for periodical overhaul (POH) during 2008. On being pointed out that the expenditure of ₹ 4.34 crore on POH was avoidable and wasteful it was replied that they were to be transferred to other Zones. Audit observed that in July Northeast Frontier Railway took 8 AC coaches and other Zones were not willing to take any of them. (Union Railways 2009-10 Para 4.4.2)

As per Delegation of Financial Powers (DFP) Rules, 1978, (adopted in Mizoram), the Director General of Police, PHQ may accord expenditure sanction for local purchase of stationery stores limited to ₹ 20,000 per annum (₹ 40,000 from Sep 2011) while the Superintendent of Police/Commandant of the Battalion may accord expenditure sanction limited to ₹ 10,000 per annum (₹ 30,000 from Sep 2011).

Test check of the records of the revealed that the DGP/Inspector General of Police (IGP) accorded expenditure sanctions (total of ₹ 70.38 lakh) in excess of their delegated annual financial limits towards purchase of stationery items during 2008-13 in violation of the prescribed procurement procedures.

Test check of the records of the 10 units at four sample Districts revealed that the concerned Head of the Offices also accorded expenditure sanctions towards purchase of stationery totalling to ₹ 1.10 crore during 2008-13.

For maintenance, upkeep and repair of vehicles DG can accord sanction up to ₹ 30,000 (₹ 50,000 - Sep 2011) and Superintendents/Commandants can sanction up to ₹ 7.500 (₹ 20,000 – Sep 2011). Scrutiny of the records revealed that all the 11 DDOs accorded expenditure sanctions for ₹ 180 lakh towards repairs of 437 vehicles during 2008-13 against ₹ 60.65 lakh. (MZ 2013 para 1.3.9)

Government of India released (April 2008) ₹ 11.40 crore under NRHM for procurement of identified drugs, kits and equipment under a particular scheme to State Health Society (SHS) of Uttarakhand. On the basis of rates obtained from the central public sector undertakings, Director General Medical Health & Family Welfare (DGMH&FW) placed (Dec 2008) supply order to Hindustan Antibiotics Ltd. (HAL) for supply of Kit-A (2500 kits), Kits-B (2050 kits) and ASHA Kit (10,000) at unit rates of ₹ 32,105, ₹ 3,822 and ₹ 3007 respectively.

During scrutiny of records it was observed that a consignment of 726 Kit-A and 276 Kit-B was made available to Joint Director DGMH&FW Dehradun but due to non-availability of space at Drug Warehouse-Dehradun, these kits were delivered (Feb 2009) at Drug Warehouse Roorkee. Of these 362 Kit-A and 130 Kit-B were delivered to three CMOs, remaining Kits costing ₹ 1.21 crore expired at the Drug Warehouse Rookee. Audit also observed that one lakh large IFA tablets received along with Kit-A expired. (UK 1 of 2014 Para 1.2.9)

Magnetic Resonance Imaging (MRI) scan facility is used as an accurate method of disease detection of aneurysms, stroke, tumours of brain, tumours or inflammation associated with the vertebral or intervertebral discs of the spine. In terms of GFR provision for propriety items procurement should be initiated as per Office Establishment Manual (OEM). In Nagaland the Department (Health & Family Welfare Department) in 2013 without following the procedures released ₹ 16.23 crore in two installments (including cost of civil work for ₹ 0.98 crore) to the contractor for setting up MRI (Seimens-Magnetom Essenza 1.5 Tesla with Tim + Dot MR) at Naga Hospital Authority, Kohima. There was no supporting bill/invoice of any agency. Audit observed that the contractor charged ₹ 15 crore for the MRI whereas as same make along with all supporting accessories from Siemens Ltd India was available for ₹ 5 crore. The undue benefit to the contractor was ₹ 10 crore. (NL 1 of 2015 para 1.3.10.8)

Manual sprue washing of newly manufactured wheels in Rail Wheel Factory, Yelahanka (RWF) was found to be time consuming and health hazardous. With an objective to avoid manual operations, minimise grinding time and enhance the aesthetic look of the wheels, RWF entered into an agreement (May 2003) with M/s HYT

Engineering Company Ltd., Pune, for designing, manufacturing, supplying, testing and commissioning three automatic Sprue Grinding Machines at a total cost of ₹ 6.55 crore. One machine was to be supplied initially and two after the acceptance of the first. The firm supplied (Sep 2003) the first machine. It failed to prove the performance capacity. RWF served a notice (Sep 2004) threatening to forfeit the security deposit and recover the amount paid if the rejected equipment was not replaced and pending works completed within eight weeks. The vendor challenged the rejection of RWF and requested (November 2004) Railway Board to intervene. A committee appointed by the Railway Board examined the issue. The Committee in Dec 2006 observed that specifications and drawings given by the RWF to the supplier were not correct. RWF accepted the Committee's suggestion to accept the first machine with a reduction of 10 percent in the basic price and to procure three machines instead of two with improved specifications and additional features. One machine received in Mar 2009 could not be commissioned on line due to its incompatibility with the online production of wheels and has been used offline negligibly. Against the monthly production of 12500 wheels, the monthly average number of wheels processed on the machine was 270. Against the projected time of 4.5 minutes for the operation, time taken was 20 to 25 minutes. The remaining two machines are yet to be received (August 2009). RWF paid ₹ 1.95 crore for the first one and agreed to procure three more machines at a total cost of ₹ 12.30 crore. (Union Railways 2009-10 Para 4.1.3)

Government of Tamil Nadu placed orders for ambulance base vehicle, digital X-ray unit etc. in January 2011. As per tender conditions, bid validity period was 90 days and if the award was delayed by a period exceeding 56 days beyond the expiry of initial bid validity, contract price would be increased by three per cent of the foreign currency component per annum (5.5 per cent per annum in case of local currency component) and payable for each week that elapsed from the expiry of the initial bid validity period to the date of purchase order. Scrutiny of records revealed that purchase orders in four packages were placed belatedly due to delays in processing of tenders and there was avoidable expenditure of ₹ 48.35 lakh. (TN 4 of 2014 Para 3.2.1)

| Description of equipment | Delay exceeding bid validity period + 56 days | Amount paid for the delay (In ₹ ) |
|---|---|---|
| Ambulance base vehicle | 104 days | 15,38,180 |
| Ring lens | 84 days | 1,68,942 |
| Cryotherapy unit | 112 days | 1,13,054 |
| Digital X-ray, Picture Archiving and Communication System, Cables etc. | 89 days | 30,14,758 |
| **Total** | | **48,34,934** |

At the State level (Gujarat), NRHM functions under the overall guidance of the State Health Mission (SHM), headed by the Chief Minister. The State Health Society (SHS) a governing body headed by the Chief Secretary of the State. The Principal Secretary, Health and Family Welfare Department (Department) was the head of the Executive Committee of SHS. As per provisions in the Procurement Guidelines, the monetary ceiling for each contract prevailing in the State was required to be adopted for purchases under NRHM. State Government procurement policy (Sep 1997) envisaged that purchases above ₹ 2 lakh per annum require inviting of open tenders. Audit observed out that purchases were made keeping the monetary value as ₹ 25 lakh and pointed out that was in violation of its own procurement guidelines.

Even contracts and purchases exceeding ₹ 25 lakh were awarded without following procedure of open tenders and some of the purchases were not related to the service delivery functions. Printing works amounting to ₹ 41.50 lakh for printing 50,000 Swarnim Gujarat Calendars (₹ 41.50 lakh) were awarded to M/s. Smart Graph Art Advertisement Pvt Ltd Company, Ahmedabad and M/s. Gujarat Offset Pvt Ltd, Ahmadabad respectively (between Dec 2008 and Mar 2009) on quotations instead of inviting open tenders. Scrutiny of records in SHS revealed that printing works (Booklets, Modules, Stickers, Cards etc.) for amounts aggregating ₹ 1.44 crore were got executed from three (Dharam Printers, Honey Printers and Pathik Printers) during 2008-09. These three were in the list of 11 suppliers blacklisted by Commissioner of Health in April 2008. They were black listed based on the post procurement review done by SGS Netherland appointed by the World Bank for TB Project in the State during that period. (GJ 2009 1.3.11)

Gujarat Maritime Board in October 2003 decided to replace the two Dumb Hopper Barges 27 (DHBs), in the Dredgers used at Bedi and Mandvi Ports, at an estimated total cost of ₹ 7.37 crore. A Dredger has two Hopper Barges, which has to be towed by other Boat to carry the mud/material recovered in the dredging process for dumping it into mid sea. The tenders were invited (Sep 2004) and the lowest bidder quoted ₹ 7.42 crore for two Self Propelled Hopper Barges (Barges). GMB rejected (Jul 2006) the offer on the plea that the bidder did not agree to reduce the quoted cost. When GMB re-invited in Sep 2006 the lowest offer was ₹ 8.34 crore. Tenders were not finalised within the validity period of 120 days (6 Aug 2007) because no Tender Approval Committee (TAC) meeting was held between October 2006 and April 2008. The tender was invited for a third time and the work was awarded in August 2012 for ₹ 12.70 crore. Audit pointed out that avoidable cost overrun was ₹ 5.28 crore and avoidable time overrun was 8 years. (GJ 4 of 2014 Para 2.9.4)

Eastern Railway had a bitter experience with the crane supplied by M/s Reva Industries Ltd. for Asansol Electric Loco Shed and the defects found during joint inspection were intimated (30 April 1996) to the Central Organisation for Modernisation of Workshop

(COFMOW). When the requirement of cranes of various capacities was under finalization by COFMOW during 1998, the Chief Electrical Engineer, Eastern Railway requested (April 1998) COFMOW that orders should not be given to a reputed firm.

Scrutiny of records, revealed that 5 cranes valuing 1,56 crore were procured from M/s Reva Industries and received on Eastern Railway during the period 1998 to 2002. Of them two cranes in Kanchrapara and Liluah Workshops remained almost totally inoperative and three cranes in Howrah Electric Loco Shed were found to be giving unsatisfactorily service. (Union Railways 2009-10 Para 4.2.3)

Uttar Haryana Bijli Vitran Nigam Limited (UHBVNL) invited (May 2009) tenders for awarding annual rate contract for the year 2009-10 for procurement of tentative quantity of 11,200 KM Rabbit Conductor (Conductors). Stores Purchase Committee (SPC) and Directors on evaluation of the offers received, recommended (July 2009) for negotiation of rates with three lowest technical and commercially eligible firms. The tenderers were invited (4 August 2009) for negotiations by Special High Powered Purchase Committee (SHPPC). The rates received were ₹ 19,298 (L1), ₹ 20,206; (L2) and ₹ 20,790 (L3) per KM. SHPPC felt that the rates were on higher side and decided that a fresh short term tender be invited. Tenders were invited and opened in August 2009. The lowest three offers received ranged between ₹ 20,800 and 22,051 per KM. The SHPPC observed (24 August 2009) that the rates of earlier tender enquiry (May 2009) were reasonable and thus decided to place orders at earlier rates. When firms declined stating that there was steep hike cost of raw material the Company cancelled the orders in Nov 2009 and decided to invite fresh tenders. After opening the tenders in December 2009, the Company placed order on the L1 who offered at ₹ 22,750 (6000 KM) and 23,670 per KM (5200 KM). Audit pointed out that Company should have accepted the rates quoted in May 2009 (₹ 19,298) because they were lower than the rates at which they were purchased in May 2007 (₹ 20,522 per km). Avoidable excess expenditure was ₹ 4.33 crore. (HR 2 of 2013 Para 4.1)

For modernization and up gradation of firefighting capabilities in case of fire accidents in high-rise buildings, West Bengal Fire & Emergency Services (WBFES) invited (October 2008) global tenders for procurement of two Turn Table Ladders (TTLs) of height 30 metres, 50 metres and one hydraulic platform of height 70 metres. Tender Committee recommended (January 2009) acceptance of the lower price bids from the two successful bidders in case of 50 metres TTL and 70 metres platform. WBFES procured 50 metres TTL (in April 2009) and 70 metres hydraulic platform (in February 2010) from the lowest bidders. In case of 30 metres TTL, the lowest bidder had quoted the rate of 296.45 lakh plus 6 lakh (towards clearing/port/registration charges) plus 3.25 lakh (for off shore training) while the second lowest bidder had quoted a rate of 318.53 lakh plus port/clearing/registration charges on actual basis. The committee did not make any recommendation as it desired to ascertain the basis of port charge/

clearing charge of 6 lakh quoted by the lowest bidder. No further progress was on this issue. WBFES in August 2009 decided to re-tender for procurement of 30 metres TTL and global tender was invited (September 2009). The second lowest bidder of the first tender qualified as the lowest bidder with basic rate of 537.22 lakh. It was 69 per cent higher as compared to the basic rate (318.54 lakh) offered by the second lowest bidder 10 months back against the first tender. WBFES entered into (April 2010) an agreement for ₹ 727.45 lakh. They were delivered and commissioned in May 2011.The decision to go for re-tender for 30 metres TTL has cost the State exchequer an additional ₹ 240.77 lakh. (WB 2 of 2014 Para 3.1)

The Construction and Design Services, Uttar Pradesh Jal Nigam (UPJLN) and U.P. Projects Corporation Limited (UPPCL) are apex construction agencies of the Government of Uttar Pradesh along with other agencies viz. Uttar Pradesh Rajkiya Nirman Nigam Limited (UPRNN) and Uttar Pradesh State Bridge Corporation Limited (UPSBCL).

Audit compared the rates which the entities purchased cement. Comparison was made keeping in view the magnitude of the projects executed.

Two units of the UPJLN (Kanpur Unit and Hardoi Units) during the period from Jun 2009 to Feb 2012 procured 2.42 lakh bags of cement at the rates ranging between ₹ 244 per bag and ₹ 334 per bag. During the same period UPRNN procured at the rate ranging between ₹ 167 per bag and ₹ 277 per bag. Three units of UPPCL (Unit-13, 14, 17 Lucknow) during the period from Jun 2010 to Dec 2011 procured 2.52 lakh bags of cement at the rates ranging between ₹ 231 per bag and ₹ 295 per bag. During the same period UPRNN procured cement at the contracted rate ranging between ₹ 171 per bag and ₹ 270 per bag and UPSBCL procured cement at the contracted rate ranging between ₹ 170 per bag and ₹ 240 per bag. Audit commented that UPJLN incurred extra expenditure of ₹ 1.43 crore as compared with UPRNN and UPPCL made extra expenditure of ₹ 0.57 crore compared UPSBCL. (UP 1 of 2013 Para 3.3)

The Himachal Pradesh State Electricity Board floated (11 July 2008) a tender enquiry for the procurement of Compact Florescent Lamps (CFL). Seven firms offered their bids which were opened on 10 October 2008. After evaluation, rates of ₹ 396 per pack (four CFL) quoted by M/s HPL Socomec Private Limited, New Delhi were found to be the lowest (L1) and M/s Phoenix Lamps Limited, Noida was second lowest (L2) with its rates of ₹ 473.15 per pack. After negotiation, the rates were brought down to ₹ 387 per pack and this was also accepted by the L2 firm. Purchase orders amounting to ₹ 63.08 crore were placed (Oct 2008) on M/s Phoenix Lamps Limited, Noida (6,30,000 packs) and M/s HPL, Socomec (P) Limited, New Delhi (10,00,000 packs). These rates were inclusive of 8 per cent Excise Duty and 3 per cent cess thereon. As per the requirement of NIT, payment of duties and taxes should be made against production of documentary proof and the purchase order issued after splitting up the basic prices and taxes accordingly. This was part of the proposal approved by the Board.

Audit pointed out that while issuing the purchase order, the standard clause regarding the payment of taxes and duties against production of documentary proof was not inserted in the purchase orders. When the rates of the excise duty were reduced from 8 per cent to 4 per cent on CFL with effect from 7 December 2008, the Electricity Board could not use this benefit. The suppliers charged ₹ 3.02 crore excise duty on 15,03,546 packets on the basis of agreed FOR rates where as the actual duty paid at the prevailing rates by them was ₹ 1.51crore made by them. (HP 2009-10 para 3.8)

Health Department, Government of Bihar had laid down norms (August 2002) for purchase of medicine, machine equipment and chemicals. Separate tender should be floated in each financial year and the rate contract should be valid for that financial year only. Reasonability of rate should be ascertained by assessing the cost of the material (as specified in the tender) at prevalent market rate before opening of financial bid. Minimum period for submission of bid should be three weeks.

Scrutiny of files/records of the Superintendent, Patna Medical College and Hospital (PMCH), for procurement of medicines and surgical items for the year 2009-10, revealed that two tenders were floated for procurement of Anti Haemophilic Factor-AHF-VIII8.

| Particulars | Tender No.9705 (2009-10) | Tender No.10174 (2009 -10) |
|---|---|---|
| Date of publication of NIT | 3.3.2009 & 4.3.2009 | 4.3.2010 |
| Date of opening of Technical bid | 16.4.2009 | 19.3.2010 |
| Minimum period for submission of bid | Three weeks | Seven days |
| Date of opening of Financial bid | 2.12.2009 | 29.3.2010 |
| Name of bidder who was declared L 1 for purchase of AHF-VIII | M/s Vaishnavi Associates, Mehta colony, Sandal pur road, Kumhrar, Patna-6 | |
| Price quoted by the L1 bidder | ₹ 2500 per vial | ₹ 3850 per vial |

Time given in the second tender was only one week against the prescribed time of 3 weeks. In both the tenders the lowest supplier was the same. However rate quoted by the same firm in the second was higher. The Superintendent, PMCH did not place any purchase order for procurement of 7200 vials of AHF -VIII (between June 2010 and January 2011) on the second tender at the rate of ₹ 3850.00 per vial. Audit pointed out that it resulted in loss to Government of 97.20 lakh. Audit also pointed out that State Health Society, Bihar has finalised the rate contract of this medicine at 2678.40 per vial from the same manufacturer in March 2012. Audit did not agree with the contention that the second one more suitable because internal correspondence recorded AHF-VIII having monoclonal made no difference and was being used in PMCH without any adverse effect on the patient. (Bihar 1 of 2013 Para 5.1.4)

Army Purchase Organisation (APO) in the Ministry of Defence is responsible for procurement of dry ration items centrally which are delivered to the Armed Forces through Army Service Corps. APO contracts are governed by Manual of Office Procedure for Supplies, Inspection and Disposals of the Directorate General of Supplies and Disposals (DGS&D).

For procurement of 1700 Metric Tonne (MT) of Tea for the consumption year 2011-12, APO floated tender enquiry on 03 Dec 2010 with validity of tender up to 19 Jan 2011. Tender Purchase Committee (TPC) meeting was held on 20 Dec 2010 and recommended procurement of 1700 MT of Tea at a total cost of ₹ 15.50 crore from three lowest firms. Case was forwarded to Defence (Finance) for concurrence on 05 Jan 2011. After prolonged correspondence on the comparability of rates, Defence (Finance) gave concurrence for procurement on 10 Mar 2011. The three firms refused to extend validity period tender beyond the agreed date of 5 Jan 2011. APO again invited tenders in Mar 2011 and finally purchased for ₹ 17.83 crore. Audit pointed out that the delay resulting in excess expenditure of 2.33 crore was avoidable and audit also questioned the justification stating that description of packing material mentioned March 2011 and December 2010 were similar. (Union 35 of 2014 para 3.2)

One of the conditions stipulated in the Guidelines issued by Integrated Headquarters, Ministry of Defence (Navy) [IHQ MoD (Navy)] of November 2006, for decentralization for purchase of victualling stores was that information on brands chosen and pricing be exchanged between the Command Headquarters / Base Victualling Officers of all Stations. In Jan 2010 HQ ENC (V) floated an Open Tender Enquiry (OTE) for the supply of 10,000 Kgs of Coffee (100 %) at the Base Victualling Yard, Visakhapatnam [BVY (V)] for the period from 01 Apr 2010 to 31 Mar 2011. M/s Nestle, Chennai emerged L1 at ₹ 880 per Kg coffee (Brand-Nescafe Classic) and accordingly Rate Contract (RC) was concluded (March 2010) for 10,000 Kgs of Coffee (100%).

During Audit (Aug 2012) it was noticed that for the same period, Headquarters Western Naval Command, Mumbai [HQ WNC (MB)] had concluded (Apr 2010) a contract with M/s CCL Products (India) Pvt. Ltd., Hyderabad for the Continental brand of Coffee (100%) at 435 per Kg. Audit pointed out that HQ ENC (V) did not call for rates and the brand name from HQ WNC (MB) though this was required to have been done as per the IHQ Guidelines of November 2006. M/s CCL Products Pvt. Ltd., Hyderabad was registered with HQ WNC since the year 2009 and a contract for 2009-10 was also concluded by HQ WNC with them in May 2009. Lack of timely communication between the Commands led to an extra expenditure of ₹ 53.40 lakh which could have been avoided. (Union Defence 4 of 2014 Para 4.4)

According to the Government of Assam, Delegation of Financial Power Rules, Joint Director Health Services (JDHS) is empowered to incur expenditure up to ₹ 10,000 in each

case with a limit of ₹ 2 lakh in a year. Scrutiny (Jan-Feb 2012) of records revealed that the JDHS, Diphu purchased (August 2009) 98,800 number of ARTESUNATE tablets (medicine for malaria) from a Guwahati based firm at a cost of ₹ 23.71 lakh. Payment was made in December 2009. The life span of the medicines was nine months (expiry date April 2010). Tablets were stated to be for distribution to health units but Audit found no requisitions from health institutions. Stock register of JDHS, indicated that 94,599 tablets were issued to the District Malaria Officer (DMO), Diphu on 16 February 2010 when they were due for expiry in April 2010. Cross verification of stock register of DMO, Diphu revealed that the tablets were not accounted by the DMO, Diphu. DMO stated that neither they were received nor there was any requirement as there was a balance of 23,500 tablets. DMO usually receives them from Joint DHS, Malaria, Guwahati against requisitions. (AS 2013 Para 1.2.3)

Andhra Pradesh State Government imposed (January 1994) ban on purchase of vehicles by Government departments and Government affiliated organisations. It allowed hiring of vehicles in cases of extreme necessity subject to certain conditions.

Audit scrutinised 866 paid vouchers (₹ 4.87 crore) monthly payments for hired vehicles in 12 Departments across 22 districts for the period 2009-10 to 2012-13. Audit cross-checked the vehicle numbers with details in the State Transport Department website. It was observed that 38% of the transactions (326) in 8 of the 12 departments were not compliant with the rules. In 63 vouchers involving payment of ₹ 21.72 lakh for 100 vehicles it was found that they were not cars but were two wheelers/tractors/ auto rickshaws/ goods carriers. Random numbers had been quoted and incorrect class of vehicles was cited. Hire charges of ₹ 1.19 crore was paid for 483 cars (263 vouchers) which were not registered as taxis. (AP 1 of 2014 Para 5.7)

In Uttar Pradesh generation of thermal power is carried out by Uttar Pradesh Rajya Vidyut Utpadan Nigam Limited (UPRVUNL). It entered (Jul to Nov 2009) into coal supply agreements (CSA) with Bharat Coking Coal Limited (BCCL), Northern Coalfield Limited (NCL), Central Coalfield Limited (CCL) and Western Coalfield Limited (WCL) for supply of coal to its power stations at different places. Coal is transported to thermal power stations from collieries through rail wagons. The railway has fixed time limit of seven hours for unloading of one coal rake (58 wagons). Demurrage charges at the rate of ₹ 100 per wagon per hour were payable for delay in unloading of wagons. Audit pointed out delays in unloading at Parichha Power Station by the private contractors during the period 2006 to 2010. It resulted in payment of demurrage of ₹ 17.84 crore to Railways. During the period 2797 coal rakes were received of them 2381 were unloaded after a delay of 1 to 118 hours. (UP 2010 Para 2.2.31)

In a meeting held (August 2011) under the Chairmanship of Principal Secretary, Medical Education, Karnataka it was decided to entrust the work of overall maintenance of

Super Speciality Hospital (SSH) of Bangalore Medical College and Research Institute (BCMRI) including operation and maintenance of utility services, housekeeping, security, firefighting etc., to Hindustan Lifecare Limited (HLL) as they had rich experience in the field. A contract was awarded to HLL for the period March 2012 to March 2013 for ₹ 42.43 lakh.

Audit pointed out that it was in violation of Karnataka Transparency in Public Procurement Rules, 2000 which permits single source selection for consultancy services only in exceptional circumstances where (a) the assignment represents a natural or direct continuation of a previous one and the performance of the incumbent consultant has been satisfactory; (b) a quick selection of the consultant is essential (e.g., in emergency operations such as natural disasters and financial crisis); (c) the contract is very small in value (less than ₹ 5 lakh for consulting firms); and (d) only one consultant has the qualifications or has experience of exceptional worth to carry out the assignment. Audit also pointed out that the basis on which the cost was arrived was flawed. The entity adopted Central Public Works Department (CPWD) charges for maintenance works that is not applicable. The payment of consultancy charges of ₹ 42.43 lakh to HLL, therefore, lacked justification (KA 3 of 2014 Para 3.5)

In terms of Rule 121 of Madhya Pradesh Financial Rules all material received should be examined, counted, measured or weighed as the case may be, when delivery is taken and they should be taken in charge by a responsible Government servant who should see that the quantities are correct and their quality is good. He should also record a certificate to that effect on the bill. The Government servant receiving the stores should also be required to give a certificate that he has actually received the material and recorded them in the appropriate stock register. Each voucher should contain signature of the responsible drawing and disbursing officer and the order for payment should be indicated in ink both in figures and words (Rule 193). All payment orders should bear his signature.

During test check of records relating to purchases made in the office of Civil Surgeon cum Hospital Superintendent (CS), Dhar in Sep 2011, Audit observed that CS placed four supply orders dated 17th, 26th and 27th July for local purchase of 2,27,000 disposable syringes for ₹ 10.12 lakh. Audit found that supplier in 3 out of 4 invoices submitted double invoices with same numbers and date for same quantity. The storekeeper who was responsible for inspection and receipt of supplies failed to detect the double invoices and entered them in different stock registers. The bills were passed for payment by the CS and the payment was made in October 2010. Audit pointed out that against the total purchase orders of ₹ 10.12 lakh payment of ₹ 21.24 lakh (inclusive VAT) was made by admitting the double claims with two identical invoices. (MP 3 of 2014 Para 3.2.2)

# CHAPTER -10

# Controls over infrastructure

Depending on the type of service delivered, a department needs infrastructure like machinery, plant and buildings. Inputs are consumed during a shorter period of time where the infrastructure is consumed or depreciated over longer period of time. Union or State Government Departments usually create such infrastructure through Public Works Department (PWD) that exist for this purpose. Governments also create general purpose infrastructure like roads, bridges, canals etc., through Departments created for such purpose such as PWD Irrigation, Bridges and Roads.

Infrastructure is usually created through by awarding a contract to a private entity through a bidding process as a turnkey project or stage-wise implementation. The created infrastructure is usually maintained by concerned PWD department. Occasionally they also create infrastructure by using its manpower, tools and equipment. Land and buildings are considered as Major Works with Object Code/Head 35 and they fall under Object Class 6 - Capital Assets and other Capital Expenditure.

The financial resources that are used for creation of infrastructure need to be safeguarded from the risk of loss or waste due to inappropriate procurement procedures. The created infrastructure needs to be safeguarded till the end of its useful life through appropriate procedures and practices for use and maintenance. Created infrastructure need to be safeguarded from the risk of loss due to improper maintenance resulting in premature depreciation, degradation. Infrastructure need to be safeguarded from misuse and improper use.

The Central Public Works Department (CPWD) is the agency of the Central Government operating throughout the country for planning, construction, maintenance and repairs of all works and buildings financed from Civil Works Budget. Rules governing the creation of infrastructure of the Union Government are General Financial Rules (GFR), Delegation of Financial Powers (DFPR), CPWD Works Manual, and CPWD Account Code. There would be special provisions in some departments like Railways, Defence and Scientific Departments which would be governed by related codes and procedures. State Government have their own Public Works Department with its codes and manuals similar to Union Government.

Process of creation of infrastructure is also a procurement process and the principles governing public procurement explained in the previous chapter are equally applicable. Rules and procedures laid in works manuals are based on these principles. Unlike procurement of equipment, this procurement involves extensive contract management at each stage of implementation of works contract.

To what extent the procuring authority/head of the office/department by complying with the related rules could safeguard the financial resources of the government at the time of creation of infrastructure (bidding, award, and implementation of works), its usage and maintenance from the risk of loss or waste is examined by framing the audit objectives as follows.

Audit Objective 1: Whether adequate controls were exercised over creation of infrastructure at the stage of planning, bidding, award, and implementation of works contract (by the procurement official/head of the office/ department)?

Audit Objective 2: Whether adequate controls were exercised over use of infrastructure and its maintenance.

User department identifies its infrastructure needs and seeks funds through its demand for grant. Depending on the cost of the proposed infrastructure 'approval-in- principle' is sought from Secretary of the Department in concurrence with IFA or Secretary (Expenditure) Finance Ministry or a Committee of Secretaries or a Cabinet Committee. Controls exercised over budgeting by the user department can be examined by framing audit objective as follows.

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| Audit Objective 3:<br>Whether adequate controls were exercised by the user department over estimating the requirement of infrastructure and its budgeting | |
| | *To examine whether:*<br>The infrastructure under the project/scheme or administrative functions was taken up with adequate justification of its utility; it could be a new facility or addition to existing one, arising out adoption of policy/scheme/project<br>Preliminary survey to assess suitability of sites, the needs of users, technical viability and cost was conducted by user department<br>Existence and availability of linkages like water for irrigation project/canal, raw material for manufacturing unit etc., were established<br>Full details with explanations and a statement of the cost, recurring/non-recurring for each item was prepared by estimating officer and sent to HoD<br>HOD had taken care to consider the date on which the scheme/infrastructure can be brought into effect and sent to Finance Department with a statement of the cost, recurring and non-recurring for ensuring year and subsequent years.<br>Budget estimate is planned in such a way that the funds required are sought through annual budget to the extent that can be spent during that year.<br>The schedule of new expenditure was prepared in the prescribed format following the classification for items considering it as new item of expenditure.<br>Proposed budget for the infrastructure correctly reflected the expenditure incurred up to end of previous year, provision for current year and for next year |
| | No liability was incurred prior to voting of budget estimates (in contravention of rules) |

After the user department is provided with the budget for proposed infrastructure it would request the Public Works Department to create this infrastructure. PWD prepares the technical specifications, selects a contractor through a bidding process and monitors the execution of the work/project. It is a kind of public procurement. Once completed, PWD hands it over to the user department. PWD is responsible only to that extent. It is the responsibility of the user department to clearly identify its infrastructure needs and propose the exact facilities that would meet its requirement. The responsibility of its usage, upkeep and maintenance lies with the user department.

If the land has to be acquired, and if it is a public land of the State Government, the concerned Revenue Department is requested by the user department. Land acquisition is governed by Land Acquisition Act, 1894, Land Acquisition (Companies) Rules, 1963, National Rehabilitation & Resettlement Policy, 2007, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 and subsequent Amendments to it, The Registration Act, 1908 (Amendments to it) and provisions of General Financial Rules and instructions issued by Finance Ministry from time to time. Purchase of private land is subject to approvals from the Finance Ministry.

Audit Objective-1 is applicable for audit of the Public Works Department. It is also applicable to other departments if they undertook the procurement on their own without depending on the PWD. They may hire consultants to assist them in preparing the specifications, bidding and monitoring the execution.

The process of creation of infrastructure broadly involves (a) preparation of preliminary estimates and detailed estimates based on technical and other requirements, (b) selection of procurement method and preparation of bid documents, (c) invitation of bids, evaluation and award (d) entering into contract and implementation of contract. These issues are examined by framing the Audit objective as whether adequate controls were exercised by the procurement official/ head of the office/department over creation of infrastructure at the stage of planning, bidding, award, and implementation of the works contract.

The above stages and rules governing them are the sub-objectives and the criteria. Selected number of works/contracts that is representative of the total number is the sample. Instances of non-compliance that are significant and pervasive indicate the extent of failure to safeguard the resources.

Audit Objective-1: Whether adequate controls were exercised by the procurement officials over creation of infrastructure.

| Sub-objectives for the Audit Objective-1 | |
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| Whether adequate controls were exercised over: | |
| | Preparation of preliminary estimates and detailed estimates |

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|---|---|
| | Selection of procurement method and preparation of bid documents |
| | Invitation of bids, evaluation, selection and award of works contract |
| | Execution of work through implementation of contract |

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|---|---|
| Sub-Objective<br>Whether adequate controls were exercised over preparation of preliminary estimates and detailed estimates | |
| | *To examine whether:*<br>- On receipt of requisition from a department, PWD engineer carried out the site inspection and gathered information about soil, water etc. (feasibility)<br>- Prepared preliminary drawing incorporating the civil, electrical, mechanical requirements if necessary in coordination with architects<br>- Preliminary drawing kept in mind the applicable requirement under the laws of the municipality, forest & environment department etc.<br>- Preliminary estimates (approximate cost) were prepared basing on the preliminary drawings by the concerned engineers by including the provision for services like electrical installations, water supply, drainage etc.<br>- Preliminary estimates (cost) included component of contingencies that is at the prescribed value of the total estimated cost (usually 3% to 5%), that includes cost of work-charged establishment<br>- Preliminary estimate was sent to the user department, who obtained the administrative approval for the work and communicated the approval to PWD<br>- User department provided unencumbered land and obtained environmental clearance<br>- Plans (preliminary drawings) were sent to municipal authorities and their approval was obtained. Issues related to drains, water supply mains, sewerage, electricity, access road etc., sorted out.<br>- Architects prepared detailed architectural drawings and/ or technical specification for various components of works<br>- Civil, electrical and mechanical engineers prepared detailed estimates (of cost) on the basis of architectural drawings. Detailed estimates are complete and comprehensive to execute the work the way it is expected to be<br>- Engineers made use of 'Schedule of Rates' (SOR) for preparing the cost of each item and each piece of work. SORs include hire charges for all types of 'plants' like 'concrete mixer, tipper, loader, crane etc.'; unit cost of all types of material like bitumen, items of iron, steel; labour charges like rock excavator, rock breaker, mason, blacksmith, carpenter etc., and also for carriage rates; electrical items & equipment and also for the activities like flooring etc.<br>- SOR was periodically revised by the PWD. If SOR is not updated and price index and prevailing markets rates were applied correctly |

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| | - 'Manual of Specification' was used to take determine the quality of material, correct proportion in mix of material, activities (like concreting work) etc.<br>- Detailed estimates were in the prescribed format consisting of plans architectural designs, specifications and detailed statements of measurement, quantities and rates etc., with an abstract showing the total estimated cost of each item.<br>- Detailed estimates contained the history of the initiation of the proposal, its description, its location and design, its cost, method proposed for carrying out the work (by contract/daily labour /combination), estimated completion time<br>- Detailed estimates contained compensation for cost of land, cost of sheds for workmen and stores, cost of establishment, tools and plants, cost of surveys (separately specified), expenditure incurred prior to submission of the estimate, requirement of labour and materials, charge for contingencies.<br>- Technical Sanction was obtained from the competent authority (AE/EE/SE/CE depending on the work) for the Detailed Estimates |

| Sub-Objective<br>Whether adequate controls were exercised over selection of procurement method and preparation of bid documents | |
|---|---|
| | *To examine whether:*<br>- Tenders are invited for all works costing more than prescribed amount (CPWD ₹ 50,000)<br>- Tenders/bids exceeding the prescribed value (CPWD ₹ 15 crore) were invited only from the appropriate category or class of contractors listed with them, if listed with other similar departments they had this work experience<br>- Tender is floated as composite tender (that includes civil, electrical and mechanical aspects of the work), then the main contractor entered into agreement with his minor contractor(s) and is responsible for their work.<br>- Competent authority has declared certain works as specialized works. List of names of eligible contracts was approved by the competent authority.<br>- Precise reasons recorded and found to be convincing if contract was awarded without calling tender stating it urgent and in the interest of the work<br>- Award of contract of without tender was within the delegated powers of the designated authority. (CPWD AE 60,000; EE up to 4 lakh; SE up to 12 lakh, CE up to 25 lakh); total annual limit (3 lakh for EE, 6 lakh for SE) adhered to<br>- Bid documents were prepared after the technical sanction for the detailed estimates is obtained<br>- Bid documents were prepared using the standards forms prescribed (that contained clauses and schedules) separately for general conditions of contract, special conditions of contract, schedules of items of work/material and a notice inviting tender form (NIT). |

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| | - Notice Inviting Tender (NIT) (CPWD Form 6) clearly mentioned the name of the work, the estimated cost put to tender, period of completion, criteria and eligibility for contractors, time and date of receipt and opening of tenders etc.<br>- The rates adopted and applied correctly if cost of items was based on schedule of rates (CPWD Form-7 Percentage Rate Tender)<br>- The rates adopted and applied correctly if cost of items was not based on schedule of rates (CPWD Form 8- Item Rate Tender). Contractors were asked to quote the rates (CPWD Form 9) that would be verified during evaluation?<br>- Detailed architectural and structural drawings, detailed specifications for all items and components of the work, schedule of quantities for each item/component are explained in tender if it is lump sum contract (CPWD Form 12). Whether the bid specified stages of work, and the percentage of the contract value & payment for each stage and final payments.<br>- Tender documents are prepared by the designated engineer and approval of the competent authority (depending on the work) was sought<br>- Limits of deviations for foundation (usually 100%) and superstructure (30%) etc., were clearly provided for in the general conditions of the contract reasonable<br>- Tenders/bids exceeding the prescribed value (CPWD ₹ 15 crore) were invited under two/ three envelope (two/ three bid) system. Technical specification of the work is defined clearly in the NIT.<br>- Three bid system was followed if technical specification of the work was yet to be finalised. Bids containing documents related to eligibility criteria in the first, technical bid in the second and financial bid in the third envelop.<br>- Tenders were invited in the most open and public manner possible, by advertisement in the website/press, and by notice in at PWD Divisions, Zonal, Circle Offices, Local Municipality, Collector's office etc.<br>- For works valuing more than ₹ 5 lakh, a brief advertisement inviting tenders inserted in the press in the classified category. Advertisement for NIT was sent to DAVP; NITs remained on the notice board of the Division from the date of issue of NIT to the date of opening of tenders.<br>- Tender documents were made available to the eligible contractors as soon they gave written application. They were issued under the signature of Engineer or Divisional Accountant, to only those contractors who fulfill the eligibility<br>- The tender forms were sold as per approved rates. Additional costs were imposed for any drawing provided with NIT.<br>- NITs were serially numbered in the form "X of Y". X is the running number, applicable for all from AE to CE and is allotted from the Register. Y is the year. The agreement with the contractor bears the serial number of the NIT |

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| | - Chronological record of the issue of tender documents, the names of the persons to whom issued, the number of forms issued and the sale proceeds received are recorded in the prescribed register.<br>- Surplus/unutilized tender documents destroyed after one month of acceptance of tenders.<br>- Prescribed value of Earnest Money Deposit-EMD (CPWD 2% pf value of the contract up to ₹ 10 crore and an additional 1% for the amount above ₹ 10 crore) was collected. EMD of unsuccessful bidders was returned within the prescribed period (CPWD – one week) after receiving the tenders.<br>- There was reasonable time limit between the date of publication of tender and the date of receipt of the tenders (CPWD 7 days for works valuing up to ₹ 20 lakhs, 10 days up to ₹ 2 crore, 14 days for more than ₹ 2 crore).<br>- Tenders were invited/accepted only after the work is technically sanctioned and NIT was approved.<br>- The time and place of opening the tenders was made known to the tenderers.<br>- The tenders that were received after the due date and time are rejected.<br>- All the tenders opened in presence of tenderers or their representatives. After opening, the total amount worked out by different tenderers were read out.<br>- A list of tenders received is prepared and entered in a register.<br>- In a two/three bid system, the envelopes containing technical eligibility criteria were opened first and evaluated. The second envelope of financial bid of successful technically qualified bidder was opened subsequently.<br>- Where three bid system was adopted because technical specifications were to be sought from bidders, the first envelop (eligibility criteria) of all tenderers were opened first. It is followed by opening of technical bids of successful tenderers thereafter financial bids of technically eligible bidders are opened.<br>- The officer opening the tenders encircled all corrections, cuttings, conditions, additions and over-writings and numbered them and attest them. Corrections are numbered, mentioned at the end of each relevant page of the Schedule attached to the tender documents and properly attested with date.<br>- The designated Engineer carefully prepared a comparative statement without mistakes and sent it to the tender accepting authority.<br>- Scrutiny was carried out in office of accepting authority who is responsible for arranging proper check of tenders and comparative statements.<br>- Officials initialed all papers of calculations which they have checked and ensured that all working sheets are preserved. |

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| | - All the corrections in the comparative statement were initialed by the person making the corrections and attested by the authority concerned. Correction may arise due to mistakes/discrepancies in calculation by the bidder.<br>- Post-tender modifications by bidders were rejected. Those with any condition / conditional rebates etc., were rejected. Rules may provide unconditional rebate<br>- Revised technical sanction from competent authority was obtained if the bid amount exceeded technically the sanctioned amount.<br>- Revised expenditure sanction was obtained if the difference was more than 10%.<br>- Variation accepted was within the prescribed limit (CPWD up to 5% and up to 10% in special circumstances).<br>- The tender accepting authority prepared Justification Statement containing detailed analysis of rates and satisfied that the items mentioned were of specified quantity and conform to standards/ specifications laid down in the Tender document (prepared if cost estimates of lowest tender exceeds estimated cost by more than certain per cent – CPWD 10%)<br>- Evaluation was carried out according to pre-determined evaluation criteria that were approved by the competent authority or a committee. Analysis of rates was carried out as prescribed<br>- The lowest tender was accepted. It was accepted by the authority who was competent to accept (CPWD ₹ 3 lakh for AE, ₹ 30 lakh to 45 lakh for EE and ₹ 250 lakh for SE up to 1000 lakh for CE etc.).<br>- If open tender resulted in single tender, it was accepted by competent authority (CPWD ₹ 4.5 lakh for EE on his own and ₹ 30 lakh with prior approval of next authority; ₹ 125 lakh for SE on his own and ₹ 250 with prior approval of next authority. CE has powers up to ₹ 500 lakh on his own, and ₹ 800 lakh and ₹ 1000 lakh with prior approval of ADG and DG respectively).<br>- Tenders to be rejected were submitted to the higher authorities for their review.<br>- Re-tendering was followed if the lowest tenderer backed out<br>- Re-tendering was followed if the response to tenders from the contractors of the appropriate class was poor or rates quoted were unreasonable. Any revision of eligibility criteria in re-tendering was approved by competent authority. In case of re-invitation of tenders, all the formalities should be observed.<br>- Acceptance of a tender is communicated to the contractor in a prescribed format, after acceptance, an intimation to commence was sent within reasonable time.<br>- Rejection letters were sent to other contractors.<br>- Performance guarantee was collected from the contractor who was awarded the contract; in the form of banker's cheque, DD, PO, deposit at call receipt, FDR, government security, an irrevocable bank guarantee on Scheduled Bank was it at the prescribed per cent of value of contract (CPWD 5%). |

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| | - In addition whether security deposit at prescribed value (CPWD 5%) was to be collected. If so, it was collected. Was it proposed to be deducted from every payment made (running bill).<br>- Duration of Bank Guarantee (BG) was periodically extended till the execution was complete.<br>- The performance guarantee was refunded after the completion of the work and also issue of completion certificate.<br>- Security Deposit was returned only after the maintenance period was complete. If any recoveries are due, were recovered from it. |

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| Sub-Objective<br>Whether adequate controls were exercised over execution of work through implementation of contract | |
| | *To examine whether:*<br>- Site Order Book (SOB) in the prescribed form was maintained at the site. Site Engineer verified SOB for any compliance due from contractor and certified that he has verified the Site Order Book before signing the bills for payment.<br>- An Inspection Register in the prescribed proforma was maintained at the site of work. It was issued by Division Head and docketed from the Division Office.<br>- Engineers/ Officers concerned with the work inspected the work regularly to ensure that they were being executed according to the design, drawings and specifications and within time limits laid down in the contract.<br>- Date and time of visit, items inspected and observations of Engineers visited site were recorded and signed by them. Copy of inspection notes/ instruction issued noted in the Inspection Register.<br>- Inspection notes were pasted/noted on the SOB for compliance by Contractor. SOB is never removed from the site.<br>- Defects, delays pointed out were rectified by the contractor. Field staff have pursued the notes and compliance.<br>- Inspection notes were taken into account before passing the bill. Payments are made after ensuring compliance to issues pointed out in SOB.<br>- Contractor recorded any of his difficulties in the Site Order Book and they were addressed.<br>- Competent authority permitted the contractor to sub-let execution of work. If so, the reasons for doing so were recorded and were convincing. Composite contract bid provides for use of sub-contractors.<br>*In respect of material brought by contractor examine whether:*<br>- the contract incorporated special conditions relating to quality and quantity of the material the contractor would bring and provision for their testing by PWD. |

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| | Contractor submitted a list of manufacturers from where he bought its supply, indicating specification and quality mark.<br>- PWD got tested the quality of material brought by contractor<br>- Contractor obtained and furnished test certificates in respect of all supplies of steel brought by him to the site of work. Engineer-in-charge got samples tested.<br>- Contractor bought required quantities of steel and cement stored at site in the storage facility created by contractor.<br>- Rejected material, its nature and quantity was noted in the site order book and removed and details of how it is removed was noted again<br>*In respect of material provided to contractor by PWD examine whether:*<br>- Contract specified the rate to be charged and place of delivery, the provision for wastage/variation and about return of excess/unused material.<br>- Numerical account of issue was maintained.<br>- Issue was restricted to actual requirement and acknowledgement of quantity and value of material supplied obtained.<br>- Issued material was charged correctly and excess/unused material was returned.<br>- For cement, theoretical consumption statement from the start of the work up to and including the work included in the bill was prepared along with every running bill. It was compared with the actual issue of cement as per Cement Register as on the last date of the measurement of the work. Difference was properly explained and remedial action taken.<br>- Effective control was exercised on steel issued to contractors. Actual consumption of steel was measured and compared with the theoretical consumption along with every running bill. Difference was explained and remedial action taken.<br>- If free supply of bitumen is stipulated, recovery rate for supply in excess of permissible variation (CPWD 2.5% over theoretical consumption), was stock issue rate plus a per cent (CPWD 10%) or market rate whichever is higher.<br>- Issue rates of cement, steel or any other items in the contract were not less than the market rates.<br>- Excess steel and cement used by contractor was recovered at higher rate. Excess is calculated with reference to a theoretical calculation of material expected/ required to be used with prudence and economy.<br>- Difference between the theoretical consumption and the total actual issues (not returned by the contractor) was recovered at the prescribed rate in cases where PWD facilitated the contractor to purchase from government stocks.<br>- The materials issued for rectification of defective work was recorded separately and recovered at higher rate than issue rate (CPWD twice the rate). |

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| | Material at site account maintained by PWD when itself executes the work on its own, particularly roads). The account need to be reconciled and closing balance should have been worked out correctly. It might receive the material from store, other work site, and from other subdivisions. It is issued directly to the works carried out by PWD or to the contractor. The unused balances were verified and transferred. When the PWD deploys its casual labourers, it needs to maintain a muster roll and all the payments to the labourers should have been captured through the muster roll that indicates the name of each labourer, amount paid and acquittance of having received the payment.<br>*In respect of tool and plant issued to contractor by PWD examine whether:*<br>- Contract clearly specified the rates of recovery of various tools or plant (concrete mixers, road rollers etc.)<br>- Hire charges included the elements of direct charges and indirect charges. Direct charges are running expenses and maintenance charges. The hire charges will include services of operational staff, viz. Driver/Operator, and maintenance staff such as Mechanic and Cleaner, as required. Indirect charges are depreciation charges and departmental charges.<br>- Charges were correctly levied and collected and accounted to the work. They might have been borrowed by this sub-division from another sub-division. Charges are inclusive of the date the plant and/or machine is made over, and up to and inclusive of the date of its return in good order, excluding the days taken for repair for any major break down.<br>*With regard to measurement of work done examine whether:*<br>- A Measurement Book (MB) was maintained to record all accounts of quantities, whether of works done by contractors or by department labourers<br>- MB is machine numbered. A register is maintained in Divisional Office containing details of Measurement books; Serial Number of each book, Names of the sub-divisions (Camp office) to which they are issued and Date of issue. FIR should be lodged in case measurement book has been lost<br>- Each measurement book in use in the sub-division (camp office) was sent at least once a year to the Divisional Officer, for the accountant‘s scrutiny, completed measurement books are promptly sent to the Divisional officer for record<br>- The name of the work, of the contractor, estimate, location, number & date of agreement for each item of work was recorded in the MB<br>- The measurements were recorded and entered in MB by the contractor and verified by site engineer; the date of measurement were invariably recorded<br>- The entries were recorded continuously in the measurement book and no blank pages are left or torn out. In case of cancelled measurements, reasons for cancellation are recorded under the initials of the officer |

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| | - In case the measurements are taken in connection with a running contract account, on which work has previously been measured, reference to the last set of measurements were recorded<br>- Each set of measurement contained full name of work as given in the work order, location of work, name of contractor, number and date of agreement/work order, date of commencement of work as per contract period of claim, date of measurement, name and designation of the person recording the measurement<br>- Concerned Engineer made entries for date of completion of item or work, quantum of work done, date of recording and reference to previous measurements.<br>- In case of works of repetitive type, detailed measurements of prescribed per cent of the total number of units was taken.<br>- In case of steel bars less lesser size, length and number in each bundle and number and weight of bundles allowing some percentage is allowed for wastage. For normal size cross section is measured.<br>- An abstract capturing the measurements for works done and the total quantities of each distinct item of work for each sanctioned sub-head was prepared.<br>- All payments to contractors for the work done were made on the basis of the measurements recorded therein.<br>- Measurements were crossed off as soon as bills are passed for payment, voucher numbers noted and pay order signed by the disbursing officer soon after the payment<br>- Details of quantities, rate and amount of each item (for every bill) are entered in the MB in a tabular form with nomenclature of each item. It should also capture the extra /substitute items.<br>- The last set of measurements should be cross-referenced in a running account.<br>- Only authorised person made entries in MB and recorded a dated certificate 'Measured by me' over his full signature; signed by Contractor/ representative<br>- The engineer to whom the site engineer is reporting checked a per cent of works (CPWD 50%) measured by site engineer particularly. High rate items like steel cladding, structural glazing inspected. Engineer heading the division (CPWD EE) checked a per cent of the measurements, consignments in a month. If any variation, checked 100%. Head of Division is responsible for it.<br>- A record of all the checks carried out from time to time were captured in MB and results were indicated as 'satisfactory' or 'unsatisfactory'. Unsatisfactory results were reported to superiors.<br>- Earthwork measurements were recorded in Level Books in addition to MB and they were checked by superiors at the prescribed per cent. Earthwork measurement was taken following the prescribed procedure.<br>- Large scale levelling work involving both cutting and filling was measured following the prescribed procedures |

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| | - Hindrance Register was maintained at site to record genuine hindrance to the work<br>- Hindrances were recorded and reviewed by superiors. Timely action was taken to remove such hindrances.<br>*With regard to changes in work examine whether:*<br>- Any change from the drawings that becomes necessary during the execution, due to any practical difficulty, were brought to the notice of the Technical Sanctioning authority and Senior Architect.<br>- Deviation in quantities of individual item beyond the prescribed limit (+ 10%) which was beyond the overall deviation limit as specified in contract was allowed only with the prior approval of sanctioned authority. Deviations in the quantities of substituted/extra items within the overall deviation limits of the contract were approved by the competent authority.<br>- Necessity of extra items or substitute items (replacement items) were approved by the one who accorded the technical sanction.<br>- The rate of extra items and deviation items beyond the permissible limit were worked out at market rates prevailing at the time of commencement of execution. For substituted items, the agreement rate of the original item were adjusted for the difference in market rates, overheads were as prescribed<br>- Any material procured under critical situations on spot quotations were from reputed agencies. It was subsequently regularized by competent authority within reasonable time.<br>- Contract conditions for allowing adjustment in the cost of work due to variation in prices of costly materials (if it is a substantial part of the work) was correctly taken into account and approved by component authority. Contract conditions for such increase were reasonable.<br>- Any alteration, omission, substitution from original specifications, designs and instruction were made by the competent authority. They were given in writing, signed before the event. Costs were worked out correctly.<br>- Impact of increase in minimum wages due to Government notification are taken into account.<br>- Work was executed according to specifications and designs. If not contractor was made to re-execute without any compensation.<br>*With regard to progress of work examine whether*:<br>- Contract document contained construction schedule of the various components of the work (contract time schedule) showing the milestones, targeted tasks etc., prescribed monthly report (time and progress chart) on progress of work.<br>- Monthly progress report was obtained regularly. It depicted progress chart of the various components of the work planned and achieved for the month as well as cumulative, with reasons for deviations, statement of manpower used |

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| | - Monthly progress report also depicted broad details of all the running account payments received up to date, gross value of work done, advances taken, recoveries effected, amounts withheld, net payments, details of cheque payments received; details of extra and substituted items; quality assurance<br>- Contractor deployed qualified and skilled professionals at site of work. Intimated the names and qualifications of engineers and others and they were verified.<br>- Contract provided for recovery of compensation for delays and defaults at certain specified rates.<br>- Compensation was levied for delays and defaults at the prescribed rates.<br>- Rescheduling milestones done if any was done by the competent authority for valid reasons and they were recorded and were convincing.<br>- Contract provided for a system of appeal if the contractor was aggrieved. If superior authority used discretion to reduce the compensation or waive, the reasons were recorded and found to be convincing.<br>- Contract provided for forfeiture of security deposit, Ernest Money Deposit (EMD) and Performance Guarantee (PG) where contractor fails to complete the work within the stipulated date, penalty if suspends the work without reasonable cause, and persistently neglects to carry out<br>- Were they forfeited if there was persistent negligence by the contractor?<br>- Prior notices were given to the contractor for the above penalties and proof of loss is established before levying them<br>- A test run was conducted for all the projects to ensure that their working condition is in line with expectations<br>- Adequate documentation was in place to authenticate that the test runs were conducted in the presence of officials from the project team, quality assurance team, contractor etc.<br>- After satisfactory completion of the testing phase and getting all the relevant clearances such as fire etc., the project is adequately commissioned<br>- The Contractor, on completion of work, submitted a completion certificate and final bill was not paid till such time.<br>- Completion certificate in the prescribed form was recorded by the Engineer who is responsible in whose tenure the work was completed. The Certificate says 'I have inspected the work of ..... contract value of which is ₹ .....vide Agreement No. ..... today. As a result of this inspection and my previous inspections, I find that the work has been carried out generally to specifications, and has been completed satisfactorily. There are no noticeable defects except for the following'.<br>- Completion certificate was submitted after the site was cleared (removing the scaffolding, surplus material and rubbish, cleaning up the dirt etc.). The cost of site clearance was borne by the Contractor. Contract provided for responsibility, |

valuation, accounting of material of dismantled structures, salvaged material and the conditions were enforced.

- Completed asset handed over to the user department along with completion certificate

*With regard to payments examine whether:*

- Payments were based on a system of stage payment (foundation work, floor level or lintel/still level are defined in terms of block/segment). Concerned engineer verified that each unit/stage was executed as per measurement of standards of units prescribed. Test checked and verified by superiors. If any stage could not defined, the actual work done was measured.
- Whether payments were month wise (monthly running payment). Concerned engineer supplied a copy of measurements of work for the work done in the preceding month was supplied to the contractor. The contractor prepared the bill in the prescribed form and submitted to sub-divisional office. The bill was verified with reference to the entries in MB and passed and paid.
- Every bill received in the Divisional Officer was accompanied by Measurement Books and was checked with reference to contract agreement conditions.
- Rates adopted for various items of work in the running account bill are in accordance with the contract agreement
- Running account bills of succeeding month agree with the previous bill
- All recoveries such as supply of rent, water and electricity charges and hire charges of plant and equipment etc., have been made properly
- Final payment was made after the final measurement was taken. A complete list of materials issued to the contractors against the particulars of recoveries already made from the on account bills was enclosed with the final bill
- Mobilization advance, security advance adjusted from payments.
- Contractor's Ledger was maintained at Division/Sub-division (for each contractor) to record the accounts relating to contracts/ supplies with a separate folio or set of folios reserved for each contractor/supplier,
- A personal account was opened for every contractor. Entries were made correctly and those relating to running bill, total value of work or supplies were attested. Each account was closed and balanced monthly. Amount outstanding were adjusted correctly. Entries can be traced to works abstract, stock register.
- The Contractor signed in the ledger in token of his acceptance at the time of payment of each running bill/final bill
- A consolidated record of all the bills received from the Sub-Divisions in respect of works/supplies should be maintained in one register in the Divisional Office, known as the Register of Bills / Bill Register. The bills of work charged establishment,

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| | muster rolls and establishment bills are not entered in this register. A similar register is maintained in the Sub-Divisions.<br>- Schedule of Works Expenditure was maintained correctly in the prescribed format. It gives the details of expenditure incurred during the month, during the year, estimate amount of each work, agreement number and year for each work.<br>- Register of Works for major works and minor works was maintained in the Divisional Office to record cumulative and collective expenditure incurred in the Division during a year. Separate folio or set of folios are assigned to each Major Works estimate and information is captured from Works Abstracts, which are maintained in sub-divisions. Entries of minor works are posted on a single page on each work. Register of Works is reviewed and signed by EE every month before the monthly account is finalised. |

Controls over stock/stores in public works department

The issues relating to audit of stores/stock are explained in the previous chapter. In PWD Stores the value accounts are maintained and issue rates are fixed in accordance with the instructions contained in works accounts code. The head 'Stock' is charged only with expenditure connected with the acquisition of stock materials and with manufacture operations and is duly credited with the value of materials issued to works, sold, transferred, or otherwise disposed of. The following are some of the registers/forms through which controls are exercised over PWD stores.

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| | Register of stock is maintained in the Store and is used for recording daily transactions (Receipts and Issues) of stock items.<br>Abstract of stock receipt (form) is used to quantity and value account of stock acquired in a particular month. At the end of the month it is submitted to the Division by the Assistant Engineer in charge of the Store for adjustment expenditure through stock.<br>Register of half yearly balance return on stock is used to record quantity and value account, is maintained at the Store showing all the transactions of receipts and issue of stock on half yearly basis. It is closed at the end of March & September<br>Profit or loss is also evaluated on the basis of stock issue rates of different items in the store at the time of closing and accordingly issue rate is reviewed and revised if needed. |

Audit Objective 2:

Whether adequate controls were exercised over use of infrastructure and its maintenance.

User department is responsible for the safety and security of the infrastructure. The department is also responsible for their non-engineering maintenance. PWD is responsible for engineering maintenance and repair of the structures such as buildings, roads and bridges etc., created by it.

Operations manuals and maintenance manuals exist for the all kinds of technical infrastructure. The user department had to adhere to the instructions in the manual. Audit would

also examine whether designated officials have prescribed the procedures for safety, security and upkeep of the infrastructure and concerned officials have adhered to the instructions.

## IT Assets/Infrastructure

Audit of automated environment of the department is another subject dealt under the title IT Audit. However, IT assets are similar to other assets and they need to be safeguarded similarly. Apart from safeguard of financial resources that are used for procurement and maintenance of IT Assets they need to be safeguarded from unauthorised physical access and logical access. Illustrative check is given below.

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| | *With regard to physical access and environmental security examine whether:* |
| | Physical Access Control Policy is documented and approved |
| | Critical Information System facilities (like data centre) are located appropriately; Protection against natural disasters like earthquakes, flooding, extreme weather etc. Not having a direct access from the outside or through a public hallway |
| | The access to IS facilities is controlled through a secured mechanism? |
| | The access to the IS facilities is limited to approved persons only? The visitor to critical IS facilities are escorted by employees? |
| | All access routes are identified and controls are in place? |
| | The usage of any equipment outside the business premises for information processing is authorized by the management? |
| | In case of outsourced software, whether all maintenance works is carried out only in the presence of/with the knowledge of appropriate IS staff? |
| | Appropriate access controls like password, swipe card, bio-metric devices etc., are in place and adequate controls exist for strong the data/ information on them? |
| | Are there controls to ensure that the issue and re-collection of such access devices are authorized and recorded? Access violations are recorded, escalated to higher authorities and appropriate action taken? |
| | Employees are required to keep the critical / sensitive documents in secured places? |
| | Verify that surveillance systems are designed and operating properly? |
| | Verify if the security controls in place are appropriate to prevent intrusion into sensitive IS facilities – data centre, communication hubs, emergency power services facilities? |
| | Facility monitoring measures to ensure that alarm conditions are addressed promptly. |
| | IS facilities are situated in a place that is fire resistant? Extinguishers are placed at required locations |
| | Adequate smoke / temperature detectors are installed, connected to the fire alarm system and tested? |
| | Fire prevention instructions are clearly posted and fire alarm buttons clearly visible? |
| | Fire prevention and control measures implemented are adequate and tested periodically? |
| | Fire drill and training are conducted periodically? |

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| | Air-conditioning, ventilation and humidity control procedures are in place, tested periodically and monitored on an ongoing basis?<br>Adequate alternate power arrangement is available? If so, is it covered under maintenance?<br>Water, fuel, air-conditioning and humidity control resources are available?<br>There are sufficient battery backup systems providing continuous power during momentary black-outs and brown-outs along with generators that protect against prolonged power loss and are in working condition.<br>fire alarm is protecting a critical IS facility like data center from the risk of fire, a water system is configured to detect water in high-risk areas of the data center and a humidity alarm is configured to notify data center personnel of either high or low-humidity conditions.<br>Check logs and reports on the alarm monitoring console(s) and alarm systems which are to be monitored continually by data center/IS facility personnel.<br>*With regard to user access examine whether:*<br>User ID & access rights are granted with an approval from appropriation level of IS and functional head? Verify the user ID creation, granting of access right and approval process.<br>User IDs are in a unique format? Verify the naming conventions for the user IDs.<br>Invalid login attempts are monitored and User IDs are suspended on specific attempt? Verify the parameters etc., for unsuccessful login attempt.<br>Procedures granting access to the third parties were followed.<br>Users were made to change password on first log-on and at periodic intervals? Verify password parameters for first log on and password aging.<br>The users IDs and Password are communicated to the user in a secured manner? Verify the procedure for communicating user ID and password for the first time and after suspension.<br>The organisation monitors logs for the user access?<br>The access to scheduled job is restricted to the authorised?<br>Use of groups and access levels were set for a specific group determines the restrictiveness of their use. Evaluate the use of passwords, access rights at the group level.<br>The parameters to control the maximum number of invalid logon attempts has been specified properly in the system according to the security policy.<br>Ascertain as to who is the custodian of sensitive passwords such as super/root user and verify if that person is maintaining secrecy of the password, whether the password has been preserved in a sealed envelope with movement records for usage in case of emergency.<br>From the log file, identify the instances of use of sensitive passwords such as super user and verify if records have been maintained with reason for the same. Ensure that such instances have been approved/ authorized by the management.<br>From the log file, identify the instances of unsuccessful logon attempts to super user account and check the terminal ID / IP address from which it is happening. Check if appropriate reporting and escalation procedures are in place |

## Procurement in the Indian Railways and Defence Ministry

Substantial expenditure is incurred by Indian Railways, Ministry of Defence and its entities, Public Sector Undertakings on public procurement for creation of assets, purchase of equipment, stores etc. Though the principles of public procurement remain same these entities are governed by rules and procedures prescribed for them. The following paragraphs provide an overview. Auditors need to be familiar with those rules and procedures while carrying out the audit of these entities.

## Indian Railways

Acquisition of assets, infrastructure, its use and maintenance in the India Railways are governed by its own codes and manuals. Codes include Indian Railways Finance Code, IR Code for Accounts Department, and Code for Traffic (Commercial Department), Code for Stores Department, Code for Engineering Department, and Code for Mechanical Department (workshops). Manuals include Operating Manual for Indian Railways, Work Manual, Permanent Way Manual, Traction Maintenance and Operations Manuals, Track Machines Manual, Engineering Manual, Telecommunications Manual etc.

Indian Railways has an extensive infrastructure with about one lakh km track, about 10,000 locomotives, 60,000 passenger coaches and 240,000 freight wagons and operates more than 7000 stations. Assets are maintained in more than 100 loco sheds, more than 200 carriage and wagon shops and about 50 repairs and overhaul workshops located throughout the Indian Railways network. Six manufacturing units are engaged in manufacturing locomotives and coaches. Workshops manufacture items such as traction motors, switch gears and control gears, cast & fabricated bogies, cast steel railroad wheels and forged axles.

About 40 percent of the procurement expenditure is on items required for manufacturing, 30 percent for purchase of items required for repairs, operation and maintenance, 27 percent for purchase of fuel and the rest for purchase of items required for construction. Indian Railway Stores Service (IRSS - one of the nine organized services of Indian Railways) is responsible for forecasting, planning, procurement of material, logistics management, ware housing and for giving material support for manufacture of locomotives, coaches and wagons. Stores is one of the Directorates of the Railways. Controller of Stores at the zonal level is responsible for procurement. Procurement for certain categories is done centrally by the Board on receiving the indents from Zone through their Controller of Stores. Out of ₹ 42,447 crore worth procurement in 2013-14 about 48% was done by Zonal Railways and Production Units, 50% by Railway Board.

The stocking depots are responsible for inspection, receipt, storage and issue of the stock materials to the consuming departments. There are more than 250 Stocking Depots (Stores Department) attached to track maintenance units, loco sheds, carriage and wagon shops, signal repair shops, repair and overhaul workshops and manufacturing units etc. There are more than one lakh items/components. Railways maintain a list of approved vendors for items specified by the Board. Railway Board has formulated the Standard Conditions of Contract (SCC) which must be adhered to by all units of IR for procurements. Deviations from SCC will require approval from the Accounts and Legal Departments. Tendering procedures are similar to the standard tendering procedures.

Financial powers are delegated to Controller of Stores at the Zone General Manager of the Zone except those that reside with the Board. Purchase Orders are issued by the COS Office after Tender Committee's recommendations are considered by the tender accepting authority. Tender Committee is formed with representatives from the Stores, Accounts and user departments. The inspection of the material is usually done by a third party (other than Stores or User department). The material is received and stocked by the Stores Department; during the process of receipt, the Stores Department can inspect and reject the material if it does not conform to specifications (in the opinion of the Stores Department). The user department can also reject the material while receiving it from the Stores Department if it feels that the material does not conform to specifications. All units have a vigilance organization headed by a full-time Chief Vigilance Officer (CVO).

Compliance Audit of procurement/acquisition, use, maintenance and repair of equipment and infrastructure is carried in the similar lines explained in this chapter and the previous chapter.

**Defence**

The Defence Secretary functions as head of the Department of Defence and is additionally responsible for coordinating the activities of the four Departments headed by Secretaries in the Ministry. Department of Defence deals with the Integrated Defence Staff (IDS) with a Head Quarters Integrated Defence Staff (HQ IDS) under the overall Command and Control of Chairman Chiefs of Staff Committee (COSC) and various Inter Service Organisations. Three services each headed by a Chief have Head Quarters Naval HQrs, Air HQrs and Army HQrs. Department of Defence Production with Directorate General of Quality Assurance (DGQA), of Aeronautical Quality Assurance (DGAQA), Directorate of Standardisation etc., and along with its 40 Ordinance Factories (under Ordinance Factories Board-OFB and 8 Defence Public Sector Undertakings (DPSUs) deals with matters pertaining to defence production

and indigenisation. Department of Defence Research and Development with its Autonomous Body Defence Research and Development Organisation DRDO having 46 laboratories deals with research, design of defence equipment for the defence services. The fourth department is the Department of Ex-Servicemen Welfare.

Inter services Organisations under the Department of Defence include Military Engineer Services (MES) with more than ₹ 1000 crore annual budget; Directorate General Defence Estates managing 17.54 lakh acres of land throughout the country under three Services and other Organizations OFB, DRDO, DGQA etc.; Office of the Chief Administrative Officer providing civilian manpower and infrastructural support to the Services Headquarters and the Headquarter Offices of Inter-Service Organisations (ISOs; Army Purchase Organisation (APO) with the responsibility of procurement and timely supply of different types of food stuffs and dry rations for the consumption of Defence Forces and Armed Forces Medical Services etc. DGQA Organisation is divided into eleven Technical Directorates, each responsible for a distinct range of equipment. The Technical Directorates are structured in two tiers for functional purposes, comprising Controllerates and Field Quality Assurance Establishments. DPSUs are Hindustan Aeronautics Limited; Bharat Electronics; Bharat Earth Movers; Mazagon Dock Ltd; Garden Reach Shipbuilders and Engineers Ltd; Goa Shipyard Ltd; Bharat Dynamics Ltd; and Mishra Dhatu Nigam Ltd.

Defence capital procurement budget accounts for 42 per cent of the defence budget. Defence Procurement Procedures (DPP) 2013 governs Capital acquisitions by the Ministry of Defence, Defence Services and Indian Coast Guard. Ordinance Factory Board (OFB) is governed by its OFB P&M (Plan & Machinery) Manual 2013 and DRDO is governed by its Purchase Management Manual 2006. Capital acquisition under DPP 2013 can be outright purchase referred to as 'buy' which can be 'buy India' of 'buy global. Capital acquisition can be a 'buy' along with licence for production. This can be from foreign vendor with technology transfer or 'buy and make Indian'. In the later type, the buy component can be from the foreign vendor. Capital acquisition can also be 'make'.

Procurement process is linked to the planning process through the 15 year Long-Term Integrated Perspective Plan (LTIPP), which outlines the technology perspective and the capability road map; the five year Services Capital Acquisition Plan (SCAP), which indicates the list of equipment to be acquired, keeping in view operational requirements and the overall requirement of funds; and a short-term Annual Acquisition Plan (AAP) of each service, which is a two year roll-on plan for capital acquisitions and consists of the schemes from the approved SCAP.

There is a hierarchical procurement structure with four pillars for capital procurement. They are the Defence Procurement Board, Defence R&D Board, Defence Production Board and the Defence Acquisition Council. Each case of capital procurement goes through various committees comprising of various officials among several departments and agencies, namely, the respective service headquarters (SHQ), the Integrated Defence Service Headquarters (HQIDS), Director General of Quality Assurance (DGQA), Defence Research Development Organization (DRDO), the Acquisition Wing, MoD and MoD (Finance) at various stages of acquisition.

A capital procurement decision goes through various stages: the formulation of staff qualitative requirements (SQR), acceptance of necessity approval (AON), solicitation of offers through bidding and RFP, Evaluation of offers by Technical Evaluation Committee (TEC), field evaluation, staff evaluation, oversight by the Technical Oversight Committee (TOC) for acquisitions costing above the prescribed threshold value, commercial negotiations by the Contract Negotiations Committee (CNC), approval of the Competent Financial Authority (CFA), award of contract of supply orders (SO), contract administration and post-contract management.

DPP prescribes formats and procedures for each stage, each document (RFP, commercial offer etc.) and composition of the committees and a compliance table. Competent authority for expenditure is governed under the provisions of delegations of financial powers for capital expenditure.

DPP prescribes that in acquisition proposals valuing ₹ 300 crore or more 30 per cent of buy-global and 30 per cent of foreign exchange component of buy-and-make-with-ToT would be the off-set obligation. DPP also explains how to discharge off-set obligations and lays down the procedures for processing and formats. Similarly explains for Technology Transfer (ToT). Make category goes through the stages of Preliminary Services Qualitative Requirements (PSQRs), Feasibility Study, Categorisation and AON by DAC, Constitution of IPMT, Stages Leading to Detailed Project Report (DPR), CFA approval, Design and Development of Prototype, User Trials by Service HQ, Staff Evaluation, Solicitation of Commercial Offers, Commercial negotiations by Contract Negotiation Committee (CNC) and Award of Contract. Make category covers high technology complex systems; upgrades undertaken by indigenous research, design and development through OFB, DPSUs and Indian industry consortia. A separate chapter in DPP lays down the procedures and formats for make category and another chapter in DPP prescribes procedures for acquisition of naval and coast guard ships, sub-marines, yard crafts etc.

The Defence Procurement Manual (DPM) 2009 and Supplement 2010 contains the rules and procedures to be adopted for procurement of equipment and stores and is uniformly

applicable to all the goods and services procured by the Defence Services, Ministry of Defence and Inter Services Organisations out of the Revenue Budget to meet the Defence needs. Delegation of Financial Powers to Defence Services (DFPDS) 2015 explains the powers delegated to various levels with and without concurrence of Integrated/Competent Financial Advisor IFA/CFA.

DPM 2009 contains provisions that prescribe and govern types of tendering/contract covering original equipment manufacturer (OEM; stores commercial available off-the-shelf (COTS), local purchase items; high value technical complex plant machinery equipment from foreign/ indigenous firms; repair contracts with foreign and indigenous firms; design, development and fabrication; up gradation, refurbishment, modification, overhaul and life extension et. DPM also explains the standard terms of different types of contracts, about banking instruments and payment procedures.

Approval process is almost similar to that of capital acquisition. Services lay down the technical parameters of the equipment/item required by them in their Staff Qualitative Requirements; NSQRs of Navy, AFSQRs of Air Force, General SQR of Army and Joint SQR or common for all three. Suppliers are identified through bidding and registered using the provisions of Defence Joint Services Guide on Assessment and Registration of Suppliers 2007. The manual categorises foreign procurement and indigenous procurement. All stores falling within the product range of the Ordinance Factories should be procured through the OFB by placing indents without issuing RFPs. Any item developed/manufactured by a Defence PSU specifically for the Defence Services, with transfer of technology or through design and development, should be procured from the concerned Defence PSU only. Similarly, Defence PSUs should be approached for providing any service, such as repairs and overhauling, if facility for providing such services has been set up by a Defence PSU exclusively for the Defence Services.

The normal mode of payment to foreign vendors (USD one lakh and above) is through irrevocable Letters of Credit in the prescribed form valid for 90 days. For contracts below that is Direct Bank Transfer (DBT) (30 days). Import is regulated by the Directorate General of Foreign Trade (DGFT) and Foreign Exchange Management (Current Account Transactions) Rules, 2000 and the directions issued by Reserve Bank of India under Foreign Exchange Management Act from time to time.

The Military Engineer Services (MES) provide engineering support and executes works to/ for various formations of Army, Air Force, Navy, Ordinance Factories, Border Road Organisation and DRDO. Its works are governed by Regulations of MES (R MES) 1968, Defence Works Procedure 2007, Manual of Contract 2007 and Scales of Accommodation 2009 etc.

### *Examples*

In February 2002 Air HQ firmed up the Operational Requirements (ORs) for the VVIP fleet in consultation with the Prime Minister's Office (PMO). Amongst other ORs, Air HQ prescribed mandatory altitude requirement of 6000 metre. In March 2002, Ministry of Defence (MoD) issued an RFP to 11 Original Equipment Manufacturers (OEMs)/authorized vendors who were shortlisted by Air HQ/ MoD for procurement of eight helicopters. Four vendors responded to the RFP and three helicopters, namely, Mi-172, EC-225 and EH-101 were recommended by the Technical Evaluation Committee (TEC) for flight evaluation.

Of the three, Mi-172 (Russian) and EC-225 (Eurocopter, France) were flight evaluated (Nov-Dec 2002). EH 101 (AW-101) (Augusta Westland Italy-UK) could not be evaluated as it was not certified for an altitude of 6000 metre (certified up to 4572 metre). EC-225 (Eurocopter, France) was found suitable and the flight evaluation report was sent to MoD (May 2003) for approval.

In June 2003, the Technical Manager (Air) in MoD asked Air HQ to reassess the EC-225 and also obtain the views of PMO with regard to the suitability of cabin height. In a meeting convened on 19 Nov 2003 by the PMO (Principle Secretary to PM), with representatives of MoD, Air HQ and Special Protection Group (SPG), PMO observed that framing of mandatory requirements had effectively led to a single vendor situation.

PMO suggested that the Air Chief and the Defence Secretary may jointly review the matter to draw up realistic mandatory requirements satisfying operational, security and convenience requirements of VVIPs involving SPG. On 01 Mar 2005, National Security Advisor (NSA) directed MoD/Air HQ to revise the ORs in consultation with the PMO and to reissue the RFP. NSA also directed that ORs should broadly conform to the parameters of Mi-8 (in use for VVIPs inducted in 1988) operational specifications and should be drawn by taking into account security, communication and cabin configuration to ensure comfort for VVIPs. In a meeting on 7 Mar 2005 chaired by Deputy Chief of Air Staff (DCAS) in Air HQ and attended by Joint Secretary & Acquisition Manager (Air), Director SPG and other officers from Air HQ (07 March 2005) revision of ORs was discussed. Height altitude capability was reduced to 4500 metre. Cabin height of at least 1.8 metre was proposed to be added as a mandatory OR (Operational requirement). In a meeting convened by the Defence Secretary (9 May 2005) and attended by officers of Air HQ, it was decided to lower the altitude requirement to 4500 metre and to make the cabin height of at least 1.8 metre, as a mandatory SQR. In Oct 2005 Air HQ revised the requirement of helicopters from 8 to 12 due to insistence of SPG for addition of four helicopters in non-VVIP configuration.

The Acceptance of Necessity (AON) for the procurement of 12 helicopters was accorded by the Defence Acquisition Council under 'Buy' category with 30 percent offsets on 3 Jan 2006. A proposal for procurement of 12 helicopters at an estimated cost of ₹ 793 crore was submitted (Jan 2006) to the Raksha Mantri (RM). Quantity vetting was approved by the RM in March 2006. Based on the revised SQRs, MoD issued (September 2006) a fresh RFP to six vendors (the earlier ones responded to 2002 RFP on 27th September, 2006.

Three vendors, namely M/s Sikorsky, USA (S-92 helicopter), M/s AgustaWestland, UK (EH-101 helicopter) and M/s. Rosoboronexport, Russia (Mi-172 helicopter) responded to the RFP. The offer of Mi-172 helicopter was rejected due to non-submission of Ernest Money Deposit (EMD) and absence of the pre-contract Integrity Pact (IP) as required by the RFP. The TEC (Technical Evaluation Committee) constituted in Feb 2007 evaluated the technical proposals of Sikorsky (S-92) and AgustaWestland (AW-101) and recommended the two for field evaluation. The report of the TEC was accepted by the Director General (Acquisitions) in Dec 2007. Thereafter, it was sent to DG (Acquisitions) for acceptance of the TEC report. The Field Evaluation Trial of M/s AgustaWestland was carried out in UK and trials of M/s Sikorsky were carried out in USA from 16 Jan 2008 to Feb 2008. The Field Evaluation Trial team submitted its report in April 2008 and recommended AW-101 helicopter of M/s AgustaWestland for induction into Service. SPG was also part of the Field Evaluation Trial team.

Staff Evaluation Report of Air HQ concluded that the S-92 helicopter was non-compliant and AW-101 is fully compliant. Technical Oversight Committee constituted on 6 August 2008 found that the field evaluation trials, compliance to SQRs and selection of vendors were done according to the prescribed procedures. Contract Negotiation Committee (CNC) was constituted and it carried out its discussions with the vendor between 19 September 2008 and 21 January, 2009. Air HQ, and SPG PMO added some additional features and contract was firmed at a negotiated price of EURO 556.262 million. Cabinet Committee on Security (CCS) considered the proposal in its meeting held on 18 Jan 2010 and approved the proposal. Ministry of Defence concluded a contract for the supply of 12 AW-101 VVIP helicopter with M/s AgustaWestland, UK on 08 Feb 2010. Ministry of Defence (MoD) concluded a contract on 8 Feb 2010 with M/s AgustaWestland International Limited, UK (Agusta Westland) for the purchase of 12 number of AW-101 VVIP/non-VIP helicopters along with Engineering Support Packages and accompanied accessories at the total contract price amounted to Euro 556,262,026 (₹ 3726.96 crore). Along with the main contract, an offset contract was separately concluded for discharging the offset obligation valuing Euro 166,879,000 (₹ 1118.09 crore).

Audit pointed out that Operational Requirements (ORs) and Services Qualitative Requirements (SQR) followed by Acceptance of Necessity (AON) should be comprehensive and should be firmed up before inviting the bids. This was not followed. Altitude requirement was changed. Cabin height requirement was changed. The number of helicopters required was increased from eight to twelve. Conducting filed tests abroad in UK for Agusta Westland and in USA for Sikrosky was violation of contract conditions. Helicopter of Agusta Westland subjected to field evaluation test (FET) was not the one proposed to be purchased. Even though a single trial directive was issued, Air HQ allowed different methodologies for the trial evaluation of S-92 and AW-101. Both the vendors shortlisted for FET were not fully compliant with SQR. DPP stipulates that a technical offer once submitted should not be materially changed. MoD sought approval for 8 deviations which were to be invoked only in exceptional circumstances. These deviations included acceptance of partial compliance of two of the ORs, additional items, on warranty etc. MoD submitted the proposal in the form of draft cabinet and sent to MoF in February 2009 for its comments/concurrence. MoF did not given any clear cut approval. The allowed offsets were not compliant with the DPP, besides many Indian Offset Partners (IOPs) selected for discharge of offset obligations were not eligible. (Union Defence 10 of 2013)

Paragraph 378 of the Uttarakhand Financial Hand Book (Vol-VI) provides that no work should commence on land which has not been duly handed over by the competent authority. The State Government accorded (Jan 2006) administrative and financial sanction of ₹ 4.78 crore for construction of 132.50 metre span motor bridge and 1.30 km approach road between Jamunwala and Dehradun Cantonment area over Noon river of Dehradun district. Technical sanction was accorded (May) by the Chief Engineer (Garhwal Region), Pauri and the work was awarded (Nov 2006) to a contractor for ₹ 4.66 crore with the stipulated date of completion by Nov 2007.

Audit in Jun, 2010 observed that the work stopped in July 2008 after construction of 250 meter approach road and 54.50 metre bridge from right portion after incurring expenditure of ₹ 1.6 crore. Objections were raised by Defence authorities stating that the left portion of the bridge along with 1.05 km approach was falling under defence cantonment area. As of May 2011, land issue remained unresolved and thus the bridge incomplete. (UK 2010-11 Para 3.1.1)

Bihar Public Works Departmental BPWDC Rule 159 specified that normally 10 days' time from the date of publishing of tender in paper/internet was to be provided to bidder for submission of tender documents in emergency. Audit noticed that in six agreements of anti-erosion (AE) works, only two to six days' time was provided for submission of tender documents from the date of publishing of Notice Inviting Tenders (NITs) in newspapers. (BR 2013 Para 2.1.8.1)

Para 14.1 of Central Public Works Department (CPWD) Works Manual, 2007 (followed by Government of Mizoram) provides that tenders should be called for all works costing more than ₹ 50,000 except in urgent cases, or when the interest of works demands in which works may be awarded by the Executive Engineer (EE) without call of tenders after approval of the competent authority. State Government, Finance Department in their notification (August 2002, March 2010 and March 2013) reiterated that works shall commence after inviting tenders and selection of contractors in accordance with General Financial Rules, 2005.

Audit, on scrutiny of the records pointed out that the Director General of Police, PHQ awarded 104 works valued at ₹ 15 crore to contractors during 2009-12 without calling tenders for execution of works viz. construction of office buildings, sentry posts, check gates, staff quarters, barracks, play grounds etc., although none of the works can be considered to be an urgent nature. (MZ 2012 Para 1.3.10)

Standard bid documents of Bihar Public Works Departmental (BPWDC) mandate that bidders have to compulsorily fulfil conditions such as registration with the department, Sales Tax clearance, labour license, turnover, experience of similar work executed, key plant and equipment, technical persons, experience in terms of quantity, bid capacity, programme of construction, an affidavit made by contractor and power of attorney. No opportunity for clarification and modification was to be given to a bidder who did not fulfil the compulsory requirement. In a joint venture bid all the partners of the firm would have to individually fulfil all conditions/criteria. Bidders who meet the minimum qualification criteria will be qualified only if their available bid capacity is more than the total bid value. In no case, the contract shall be awarded to any bidder whose available bid capacity is less than the evaluated bid price, even if the said bid is the lowest evaluated bid.

After review of 138 works of flood protection schemes valuing ₹ 813 crore of the period 2008-2011, audit pointed out that in 13 cases, works valuing 125 core the awarded contractors did not meet one or more conditions. Two other works for ₹ 124 crore were awarded to a debarred private contractor (M/s JKM Infra Project Pvt. Ltd. New Delhi). In another case (work for ₹ 239 crore) the one of the partner of the Joint Venture Company (M/s NCCL-Bashishtha, Hyderabad) did not possess registration, labour license and sales tax clearance and none of the partners had enclosed the proof of ownership/lease of key plant and equipment. In another case work for ₹ 3.45 crore was awarded to a private who submitted documents of other company. (BR 2013 Para 2.1.8.1)

Scrutiny of the records of Dalhousie division revealed that Himachal Pradesh State Government administratively approved the construction of sewerage systems in Dalhousie and Chowari towns of Chamba district for ₹ 11.19 crore in the year 1996

with a stipulation to complete them in four years. Records revealed that the detailed estimates for according technical sanctions were submitted to the Chief Engineer (Dharamshala Zone) in October 2009 after thirteen years. The CE accorded technical sanctions to these estimates in Mar 2010. Meanwhile during the period from 2003 to 2009 without technical sanction for the scheme, material such as Cast Iron (CI), Ductile Iron (DI) and Galvanised Iron (GI) pipes and tor steel valuing ₹ 2.5 crore was procured. In 2011, they were lying idle and deteriorated. (HP 2009-10 Para 3.8)

The Department of Irrigation Haryana accorded administrative approval for Dadupur-Nalvi Irrigation Scheme in Oct 2005 for ₹ 267.27 crore. According to project report, 590 cusecs of surplus water from Dadupur complex was to be carried through Shahabad feeder. On completion, the project was to provide irrigation to 92,532 hectares besides recharging of ground water. The work of Phase-I started in Apr 2006 and was completed in Jun 2009 at a cost of ₹ 126.11 crore except 'RCC Box Railway Bridge' which was to be constructed by Railways. The Department had deposited ₹ 2.47 crore till July 2010 with the Railways but the work was not started by Railways. Additional demand of Railways (Jun 2011) for ₹ 2.29 crore was also deposited in Dec 2011. As of Nov 2012 the Railway authorities had not started the work (Nov 2012). The work of phase III including minors of phase I and II off-taking from main canals was deferred due to protests by farmers who stated that this water from this project would be available to them only during rainy season not in other seasons. Audit pointed out unfruitful expenditure of ₹ 126.11 crore could have been avoided had Haryana Government conducted proper feasibility study before approving the project to irrigate 92,532 hectares at the cost of ₹ 267.27 crore (HR 2012 Para 2.2.9.1)

Sardar Sarovar Narmada Nigam Limited, Gujarat (SSNNL) invited (23 July 2010) tenders for the work of construction of canal network consisting of distributaries and minor channels for the cultivable command area (CCA) under Dhrangadhra Branch Canal (124 km) at an estimated cost of ₹ 239.23 crore. Tender provisions stipulate that after technical evaluation the successful bidders would be declared as pre-qualified and their price bids would be opened for further (financial) evaluation. Among the four lowest bidders, SSNNL (Apr 2011) for some reasons found only L4 was technically suitable and asked L4 (₹ 232 crore) to match the quote of L1 (₹ 216). L4 declined but expressed willingness to accept the price of L3 (₹ 229 crore). SSNNL (May 2011) scrapped the tender and retendered by dividing it in three works (74 km, 24 km and 26 km.). It resulted in award (Nov 2011) of works for a total cost of ₹ 283 crore. Two of the works were awarded to earlier L4. Audit was of view that offer of L4 to match L3 was acceptable because L4 was the only bid technically found suitable and thus would become L1 when financial bids were opened. (GJ 1 of 2013 Para 3.2)

Larji Power Generating Station on river Beas with an installed capacity of 126 MW (3x42MW) was approved (March 1987) by Government of India (Planning Commission) at an estimated cost of ₹ 168.85 crore. According to construction schedule, the project was to be commissioned within five years. Board took up the project for execution during 1990-91 with completion schedule up to March 1996. Envisaged per unit and per MW generation cost was 24.47 paisa and ₹ 1.34 crore respectively. The project was commissioned during September/October 2006 at a cost of ₹ 1293.69 crore. Thus, due to time and cost overrun per unit, per MW cost increased to ₹ 2.40 and ₹ 10.27 crore respectively. The time and cost overrun was mainly due to late taking up of construction work, change in designs, non-inclusion of some items in the awards/DPR, award of works at higher rates and overpayments to contractors. (HP 2011 Para 2.1.6)

Ministry of Road Transport and Highways (MORTH)/ PWD Manual provide that only 10 per cent of total cost of work should be included in rate analysis. Uttarakhand Government (2006) sanctioned ₹ 29.23 crore for improvement and strengthening of two roads of district Pare (about 80 km). Technical sanctions (TS) for entire amount were accorded by the Chief Engineer PWD, Garhwal Regions, Pauri. The works were awarded in Nov/Dec and was completed in Oct 2009 and Mar 2010. Audit (Oct 2010) pointed out that contractors profit (CP) at the rate of 10 per cent on material (like grit, stone dust and bitumen) were applied twice by the division authorities (Executive Engineers) for preparation of work estimates. They were applied first time while making rate analysis for collection of raw material from quarry etc; and second time for analysing the rates of bituminous macadam (BM) and semi-dense bituminous concrete (SDBC) items of work. This error was not detected by the authorities (Superintending Engineer and Chief Engineer) when they approved these estimates by Executive Engineers. This resulted in undue benefit of ₹ 1.61 core to the contractors and loss to the public exchequer. (UK 2010-11 Para 3.2.3)

For construction of a new complex for the Tamil Nadu Legislative Assembly in Chennai, State Government sanctioned (May 2009) ₹ 427 crore for Block A and ₹ 279.56 crore for Block- B. Construction of Block-A commenced in Nov 2008. The design for the dome, which was a main component, was completed by the consultant in Aug 2009. The work of construction of dome was entrusted to another contractor in Nov 2009 for ₹ 17.80 crore. The agreement was signed in Dec 2009. In the meantime, Government fixed 13 Mar 2010 as the date of inauguration of the building. Since the available time was short, it was decided to construct a temporary dome for the inauguration. This work at a cost of ₹ 3.28 crore was awarded (Mar 2010) to a firm without calling for tenders. Audit pointed out that ₹ 3.28 crore is wasteful expenditure of public money. (TN 2009-10 civil Para 3.1.8.2)

According to paragraph 2.1 of the Central Public Works Department Works Manual (applicable in Puducherry) availability of adequate funds is one of the pre-requisites for execution of any work and no work should be commenced and liability created before allotment of funds. Government of Puducherry accorded (Sep 2006) administrative approval and expenditure sanction for ₹ 21.83 crore for construction of a Manimandapam for Perunthalaivar Kamarajar at Karuvadikuppam. PWD, Puducherry awarded (Aug 2007) the work to a firm for a contract price of ₹ 14.72 crore for completion within 12 months. The firm commenced the work in Sep 2007 and stopped it in Apr 2008 after executing up to plinth level due to non-payment of bills by the Department. Audit observed that for this project Government made budget provision for ₹ 1.65 crore only. In subsequent years a token provision (₹ 1000) was made. The work remained incomplete. Government executed the work without availability of funds and ₹ 2.30 crore was paid to the contractor (for the work carried out up to plinth level became wasteful expenditure. (PY 2009-10 Para 2.2.2)

Paragraph 167 of Karnataka Public Departmental Code strictly prohibits splitting of major works into smaller estimates so as to bring it within the delegated powers of the sanctioning authority and to evade the necessity of sanction from higher authority. The invitation of tender through e-procurement is mandatory in all cases where the value of procurement exceeds ₹ 20 lakh. Audit observed that during 2010-12, in Roads and Buildings Special Division, Bangalore, 40 road improvement works were split into 175 estimates of less than ₹ 20 lakh each. These contracts were accepted by EE with average tender premium of plus 4.75 per cent while the rates for similar works accepted through E-tendering during the corresponding period was minus 12.37 per cent. Non-compliance with the provision of Public Departmental Code resulted in extra financial burden of ₹ 5.08 crore (Procurement value ₹ 29.67 crore × 17.12 per cent (12.37 per cent + 4.75 per cent) = ₹ 5.08 crore) to Government. One of them, a State Highway improvement work costing ₹ 4.83 crore was split into 50 estimates and was contracted through manual process. Finally, all these works were awarded to a single agency on single bid with a premium of 4.7 per cent above the estimated cost. Bidding time allowed in these cases was one day as tender forms were issued only one day prior to the last date stipulated for submission of tenders. (KA 2 of 2014 Para 3.1.1.6)

The Bansagar multipurpose project on the river Sone is an inter-State project of Bihar, Madhya Pradesh (MP) and Uttar Pradesh (UP).Construction of Bansagar Project Unit-II Canals in Madhya Pradesh was taken up in 1979 at a cost of ₹ 10.06 crore and was still in progress as of March 2010, after spending ₹ 961 crore. The canal system comprised seven canals including two lift irrigation schemes (LIS). The Unit-IT canals included construction of 445.52 km long main canal, the distributaries and the minors

of each canal. Water Resources Department (WRD) of the Madhya Pradesh in 2005-07 awarded construction of the Punva Main Canal from km 46.17 to km 68.22 (package PCP 10), estimated to cost ₹ 12.79 crore and km 68.22 to km 84 (package PCP-10 A) estimated to cost ₹ 21.08 crore to two different contractors. Their running bills for ₹ 16.49 crore and ₹ 20.67 crore were paid in March 2009 and June 2010 respectively.

Audit (2010) pointed out that during execution, the estimated quantity of excavation in hard rock in the first case and soft rock and disintegrated rock in the second case were exceeded by 502 per cent and 202 per cent respectively. As per the agreement, the rates for quantities in excess of 10 per cent were payable at the estimated rates of the accepted tenders based on USR 2003, plus or minus the percentage of the accepted tender. Accordingly, the admissible rates for the above items worked out to ₹ 155.97 per cu m and ₹ 69.48 per cu m respectively. CE directed EE that 75 per cent payment be made at the rates admissible as per agreement and remaining at rates of ₹ 200 and ₹ 107.64 per cum based on USR 2007. The EE however, paid (Mar 2009 and Jun 2010) ₹ 3.93 crore at full recommended rates.

Package PCP-10-110397.39 cu m X ₹ 200 = ₹ 220.79 lakh

Package PCP-11A-122502.12 cu m X ₹ 100.4= ₹ 122.99 lakh

45828.84 cu m. X ₹ 107.64= ₹ 49.33 lakh

Total 1683330.96 cum = ₹ 393.11lakh (say ₹ 3.93 crore)

The payable amount at 75 % of the admissible rates worked out to ₹ 2.17 crore.

Package PCP-10-110397.39 cu m X ₹ 155.97 X 75 per cent= ₹ 129.14 lakh

Package PCP-11A-168330.96 cu m. X ₹ 69.48 X 75 percent= ₹ 87.72 lakh

Total =₹ 216.86 lakh (say ₹ 2.17 crore)

Incorrect application of rates resulted in excess payment of ₹ 1.76 crore.
(MP 2010 Para 1.2.93)

Odisha Public Works Department among other things undertakes construction of new Government buildings as well as maintenance of existing buildings in State. As of March 2013, plinth area of 87.07 lakh sqm covering both residential and non-residential buildings was maintained by department. During 2008-13 it constructed 681 buildings. OPWD Code provided that Register of Buildings was to be maintained by each Divisional officer which comprised value of land, buildings created there on showing value of each structure separately. On completion of building, details of land and building should be entered in the register indicating value of each structure. It was noticed in Audit that in 10 divisions, though such register was maintained, new buildings constructed during 2008-13 were not entered. (OD 3 of 2014 Para 2.1.5.10)

Executive Engineer, Central Works Division No. 3, Ludhiana (EE) awarded (Feb 2001) the work 'Construction of High Level Bridge over Sutlej river and five small bridges including Guide Bunds and approaches on Khanna–Samrala–Machhiwara–Rahon–Nawanshahar road' to the lowest tenderer at a cost of ₹ 31.84 crore with the time limit of 18 months (up to Aug 2002). As per clause 1 of the agreement, security at the rate of five per cent was to be progressively deducted in all bill payments. This security was convertible into fixed deposit receipts pledged in favour of Engineer-in-charge by designation. Clause 2 (a) of the agreement provides that if the contractor fails to achieve progress of work as per time schedule, liquidated damages limited to maximum five per cent of the amount of contract shall be levied. Clause 3 of the agreement further provides that if contractor commits breach of contract under any of its clauses, he shall be liable to pay a compensation of five per cent of the amount of contract as penalty. Liquidated damages and compensation for breach of contract under both the clauses (2 (a) & 3) shall be limited to 7.5 per cent of the amount of the contract.

Scrutiny of records (Nov 2007) of the EE revealed that ₹ 23.34 crore were paid to contractor up to 86th running bill (Oct 2005) but the contractor could not complete the work in spite of being granted extensions from time to time up to 30 June 2005. EE in June 2006 by invoking clause (2) of agreement sent a proposal to CE for termination of the contract agreement. The EE also levied (February 2007) liquidated damages and compensation amounting to ₹ 2.39 crore (7.5 per cent of contract value) under clause 2 (a) & 3 of the contract agreement. The amount of liquidated damages/penalty could not be recovered from the contractor due to the reasons that (i) the department failed to get the bank guarantee of ₹ 1.60 crore revalidated beyond 11 Dec 2005; (ii) the FDRs of ₹ 1.01 crore, accepted by the EE in lieu of security, carried the condition of crediting the interest on FDRs in the account of contractor till its maturity (August 2016), due to which, the Banking Ombudsman (Banking Lokpal) showed its inability (August 2007) to get the FDRs encashed till its maturity. Audit commented that the failure of the EE to get performance guarantee revalidated and accepting conditional FDRs resulted in non-recovery of ₹ 2.39 crore. (PB 2007-08 Para 4.3.3)

As per a provision of the Madhya Pradesh Works Department Manual, price escalation in works contracts is required to be determined carefully with reference to the rates notified by the Indian Oil Corporation for POL (Petrol, Oil and Lubricant.) component and by the Labour Bureau, Shimla in respect of the labour component. Clause 2.40.1 of the standard Notice Inviting Tenders regulating the payment of price escalation, provided that the amounts paid to contractors should be adjusted quarterly for increase/ decrease in the rates of labour, material and POL by adopting the indices prevalent on the date of opening the tenders and the quarters under consideration. The agreement (March 2006)

of rehabilitation of the Harsi Main Canal (₹ 57 crore) provided that price adjustment for the labour component should be worked out at the average consumer price index for industrial workers for the Bhopal centre as published by the Labour Bureau, Ministry of Labour, Government of India. Audit scrutiny (June 2008) of the records of EE, Harsi Water Resources division, Dabra revealed that the division erroneously adopted 553 as the base index, on the basis of the All India Price Index, whereas the base index for industrial workers at Bhopal was 575. By adopting the incorrect index, excess payment of ₹ 52.18 lakh was made to the contractor. (MP 2008-09 Civil Para 2.2.2)

Provisions of the Works Department Manual (Manual) as well as an order (August 1993) of Madhya Pradesh State Government categorically provide for calculation of price escalation as per the base indices applicable in the month of opening of tenders. Scrutiny of records during (May 2007 to August 2008) revealed that in four divisions (ND Dn. 18, Khargone, ND Dn. 28, Punasa and ND Dn. 21 and 27, Sanawad) of Narmada Valley Development Authority (NVDA), the clause regulating price escalation was not according to the Government orders of 1993 and the provisions of the Manual. Two bids received in Feb 2003 were opened in March 2003. One received in June 2005 was awarded in Sep 2005; two received in Jan 2006 were opened in April 2006 and one received in April 2006 was awarded in August 2006. The divisions made payments of escalation charges under all the six agreements by adopting the month of receipt of tender as the base month. This resulted in excess payment of ₹ 1.82 crore towards payment of price escalation in six major works. (MP 2008-09 Civil Para 2.2.3)

Audit during the reviewed 1,399 contracts awarded by the Railways for 38 projects with a view examine to the progress of works as on 31 March 2010. Audit observed that in 891 contracts there were delays from one to 84 months. The reasons for delay in completion were non-availability of clear site (184 cases), non-availability of drawings (68 cases), change in scope of works (82 cases), non-availability of material (32 cases), slow progress by contractor (299 cases) and other reasons (213 cases).

Railways terminated 60 contracts without any liability on either side for reasons such as not able to provide site (land) to the contractors, not able to approve the drawings. Out of these, 51 contracts were re-awarded to other agencies resulting in extra expenditure of ₹ 75.67 crore.

Railways terminated 114 contracts due to fault of contractors. Amounts were due to recovered from contractors of which ₹ 116.45 crore was not yet recovered. The reasons were to failure to serve timely notices, not pursuing the matter effectively.

Out of 1,399 contracts Railways was able to complete 109 contracts within the scheduled contract period. (Union Railways 2010-11)

Instructions issued by Bharat Sanchar Nigam Limited (BSNL) on execution of works by Secondary Switching Areas (SSAs), (June 2002) stipulate that preparation of estimates as well as execution of Works should be based on the actual quantum of projections; and in no circumstances, the quantum of work awarded shall be beyond 25 per cent of the estimated works specified in the Notice Inviting Tender (NIT)/ bid documents. There should be a system to monitor the quantum of work already awarded to the contractor(s) at the time of issue of work orders. At the time of approval of the contractor's bills/ release of payment, a close monitoring is required on the amount already paid to the contractor(s) against the same tender.

General Manager (Telecom), Mizoram SSA invited a tender (Nov 2006) for trenching and laying of different sizes of underground cable for Aizawl city limits and other than Aizawl city area in Mizoram. Two bids were received in response and after negotiation; the works was awarded to lowest bidder, i.e. M/s Pathak Pvt. Limited for ₹ 157.50 lakh. GM issued another NIT on the same day for laying 5/10 pair underground cable for pole-less network and associated allied works in Aizawl city at an estimated cost of ₹ 64.66 lakh and awarded to the bidder (only bidder to respond) for ₹ 103 lakh.

Audit (March 2012) pointed out that works valuing more than ₹ 5 lakh, NITs were required to be published in National dailies in addition to Indian Trade Journals as per General Financial Rules (GFR) but were published in local newspaper only. Bidding process for second contract was a serious violation of bidding process. Agreements were signed without specifying the total value and duration of contract. The Tender Evaluation Committee did not prepare any market rate justification while recommending acceptance of the quoted rates and also failed to justify the reasonableness of the rates of both the tenders. Detailed estimates of the works were sanctioned to suit the work orders issued. For the first contract, Divisional Engineers continued to issue work orders to the contractor up to August 2010 and made payments for a total of ₹ 10.30 crore. Bill passing authority and Internal Financial Advisor (IFA) also failed to exercise the required checks to control the excess expenditure beyond the tendered quantities. Violation of the rules by the GM and the inability to superiors to enforce the compliance of rules resulted in undue favour to the contractor to the extent of ₹ 8.12 crore. (Union Civil 17 of 2014 Para 5.4)

Gujarat Industrial Development Corporation followed tender Form B1 prescribed by the State Roads & Building (R&B) Department (Tender Form) for awarding the works based on percentage rate quoted by the bidder either above or below the estimated cost put to tender for work. The clause 77 of tender form stipulated that an amount equal to one per cent of estimated cost put to tender after deducting the cost of materials as per Schedule-A (valued at the basic rate in the sanctioned estimate) shall be deducted from

the running bill of the contractor towards quality testing charges of the material brought by contractor. Test check of the records of four division offices revealed that such clause was excluded in tender form while inviting tenders for 66 works. They were awarded and executed during the period 2005-06 to 2009-2010. As a consequence ₹ 1.79 crore incurred by the Company towards inspection charges for quality testing of material through third party could not be recovered from the contractors. (GJ 2010 Para 3.11)

The Bangalore Water Supply and Sewerage Board (Board) invited (July 2009) tenders for providing raw water transmission system of the Cauvery Water Supply Scheme, Stage IV, Phase II (scheme) and awarded (February 2010) the work to a company at a cost of ₹ 210.62 crore with stipulation for completion by February 2012. As of August 2012, the Board had paid the company ₹ 159.68 crore for the work done and another ₹ 10.50 crore towards price adjustment and the work were in progress. As per the agreement, the price adjustment on account of changes in cost was to be determined in accordance with a formula attached thereto. In respect of iron and steel, price adjustment was to be reckoned considering 1993-94 base index of the average whole sale prices for 'iron and steel', as published by the Reserve Bank of India (RBI). RBI published the price indices from August 2010 by shifting the base level from 1993-94 to 2004-05. While doing so, the RBI revised the sub-groups of the commodities. While 'iron and steel' was a distinct sub-group under the group 'Basic Metals and Alloys and Metal Products' prior to August 2010, new subgroups such as 'Iron and Semis', 'Steel: Pipes and Tubes' etc., were introduced under the same group from August 2010. Audit commented that appropriate classification for the steel pipes should be 'Steel: Pipes and Tubes'. Board incorrectly classified them as 'Iron and Semis'. Incorrect classification led to an excess payment of ₹ 6.82 crore to the company for the work carried out during August 2010 to August 2011. (KA 2 of 2013 Para 3.1.7)

As per clause 10 (F) of contract agreement entered into (Nov 2005) by Himachal Pradesh State Electricity Board with the contractor for construction of intake of Ghanvi Phase II project, difference of quantity of steel actually issued to the contractor and theoretical consumption including authorised variation, if not returned by the contractor was to be recovered at four times the stipulated issue rate including storage charges.

Audit observed that recovery of ₹ 93.67 lakh was not made from the contractor on account (a) non recovery of steel valuing ₹ 72.94 lakh (54.856 MTs out of 339.062 MTs) on rescinding work in Oct 2008; (b) 6.937 MTs steel was shown utilised twice for chair and supports (₹ 14.50 lakh); (c) steel weighing 6.953 MTs was stated to have been used by the contractor for infrastructure works i.e. stock yard, workshop, labour colony, etc., (without any entry in the measurement book), which were to be constructed by the contractor at his own cost as per (Chapter VIII 8.4 of General Condition) agreement.

Board adjusted only 6.953 MT steel at issue rate of ₹ 29,000 per MT instead of applicable four time rate. (HP 2011 Para 2.1.24)

Rule 378 of Rajasthan Public Works Financial and Accounts Rules (PWF&ARs) provides that in lump sum contracts, the contractor agrees to execute a complete work with all its contingencies in accordance with drawings and specifications for a fixed sum and the detailed measurements of work done are not required to be recorded except for addition and alteration. These contracts should not include price escalation. Audit in 2006 pointed out instances of inclusion of price escalation in lump sum contracts. No action was taken by the Finance Department. Audit in March 2009 pointed out such inadmissible payments (₹ 17 crore) made to contractors during Jul 2005 to May 2008. Finance Department issued instructions in January 2010. In subsequent audit (May 2009-June 2010) of records of five Divisions of Public Health Engineering Department revealed that the Additional Chief Engineers (ACEs) of 5 Divisions through respective EEs, paid ₹ 54 crore (January 2009 to March 2010) to the contractors on account of price escalation for eight water supply projects. The works were allotted (July 2006 to March 2008) on single responsibility turnkey/ lump sum contract basis for ₹ 938.95 crore. Price escalation clause was included in these 8 lump sum contracts leading to inadmissible payment of price escalation charges of ₹ 54 crore to the contractors by five Public Health Engineering Divisions. (RJ 2 of 2010 Para 3.4.3)

The construction of circuit bench of High Court at Dharwad was entrusted (August 2006) by the Government of Karnataka to a construction company for ₹ 61.25 crore for completion in 18 months. Clause 44 of the agreement inter alia provided for Price Adjustment (PA) towards increase or decrease in cost of material and labour based on average consumer price index for the relevant quarter as compared to the base index. The base index for materials, labour was the average wholesale/consumer price index for commodities/industrial workers for the quarter preceding the date of opening of bids. For bitumen/petrol, oil and lubricants (POL), the official retail price at the local depots on the day 30 days prior to the date of opening of bids was applicable. The PA was payable on the value of work done during each quarter excluding the value of work of variation items paid at mutually agreed rates. The rate payable for variation items was governed by Clause 13 of the agreement i.e., schedule of rates prevalent at the time of execution of variation items with plus or minus tender premium. Clause 44 of the agreement specified that date of opening of bid as the criteria for reckoning base index calculation. The work was completed in September 2008 and a sum of ₹ 94.14 crore was paid to the company which included ₹ 43.37 crore for work executed under variation items through running account bills. The company was paid ₹ 15.44 crore as price adjustment (PA) in seven bills.

Scrutiny of the records of the Executive Engineer, in Audit revealed excess payment towards PA on two counts; (a) adoption of incorrect quarter for calculation of base index. The bids were opened on 01 July 2006. As per terms of the agreement, the average index of three months for the quarter ended June 2006 should be considered for the base index. But, the EE had considered index of quarter ended March 2006. The mistake in reckoning the quarter resulted in lower base index, which in turn resulted in excess payment of PA. (b) Inclusion of payments for variation items in the value of work done. Clause 13 of agreement specifies rates payable for variation items did not contemplate payment of PA on variation items that were paid at current SR with tender premium. Variation items payments of ₹ 43.37 crore were not deducted from the value of work done for the purpose of PA. The total PA payable works out to ₹ 6.01 crore as against ₹ 15.44 crore paid resulting in excess payment of ₹ 9.43 crore. (KA 2010-11 Civil Para 3.1.5)

According to clause 45 (i) of Standard Bidding Document (SBD) of Pradhan Mantri Gram Sadak Yojana (PMGSY), the employer may provide mobilization and machinery advance to the contractors against unconditional Bank Guarantee (BG). According to CVC guidelines where the BG is received through the contractor, the issuing bank should be requested immediately to send an unstamped duplicate copy of the BG, to compare with the original BG and confirm that it is in order. BG should also be verified independently by the organisation (e.g. the Executive Engineer). Superintending Engineer Lucknow executed (2006-007) three agreements for the works of three packages of PMGSY ₹ 7.85 crore with one contractor. Scheduled date of completion was May-Sep 2008. Contracts were terminated during Jul 2008 to Feb 2009 due to breach of conditions by the contractor by which time an expenditure of ₹ 1.04 crore was incurred on the works. SE imposed (Nov 2009) a penalty of ₹ 1.36 crore against the contractor and revised it to ₹ 2.15 crore in Feb 2012. In May 2008, when the circle initiated action to adjust the BG for ₹ 38 lakh that was submitted by the contractor it realised BG was valid only up to July 2007 and BG was for only ₹ 38,000. (UP 2008 Para 3.1.6)

Government of Chhattisgarh (GOCG), Public Works Department (PWD), is responsible for road sector management and development. PWD Manual state that the Measurement Book (MB) must contain complete record of facts so as to be conclusive evidence in court of law. Every measurement, at the time it is taken, must be recorded directly in the MB and in no other book. The measurements should be as described under various items of the Bill of Quantities (BOQ) conforming to MORT&H specifications. Executive Engineers and supporting staff had to check the measurements. Scrutiny (2011) of road works (earthworks, GSB - Granular Sub Base, WMM - Wet Mix Macadam, WBM -

Water Bound Macadam) under State Road Sector Development Project revealed that only the area, length and volume surface area of the road were recorded in the MB and payments were made accordingly. No chainage-wise width and depth of the road was recorded in MB. The cross sectional measurements derived from computer calculations were not conforming to the relevant specifications. The levels recorded in MB were different from the levels entered in computer software for computation. There were several other inconsistencies. Extent of overpayment in the total payment of ₹ 437 crore could not calculated due to poor maintenance of MB.(CG 2011 Para 1.2.7.1)

As per provisions of Chhattisgarh WD manual, mobilization advance may be paid for tenders of ₹ one crore and above. It should not exceed five per cent of the contract amount and limited to ₹ 10 lakh. It is recoverable in installments. This advance shall bear interest at the rate of 14 per cent per annum. Scrutiny of records of work of sewerage and road restoration revealed that, the contractor was paid mobilization advance amounting to ₹ 22.30 crore against the admissible mobilization advance of ₹ 10 lakh. No provision for time bound recovery was made in the contract. As a result, out of the mobilization advance of ₹ 22.30 crore, only ₹ 5.25 crore was recovered up to 16$^{th}$ RA bill (June 2011) and ₹ 17.05 crore was still due for recovery though the scheduled date of completion has expired (Oct 2010). Interest of ₹ 7.57 crore (14% annum) was also not levied. (CG 2011 Para 1.3.8.3)

The Government of Jharkhand passed a resolution in March 2002, whereby contractors engaged in road works could procure bitumen from Government oil companies directly. On award of work, the EE of the concerned division was to issue an authority letter to the oil company, specifying the name of the contractor, the name of the work and the required quantity and quality/specification of bitumen. The oil company was to sell bitumen to the contractor against the authority letter, under intimation to the concerned division. The contractor was required to intimate the EE about the receipt of bitumen within 48 hours and submit documentary proof of carriage of bitumen from the oil company to the work site. As soon as the bitumen was brought to the work site, the EE or his authorized representative JE/AE was to conduct physical verification of the bitumen to verify the quantity, quality and specifications with reference to the invoice submitted by the contractor and submit report. Indian Oil Corporation (IOC) used TDM/SAP for raising invoices which did not allow generation of more than one invoice bearing the same alphanumerical code of 15 characters. IOC raised invoices in triplicate (a) for original buyer, (b) for transporter and (b) third for assessee (for Central Excise purpose). The crossed/reprint copies of invoices issued by the oil company were spare copies of invoices and not meant for customers for claiming payment.

Audit scrutiny revealed the following irregularities in the test-checked project implementation units (PIU) constructing roads under PGMSY.

(a) Five contractors submitted 43 invoices in support of purchase of 408 MT of bitumen for construction of seven packages of road works, of which 34 invoices (valuing ₹ 85.64 lakh) were found to be fake one. They were not issued by the IOC Depots. In other cases invoices already shown for one work used for other works. Total fraudulent payments amounted to ₹ 1.07 crore.

(b) Eleven contractors submitted 76 invoices which were either crossed/reprints/ duplicates for transporter copies against procurement of 964 MT of bitumen shown to have been utilised in 14 packages of road works. Invoices were spare copies. Accepting inadmissible invoices resulted in fraudulent payment of ₹ 2.33 crore.

(c) ₹ 1.54 crore was paid to contractors as cost of 822 MT of bitumen without submission of invoices which was mandatory in support of procurement and utilisation of bitumen. Excess payment was ₹ 1.46 crore.

In all these cases arrival of bitumen at the work site was not reported by the contractors to EEs. Neither physical verification nor quality test was conducted by EEs. Total amount of ₹ 6.40 crore paid for 2657 MT, not received at the sites were fraudulent payments. (JH 2010 Para 1.1.8.6)

Public Works Department under the sewerage scheme for outskirts of Goa awarded four contracts valuing ₹ 92.94 crore to 3 contractors during Sep 2010 to Jan 2012. Estimates include of supplies at store or site of work of various diameters of Cast Iron (CI)/High Density Polyethylene (HDPE)/Ductile Iron (DI) pipes required for the works. They constituted 10 to 36% of total cost. Audit scrutiny revealed that, the contractors placed supply orders (Sep and Oct 2011) on M/s Jindal Saw Limited, M/s Kissan Irrigation Limited and M/s Electro Steel Casting Ltd. for supply of these pipes. A comparison of the tendered rates and the rates paid by the contractor to manufacturers of pipes (market rates) by Audit revealed that the difference in rates ranged from 49 per cent to 482 per cent. For example they purchased about 800 Rmt (running metre) of 250 mm HDPE pipes at ₹ 845 per Rmt and tendered at ₹ 2100 to ₹ 3000. They purchased 18,000 Rmt of 180 mm HDPE pipe at ₹ 440 Rmt but tendered at ₹ ,1500 to ₹ 1560. Total undue benefit to the contractors on accounting of huge variation from market rate was ₹ 11.40 crore (GA 2014 Para 3.1.2)

For construction of a new complex for the Tamil Nadu Legislative Assembly in Chennai, State Government sanctioned (May 2009) ₹ 427 crore for Block A and ₹ 279.56 crore for Block- B. As per the technical specifications and the nomenclature of the work provided

in the original agreement, the length of piles was to be measured, for payment purposes, from the top of the pile shoe to the bottom of the pile cap. Pile cap is a reinforced or mass concrete connecting beam cast around the head of a group of piles enabling it to act as a single unit to support the imposed load. Pile shoe is a pointed or rounded device on the foot of a pile to protect the pile while driving. However, while changing the design of the pile foundation, the nomenclature of the work was changed in the supplementary agreement to effect payment for the length of the pile up to the natural ground level instead of up to the bottom of the pile cap. This resulted in overpayment to the contractor for the portion of the pile length over the bottom of pile cap level. The overpayment made to the contractor due to the excess length of the pile measured was ₹ 2.46 crore. (TN 2009-10 civil Para 3.1.8.2)

In order to avoid frequent repairs and maintenance of fly ash slurry disposal system commissioned at Maharashtra State Power Generation Company's Bhusawal Thermal Power Station (BTPS) it was decided to install 3 pumps. Total savings of ₹ 1.96 crore per annum was anticipated in cost of spares and generation loss. BTPS placed in Dec 2010 placed an order on M/S Lakhavi and Eskay Engineer Pvt. Ltd (supplier) Navi Mumbai, for supply commissioning and trial run of Horizontal suction back pull out Fly ash slurry disposal system at a cost or ₹ 4.49 crore. The total period of the contract was 24 weeks form the issue of Supply order i.e. 28.06.2011. As per clause 1 of terms and conditions of tender, Security Deposit @ 10 percent of value of work was to be submitted within 10 days from the date of supply order. The security deposit will be released only after expiry of guarantee period. As per clause No. 6, supplied material should be guarantee for a total period of 18 months from the date of commissioning or 24 months from the date of supply whichever is earlier. Payment will be made against satisfactory trial of equipment at site. The pumps installed in June 2011 worked intermittently for limited number of hours. B1 went out of service on 19.10.2012 and other two on 3.3.2012. Defects were observed in B2 and B3 pumps after five days of commissioning and in B1 pumps after one month. Audit observed trial run was carried out only for one day and the pumps were certified to have run satisfactory. Even though the pumps were not functioning for more than a month, the balance amount was released on in July 2011. The security deposit of ₹ 44.95 lakh (10% of contract value) was not recovered. Pumps valuing ₹ 4.49 crore become redundant. (MH 2012-13)

As per Railway Board instructions, waiver of demurrage charges should normally be done for the reasons which are beyond the control of consignor/consignee and for act of God/ war. As per the procedure laid down in Indian Railway Code for Traffic (Commercial Department), application for waiver of demurrage charges are to be submitted to the Station Manager/ Chief Goods Supervisor within 10 days from the date of their accrual

in case of Goods sheds and within one month in case of large sidings. Initial waiver of demurrage charges is done by the Division. In case the Consignor/Consignee is not satisfied with the decision of the lower authority, he can prefer an appeal to the higher authority twice after depositing the amount of demurrage charges not waived. Entire process of all appeals of demurrage charges should be completed within a time frame of six months. Examination of the trend of accrual and waiver of demurrage charges in the selected 128 good sheds and private sidings over 16 Zonal Railways for 2008-13 revealed that demurrage charges of ₹ 267.07 crore (25 per cent) were waived. The percentage of waiver of demurrage charges was highest in SCR (43.95 per cent) followed by NWR (40 per cent), NCR and ECoR (34 per cent), ECR (33 per cent) and WR (30 per cent). Reasons given for accrual of demurrage charges were repetitive in nature such as bad condition of approach road, sheds not fully covered, bad weather condition and inadequate lighting arrangements. It was noticed in audit that reasons like sticky and muddy coal, very old and worn out tipplers, insufficient stock in sidings, non-arrangement of transport and labour etc., were recorded while seeking waiver of demurrage charges. Audit pointed out that Consignor/Consignee are responsible for making their arrangements. If any arrangements are wanting from the Railways, it is duty of Railways to make such arrangements instead of routine waiver of demurrage charges. (Union 31 of 2014 Para 3.6)

As per Para 521 of Financial Code-Volume-I, of Indian Railways, a works register in Form E.1473 should be maintained to make a running comparison between the expenditure incurred on each work and the detailed provision made in the estimate for the work and the budget allotment for the work and the actual expenditure to the end of the month. Review of Works Registers maintained for 164 works revealed that (a) estimated cost was not indicated in the works registers for 72 works; (b) Budget allotment for the year was not indicated in works registers for 115 works; and (c) Value of materials-at-site was not indicated in works registers for 159 works. Improper maintenance of works registers by the accounts department indicates the laxity on the part of accounts departments in accounting and control over the expenditure on the projects. (Union Railways 19 of 2014 Para 3.6.12.2)

Para 1483 of Engineering Code of Indian Railways stipulates that the accounts relating to contractors should be kept as personal accounts in contractors' ledger in Form E 1483 and a separate folio should be opened in the ledger for each contractor. The accounts of each contractor should exhibit all transactions with him, whether relating to one or several works or to materials purchased from him or supplied to him. The contractors' ledger should be posted as bills are paid and it should be closed and balanced monthly.

Scrutiny of records relating to the system of recording contractual payments 6,551 agreements executed through contracts for 164 selected projects revealed that (a) Contractor's ledger was maintained for all the agreements (4,299) executed by 9 Zonal Railways (WR, NWR, SCR, ECR, SECR,CR, NFR, MR and NCR) (b) In five Zonal Railways, out of 1046 agreements, contractor's ledger were maintained only for 379 agreements; and (c) No ledger was maintained for any of the 1,104 agreements in SWR and ECoR; and (d) Out of 102 agreements, contractor's ledgers were maintained for 100 agreements in WCR.

Since the transactions relating to contracts were dealt separately in individual files of executive offices, the consolidated details of a particular contractor was not available with the executives. The dues to be recovered from the contractor towards grant of advances and non-return of materials could also not be ensured due to non-maintenance of contractors' ledger. (Union Railways 19 of 2014 Para 3.6.7.2)

Railway Board stipulated (September 2009) that reconciliation of material issued to and utilized by the contractor should be done while passing each 'on-account' bill without waiting for preparation of final material reconciliation statement. Passing of on-account bills without material reconciliation statement would lead to instances where excess materials issued to the contractors would remain unrecovered from them leading to undue benefit, without being recovered.

Audit reviewed 5,737 on-account bills in respect of 164 selected projects and observed that 619 bills (WCR, SER, SWR, SCR, ER and NFR) were passed after preparation of material reconciliation statement. Remaining 5,118 on-account bills were passed without preparation of material reconciliation statement (SR, WR, WCR, SER, NWR, NER, ECR, SECR, SWR, CR, NR, NFR, MR, ECoR, ER and NCR). (Union Railways 19 of 2014 Para 3.6.7.3)

## CHAPTER -11

# Controls over creation of infrastructure through private participation

Traditionally governments have been creating the infrastructure for service delivery through regular budget, the resources mobilized through tax and non-tax revenue. For several reasons, since 1990s the public sector, the governments have been collaborating with the private sector. Under this arrangement the private sector brings in the necessary finance to some extent as equity but mostly as loans and builds the infrastructure. It undertakes design and construction and also operates and maintains the facility for duration ranging from 15 years to 30 years. Private sector has a long term interest and it receives payments either from users in the form of user charges or in the form of annuity from the government or a combination of both. Technically the infrastructure belongs to the government and the responsibility to provide the service lies with the government. The cost of the service is either fully subsidised or partially subsidised or users have to bear the full costs. Theoretically the private sector is expected to share the risks involved in the project. Competition among the bidders is expected to result in selection of the best bid that is beneficial to the government and the users.

In this mode of creation of infrastructure the public resources are prone to several risks resulting in undue benefit to the private sector entities. Governments tend to cut the budgets and force the departments to take PPP route even if there is no clear financial advantage. Theoretical concept of sharing the risk does not work easily in practice. Often the government ends up bearing all the risks. Private parties extract maximum concession from the government during project implementation and unscrupulously exploit any loop holes in the contract during the operations maintenance phase. Private parties tend to acquire larger tracks of land than actual require and exploit it commercially. Borrowing costs of the private parties can be substantially higher than the cost at which the government borrows. Government hires the services of legal and financial experts who can be exposed to conflict of interest. Transaction costs for the government can be high.

Compliance audit of an infrastructure created with private partnership is carried out by framing the audit objective as follows.

Audit Objective: To what extent the department is able to safeguard the public resources while deciding, creating and operating the infrastructure through private participation.

Identifiable stages in this process are making a choice on whether it is advantageous to create the proposed infrastructure through private participation, project preparation, planning the procurement method, procurement process, framing the contract with conditions that are not disadvantageous to the government, post award contract management through implementation, operation and maintenance. Each stage and the rules governing them can be viewed as audit sub-objectives and criteria. In this chapter the Draft Public Private Partnership (Preparation, Procurement and Management) Rules 2012 can be used criteria against which the audit sub-objectives and thus audit objective can be measured. The Draft Rules would be operational after the Draft Procurement Bill 2012 is enacted. However, to a large extent are comparable to international best standards and can be treated as acceptable criteria. The following audit check-list draws from these Draft Rules.

Public Private Partnership Appraisal Committee (PPPAC) was constituted under the chairmanship of Secretary, Department of Economic Affairs of Ministry of Finance, GoI is the highest level appraisal body. PPP Cell of Infrastructure Division of this Department assists this body. Head of the Department is the contracting authority who appoints a project officer and project team to assist him or her in making choice for creation of infrastructure through private partnership. State Governments have similar arrangements.

This process involves conducting a pre-feasibility survey, feasibility study and value for money analysis. Usually a cabinet committee would be supreme body that approves the proposals of contracting authorities.

| Audit Sub-objective 1: whether adequate controls are exercised by the contracting authority on making choice to create the infrastructure through private participating. | |
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| | *To examine whether:* |
| | Contracting Authority (CA) disclosed potential conflict of interest and if any complied with the procedures to deal with. Similarly the Project Officer (PO) and the members of the Project Management Team. |
| | Contracting Authority defined the objectives of the PPP Project, its suitability, its value for money, payment & revenue mechanism, affordability for users |
| | PO conducted pre-feasibility study of the project, prepared the report, it was approved by the CA |
| | Pre-feasibility study report contains preliminary analysis of technical & operational practicalities of the project, environmental and socio-economic aspects, preliminary assessment of financial viability and institutional capability. |
| | Financial assistance sought by CA from the Government to meet the expenditure on the project preparation was based on the work plan prepared by PO |
| | Selection and appointment of legal & transaction advisors by the PO/CA was in compliance with the applicable procedures |

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| | PO carried out the feasibility study with due diligence. Feasibility report contained assessment of current and future needs/demand, expected output its quality and gaps, assessment of potential market players, their capability, competition, sources of revenue for the service, assessment of technical feasibility such as preliminary technical design of facilities, alternative design options, assessment of capital cost, operating and maintenance cost based on preliminary design, assessment of financial feasibility indicating costs, revenue and returns. |
| | Feasibility study included environmental impact study, results of consultations with stakeholders, assessment of social impact analysis and public interest evaluation |
| | Feasibility study included value for money analysis to compare the advantage of creating in PPP mode rather than as government project |
| | PO prepared the PPP project proposal explaining the scope of services of the concessionaire. |
| | Project proposal prepared by PO identifies and analysed all the associated risks and contains risk sharing framework that clearly mentioned the risks to be borne by the private entity, by government. |
| | Project proposal contains the payment mechanisms, relief, compensation, force majeure events, default events, termination payments. |
| | Project proposal contains evaluation criteria for selection of the preferred bidder |
| | Project proposal contains the implementation plan with timelines and person/entity responsible for it |
| | Project proposal explains the requirement of financial resources during the construction period and during its operations phase |
| | CA examined the feasibility report with reference to project affordability. |
| | CA made independent assessment of all assumptions of revenue, expenditure, returns and affordability of user charges to the users |
| | CA made independent assessment on the proposed system of tariff setting and framework for revision of tariff. |
| | CA examined the financial commitments like grants, annuity payments, management fees, operational period payments, revenue guarantees and cost associated with acquisitions of land etc. |
| | CA examined the sources of contingent liabilities and their impact and whether they were found to be acceptable, assess the requirement to create sinking fund |
| | CA examined the various scenarios in the financial model presented in the Feasibility Study and assessed the maximum financial impact that could arise for the Government |

CA conducted Value for Money Assessment (VfM). It is systematic comparison of the discounted cash flows using both PPP and traditional procurement under different scenarios of sensitivity clearly indicated that value for money would be achieved through PPP.

Governments rely on the tool, Public Sector Comparator (PSC) which consists in a systematic comparison of the discounted cash flows of a specific (pre-defined) project using both PPP and traditional procurement.

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| | *PPP mode was chosen because:*<br>It was possible to clearly define required outputs to allow a payment mechanism to be structured that aligns with project objectives<br>The project had scope for innovation<br>There were opportunities for the transfer of certain risks (for example, design, cost and time overruns) to the private sector that it can better manage; risks assumed for the government and private sector are realistic and comprehensive.<br>Whole-of-life costing could reduce operating costs<br>Quality of the service can be assessed, measured and monitored<br>Reliance on user fees for revenue can create an incentive for private operators to provide good customer service<br>VfM analysis is done by considering variables such as the duration of the project, inflation costs, the likelihood of delays, predicted demand, third party revenue in the project, residual value of the project, and total estimated operating costs<br>Calculation of life cycle cost had taken into account all the costs financing, transaction costs, administrative costs, designing, building, operating, maintenance, support and replacement, residual value.<br>Assumptions, estimates made for PPP mode and government mode are reasonable, cost of all the components for all the phases used for comparing PPP mode and government mode are comprehensive and realistic.<br>Net present values particularly for the revenue are properly assessed clearly identified those that are certain (guaranteed) and uncertain (not guaranteed). The process of discounting of cash flows had taken into account (apart from time-value of money and interest rates) the risk, depending on who is bearing that risk (PPP or government)<br>There is provision for re-evaluation of discount rate at a future date in case of Change in the financial model during the life of the PPP; Project termination (including voluntary termination; force majeure, uninsurable risk and change in law; fraud/ breach of contract; and private sector default); Refinancing; and Pre-payment of debt (where applicable).<br>VfM analysis gives an evidence of risk evaluation, sharing and the associated costs. |

Next stage is the planning the procurement method, procurement process, framing the contract with conditions that are not disadvantageous to the government. Depending on the complexity of the project the stages in the procurement process include:

Single-stage: RFP (Request for Proposal)

Multi-stage option 1: RFQ (Request for Quotation) + RFP (Request for Proposal with or without RTP (Request for Technical Proposal)

Multi-stage option 2: REOI (Request for Expression of Interest) + RFP with or without RTP

Multi-stage option 3: REOI + RFQ + RFP (with or without RTP)

| Audit Sub-objective 2: whether adequate controls are exercised by the contracting authority on the procurement process; its planning, inviting competitive bids, evaluation of bids, selection of the most eligible bidder and award | |
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| | *To examine whether:* |
| | CA identified unencumbered land and decided the option of lease or transfer, with terms that ownership are coterminous with term of concession period and private party is prohibited from alternative exploitation of such land. |
| | PO and CA identified the appropriate method of procurement, whether single stage bidding or multi-stage (EOI, RFQ, RTP, RFP) or auction or competitive dialogue |
| | Competitive dialogue with the respondents was followed where the project is complex, to identify a solution and achieve clarity on the optimal project scope. |
| | Single stage procurement (RFP) was followed only the when project scope was clear, service options were well defined, potential bidder were known and identified, and number of interested bidders was limited. |
| | Multi-stage bidding included the stage of EOI when there was uncertainty about the level of interest in the project, potential bidders not yet well known |
| | Multi-stage bidding included the stage of RFQ where project scope is clear, the number of interested bidders were available but is likely to be limited |
| | Multi-stage bidding included the stage of RTP when the project scope was not clear, extensive discussions were needed to finalise the service option, considerable effort was required by bidders to submit proposals |
| | Tender documents PO (REOI,RTP,RFQ,RFP) were prepared by strictly using the model tender documents |
| | CA sought the approval of PPPAC for any deviation made to the model document (REOI, RTP, RFQ, RFP) to make it suitable for the project. |
| | CA obtained in principle clearance from PPAC by sending the documents and the procurement plan. |
| | Procurement Plan prepared by PO defined the each stage and schedule of the Tender Proceedings |
| | CA formed a Tender Evaluation Committee that should consist of members from Contracting Authority, Finance Ministry, line Ministry etc. |
| | Members have declared conflict of interest, if any, in the prescribed form. |
| | CA appointed an Independent Monitor who to oversee the tender proceedings with a provision that has access to complete information throughout the process. |

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| | *In EOI Stage to examine whether* |
| | Though an open advertisement interested parties were asked to register to receive application for REOI |
| | REOI were sent to all the applicants who have registered themselves |
| | REOI contained brief description, a date for seeking clarification (not less than a week) through a meeting, the date (not less than a week) by which they receive clarifications/amendments to EOI and the due date for submission (two weeks) |
| | REOI resulted in preparation of a list the interested bidders who prima facie seemed to have that capacity, experience and resources. |
| | *In RFQ stage to examine whether* |
| | RFQ contained project description, structure, estimated cost, and schedule of tender proceedings |
| | RFQ contained conditions of eligibility of applicants, the information sought from them for qualification, the form and procedure of the application; |
| | RFQ contained criteria for evaluating qualification of applicants, and conditions, if any, for the disqualification. |
| | Criteria were objective, equitable, unambiguous, and shall be clearly stated. Criteria covered the experience, track record, ability to delivery, ability to secure funds and invest and support the contractual agreement that of longer period. Criteria for financial capability covered network, turnover which are defined. |
| | Criteria were reviewed by the Independent Monitor. |
| | CA through advertisement asked the interested applicants to register to receive the RFQ documents. |
| | An RFQ applicant submitted one application only either individually or as part of consortium. |
| | RFQ specified the schedule, with reasonable time the date for pre-application, date by which bidders would receive clarifications, amendments. Total period was not be less than 6 weeks from floating of tender to date of submission of the same. |
| | CA asked the consortiums to remove from its consortium any member who suffers from a Conflict of Interest |
| | Received applications were stored in secure location and remained unopened. |
| | Applications were opened on the Due Date, at the time and place as specified in the RFQ, in the presence of Applicants who choose to attend. |
| | Submitted RFQ applications were evaluated by the Tender Evaluation Committee using the qualifying criteria as specified in the RFQ on the basis of their respective aggregate experience scores. |
| | Only those applications beyond the pre-specified minimum threshold were qualified to proceed to next stage. |

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| | CA promptly notified in writing all the applicants whether they are qualified or not. |
| | Objective of the RFQ stage to find qualified applicants who are most capable of meeting the project objectives for the next stage, RFP was achieved. |
| | *In RTP Stage to examine whether* |
| | RTP stage was adopted where there was requirement for the applicants to clearly understand the technical requirements |
| | RTP specified the minimum technical requirements covering the technical details of the infrastructure, construction requirements, such as design codes or standards to be complied with, operations, maintenance etc. |
| | CA defined and documented specific requirements for Technical Proposal from the applicants, depending on the nature of the PPP Project; Parameters included qualification of the applicant, experience relevant to project, technical solution, approach and methodology for implementation (business plan, financial plan). |
| | CA defined the parameters and criteria for each of the specific requirement for technical proposal and assigned scores to them and determined the cut-off criteria to qualify for the next stage of bidding (RFP) |
| | CA obtained the approval of PPAC in writing to float the RTP |
| | CA issued RTP to all the applicants who qualified RFQ stage. RTP specified scheduled dates for pre-qualification meeting, due date for clarifications and amendments and due to for submission. The time given was reasonable with at least total of 6 week and 2 to 3 weeks for each activity. |
| | Tender Committee evaluated strictly using the qualifying criteria as specified in the RTP, marks allocated for each of the above parameters were aggregated to calculate a single score. |
| | Only those applications met the pre-specified minimum threshold were qualified. |
| | CA notified all the applicants in writing whether they were qualified or not. |
| | *In RFP Stage to examine whether* |
| | PO prepared the RFP and it contained feasibility report/project information memorandum with project scope, objectives and rationale, relevant technical, quality and performance characteristics expected, site details, role of the Government, key agency and stakeholders, project scope and output specifications etc., instructions to bidders and a draft Concession Agreement |
| | Description and scope of the project was objective, functional and generic without any reference to a particular trademark or trade name, patent, design or type, specific origin or producer unless there is no option otherwise. |
| | The draft Concession Agreement clearly specified the rights and obligations of both the parties, definition of the subject matter of the agreement, payment terms, performance obligations, defaults, consequences, events of termination etc. |

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| | Instructions to bidders explained all procedures, terms and conditions to be followed by bidders for submission of their bids and which procedures that would be followed by the Contracting Authority in accepting and evaluating the Bids. |
| | The RFP should clearly defined the form and content of the Final Offer, criteria for selection and state that selection would be on the basis of arriving at the most advantageous Final Offer. |
| | Criteria were comprehensive including the grants sought, expected revenue/annuity, tariff/shadow toll, present value of lifecycle cost, period of the concession, upfront premium, equity stake, , revenue share etc. |
| | RFP specified the due dates for pre-bid meeting, date by which clarifications and amendments would be issued and due date of submission |
| | RFP along with the draft concession agreement was issued to the qualified bidders after obtaining the approval of PPPAC |
| | CA maintained a data room and kept the specific project information in it with access to all bidders at timings specified earlier in the RFP. |
| | CA agreed to a change in the composition can be permitted by the Contracting Authority, only if the lead member remained unchanged and substitute member has equal technical capacity and they applicant submitted the revised joint bid. |
| | PO ensured that received applications were stores in secured location and remained unopened. |
| | CA opened the applications on the due date, and at the time and place and in the presence of applicants who choose to attend. |
| | Tender Evaluation Committee evaluated the bids e on pre-determined criteria communicated in RFP. |
| | Independent Monitor was present for all Bid evaluation meetings. |
| | *With regard to selection of most preferred bidder to examine whether* |
| | All qualified bids evaluated on the basis of predetermined criteria and were ranked. |
| | The first ranked bidder was treated as the preferred bidder. |
| | If the first ranked bidder withdrew or not selected for any reason such reasons were well documented and justified |
| | CA invited all the remaining bidders for the second round |
| | The one who matched the first preferred bidder was selected. |
| | If more than two bidders matched the first preferred bidder, the one which got higher ranking/score from RFQ stage was selected. In case if the offer of those two or more was same, CA asked them to provide their best and final offer and selected accordingly. |
| | CA identified the preferred bidder by taking into account the aggregate experience score of each such bidder from the RFQ Stage and selected the one with higher score if the above steps did not result in final selection. |

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| | CA initiated new tender proceedings if the above did not result in final selection.<br>CA accepted the sole bid resulting from the bidding process only after the tender evaluation committee opined that there is a clear value for money in accepting it and retendering will not yield more.<br>CA treated any bid (preferred bidder) as speculative and rejected only after giving reasonably opportunity and seeking an opinion from an independent expert or a body of repute. If this process is not complete within 8 weeks, it is to be treated as preferred bidder.<br>CA notified the Preferred Bidder after approval from the competent authority<br>CA communicated to other Bidders about the selection of the Preferred Bidder, and its intention to execute the Concession Agreement with the Preferred Bidder.<br>CA issued A Letter of Award (LOA) in duplicate to the preferred bidder asking him to sign and return a duplicate copy within 7 days of receipt of LOA.<br>CA after the receipt of acceptance, executed the concession agreement with the bidder as drafted in the RFP. CA should not engage in negotiations on or modifications to the draft Concession Agreement except in the case of sole bid explained above.<br>CA ensured that Concession Agreement is comprehensive covering all aspects of the project. The terms and conditions are adequate to safeguard the public interest.<br>CA ensured that Concession Agreement provides for a hand back and exit strategy for PPP Projects. Exit strategy should include review of options to ensure service continuity, assessment of operations and maintenance needs and asset/service quality, testing and valuation of assets, implementation plan for handing back PPP Project to Contracting Authority, resource allocation for implementing the exit strategy and obligation of the parties in relation to the exit strategy.<br>CA disqualified the preferred bidder if paid up capital of the concessionaire reduced his share capital of 51% before the date of commercial operations. Similarly 26% for the term of concession. CA terminated the contract (without liability) if it happened after signing the contract.<br>*For each stage of bidding examine whether:*<br>Advertisement was given in at least one English and one Hindi daily of national repute and on hosted on the websites.<br>Tender documents were made available as specified in in the advertisement.<br>Communication between CA and respondents was adequately documented and accessible subsequently.<br>Any decision, notification or any information generated in the process of procurement was in a form that would be a record to be accessible subsequently.<br>Record of Tender Proceedings contained subject matter of the procurement process, basic information of respondents, statement of reasons and circumstances relied upon by |

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| | contracting authority for decision, a summary of request for clarification and response, state the reasons for rejection, principal terms of concession agreement and deviations from model tender documents. |
| | CA and all those who have access treated all information, submitted as part of a response, in confidence and did not disclose them except where, required to do so by law, or a legal process, or to assert any right or privilege etc. |
| | Before evaluating them, the Contracting Authority should determine whether the response is responsive to the requirement. It is considered, so only, if all items of information required from Respondents are submitted in specified format. If it is incomplete, inaccurate and conditional, it will be considered to be non-Responsive and rejected. |
| | Responses received from respondents after due date were to be returned un-opened |
| | During the phase of respondents seeking clarification, response to any clarification sought from one the respondents was sent to all others without mentioning the name of that respondent. |
| | All officers and employees signed the Code of Conduct in the prescribed form that was aimed to prevent conflict of interest in procurement and regulate matters regarding personnel responsible for procurement. |
| | CA disqualified where there was indication that respondent has offered, given or agreed to give, directly or indirectly, to any current or former officer or employee of the Contracting Authority or other governmental authority a gratuity in any form or any other thing of service or value, so as to influence a decision or an act relating to procurement proceedings. |
| | CA disqualified respondent in the case of false certificate on conflict of interest. If the Respondent is a consortium, the disqualification is effective against every member of the consortium. If a respondent engaged any legal, financial or technical advisor for the commercial operation within 3 years of there acting as advisors to the CA for this PPP it is treated as conflict of interest. |

The following is the checklist to examine post implementation issues.

| Audit Sub-objective 3: whether adequate controls are exercised by the contracting authority over implementation of the project during execution, operation and maintenance | |
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| | *With regard to post-award implementation it is to be examined whether* |
| | CA constituted Contract Management Team (CMT) and appointed Contract Management Director, Independent Engineer (to monitor construction) |
| | Concerned Ministry/Department has set up an empowered review cell headed by JS to monitor the project or it is monitored by an empowered review cell |
| | Project Officer handed over all the documents to the CMT |

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| | CMT prepared Contract Management Plan (CMP) that explains time lines, performance standards as specified in the concession agreement |
| | CMP defined the processes that enabled both parties to meet their obligations, monitor performance by the Parties of their respective obligations, manage unanticipated development, manage their differences and resolve disputes. |
| | CMP acted as a repository of management procedures and a resource tool by including Concession Agreement and its schedules, all financing agreements as well as financial models, names, roles and contact details of key individuals of both parties, implementation plan during development, construction, operations and exit phases; performance management plan, risk management plan, financial and contract administration plan, contingency plan, contract termination |
| | CA made the Concessionaire to identify the lead financial institution and ensure submission of six monthly report by Lead Financial Institution, on the financial progress, statement of debt and equity contribution, other financial information. |
| | Independent Engineer submitted monthly progress report to CMT |
| | CMT submitted quarterly progress report to Empowered Review Cell |
| | There were any events that had material adverse effect. On such occasions whether conducted a technical, financial and legal due diligence to determine whether such event constitutes a Change in Circumstances; |
| | If CA reported it to be so, whether required amendment is made to the concession agreement after it was validated and certified by an independent expert or body of repute (either on a full-time basis or in advisory capacity). |
| | CA ensured that operation and maintenance of the project was as per terms and conditions in the agreement |

***Examples***

National Highways Authority (NHAI) is responsible for developing, maintain and managing National Highways. Several projects are being implemented in PPP modes. Some of the audit findings are given below.

As per the procedure defined in the Model concession agreement (MCA), the carrying capacity of the respective highway at the end of the proposed concession period would be the guiding principle for determining project-specific concession period. The year in which the design capacity would be reached would be the last year of concession. The total traffic on the stretch of highway is to be considered for determining the design capacity/ concession period. Concession period was to be restricted to the period when the traffic reached the maximum design capacity. Audit noticed inconsistencies in adopting total traffic / carrying capacity for determining the concession period resulting in NHAI fixing higher concession periods. Users would be unreasonably paying toll for the extended period.

Audit pointed out 8 cases in which during these extended concession periods, the concessionaires would collect toll at least to the tune of ₹ 28095 crore (NPV: ₹ 3234 crore), while the roads would become congested for the toll paying users.

| Name of project and concessionaire | Concession period in years based on Total Traffic and Tollable Traffic (years) and extra burden |
|---|---|
| Jaipur Tonk Deoli<br>M/s IRB Jaipur Deoli Tollway Pvt. Ltd | 23 and 25<br>Extra burden ₹ 2061 crore |
| Beawar Pali Pindwara<br>M/s L&T BPP Tollway Pvt. Ltd | 21 and 23<br>Extra burden ₹ 2143 crore |
| Varanasi Aurangabad<br>Varanasi Aurangabad Tollway Pvt. Ltd. | 23 and 30<br>Extra burden ₹ 11548 crore |
| Pune-Satara<br>M/s PS Toll Road Pvt. Ltd | 20 and 24<br>Extra burden ₹ 3421 crore |
| Delhi-Agra<br>M/s DA Toll Road Pvt. Ltd | 22 and 26<br>Extra burden ₹ 752 crore |
| Kiratpur- Ner chowk<br>M/s.Kiratpur Ner Chowk Expressway Ltd. | 24 and 28<br>Extra burden ₹ 4631 crore |
| Zhirakpur- Parwanoo<br>Himalayan Expressways Ltd. | 14 and 20<br>Extra burden ₹ 502 crore |
| Sambalpur- Baragarh<br>Sambalpur Baragarh Expressway Pvt. Ltd. | 27 and 30<br>Extra burden ₹ 1641 crore |

(Union 36 of 2014 Para 4.3)

While Total Project Cost (TPC) worked out by DPR consultant and approved by NHAI, for a project, inter alia, forms the basis for obtaining approvals of competent authority. For deciding about eligibility of bidders for obtaining RFQ, TPC as worked out by the concessionaire's forms the basis of their bid. In 85 of the 89 projects reviewed in Audit, TPC assessed by the concessionaire was more by ₹ 36,612 crore as compared to TPC provided in CA. In these 85 projects, the excess TPC worked out by the concessionaire ranged up to 223 per cent (Bharuch-Surat). In 25 projects alone, the difference was more than 50 per cent. Some of the examples are given below.

| Stretch | Total project cost as per CA (₹ In crore) | Total project cost as per common loan agreement (₹ In core) | Difference (₹ In crore) | Difference in per cent |
|---|---|---|---|---|
| Bharuch-Surat BOT-II | 492 | 1588.91 | 1096.91 | 222.95 |
| Ahmadabad Vadodara | 2125.24 | 4880 | 2754.76 | 129.62 |
| Vadodara-Bharuch-BOT-I | 660 | 1450 | 790 | 119.7 |
| Jaipur-Tonk-Deoli | 792.06 | 1733 | 940.94 | 118.8 |

| | | | | |
|---|---|---|---|---|
| Panipat-Jalandhar | 2447.5 | 4518.17 | 2070.67 | 84.6 |
| Pimpalgaon-Nasik-Gonde | 940 | 1691 | 751 | 79.89 |
| Ghaziabad-Aligarh | 1141 | 2018.68 | 877.68 | 76.92 |
| Hungund - Hospet | 946 | 1650.92 | 704.92 | 75.52 |
| MP-MH Border Dhule | 835 | 1420 | 585 | 70.06 |
| MP/MH Border-Nagpur | 1170.52 | 1971.31 | 800.79 | 68.41 |
| Badarpur Elevated Highways | 340 | 572 | 232 | 68.24 |
| Pune-Solapur Pkg-II | 835 | 1402.78 | 567.78 | 68 |
| Salem-Karur | 205.6 | 344.77 | 139.17 | 67.69 |
| Chilakalpuripet-Nellore | 1535 | 2550 | 1015 | 66.12 |
| Panikoli-Rimoli | 1410 | 2306.16 | 896.16 | 63.56 |
| Samakhiali-Gandhidham | 805.39 | 1300 | 494.61 | 61.41 |
| Zirakpur-Parwanoo | 295 | 474.79 | 179.79 | 60.95 |
| Maharashtra/Gujarat Border-Surat/Hazira Port | 1509.1 | 2418.64 | 909.54 | 60.27 |
| Delhi-Agra | 1828.22 | 3071.49 | 1143.27 | 59.29 |
| Gurgaon-Kotputli-Jaipur | 1896.25 | 3009.01 | 1112.76 | 58.68 |
| Patna-Bakhtiyarpur | 574 | 980.02 | 334.02 | 58.19 |
| Dankuni-Kharagpur | 1396.18 | 2205.15 | 808.97 | 57.94 |
| Muradabad-Bareily | 1267 | 1983.63 | 716.63 | 56.56 |
| Bhubaneswar-Chandikole | 1047 | 1587 | 540 | 51.58 |

The higher TPC worked out by the concessionaires allows them to avail higher amount of borrowed funds. Further, in case the project gets terminated because of default of NHAI, it is liable to pay to the concessionaire, by way of termination payment as per Article of MCA, an amount equal to (a) Debt Due; and (b) 150 per cent of the Adjusted Equity. Further, as per the article for termination payments, read with definitions of 'debt due' and 'termination payment' provided in the above Article, in the event of termination of CA, NHAI would have to pay an amount equal to 90 per cent of the debt due and payable, less insurance claim admitted to principal lenders. (Union 36 of 2014 Para 5.4)

The concessionaire, M/s PS Toll Pvt. Ltd. was to complete the construction activities of the Pune-Satara project in accordance with the project completion schedule of CA. The Concessionaire commenced collection of toll from Appointed Date and continued to collect toll though it failed to achieve the I$^{st}$ or II$^{nd}$ milestone (Mar, Oct 2011) or to commence work as per CA. As per article 31.3.1 of the CA as well as clause 4.1 of escrow agreement (August 2010) with AXIS Bank, any withdrawals from Escrow

Account during the concession period could only be utilised in order of preference specified in CA such as taxes due, construction of the project highway, payment of concession fee etc., and surplus available, if any, can be utilised as per the instructions of concessionaire. The concessionaire collected toll from the date of appointment i.e. October 2010 to March 2014 amounting to 542.17 crore out of which 225.30 crore (up to 8 August 2012) were invested in Reliance Liquid Fund /Reliance Money Manager Fund which was in contravention of article 31.3.1 of CA and clause 4.1 of Escrow Agreement. Even after lapse of 42 months, only 64.99 per cent of the project was completed up to March, 2014 and despite payment of toll charges, road users were deprived of benefit of 6-laning of the project. (Union 36 of 2014 Para 6.3)

In the case of BOT (Toll) projects, equity support/grant (VGF) shall be due and payable to the concessionaire after the latter had expended the prescribed percentage of Equity. Article 25 of MCA provides for release of grant in installments after expending 80/100 per cent of equity which shall be disbursed proportionately along with the loan funds thereafter remaining to be disbursed by the Senior Lenders under the Financing Agreements. The concessionaire should also not be in material breach of CA. In four out of selected 94 projects reviewed in Audit, premature release of grant amounting to ₹ 769 crore was noticed. (Union 36 of 2014 Para 7.6)

Article 31.3.1A of the CAs for 6-laning projects provides that in case the concessionaire defaults in achieving the milestones, the toll collected from the day following the date of such defaulted milestone will be deposited in an escrow account (withheld amount account) and such withheld amount will not be released till such time that the defaulted milestones have been achieved and the project milestone falling immediately after the latest defaulted milestone is achieved in time. It further states that interest accrued on the withheld amount shall be disbursed to NHAI under all circumstances. Out of 20 number of 6-laning projects examined in Audit, in three projects toll amounting to ₹ 902.89 crore was not withheld or was prematurely released to the concessionaire. In case of Delhi-Agra project, (Reliance) no such provision was included in CA. In Gurgaon-Jaipur project as per Schedule G of CA, concessionaire had to achieve project milestone II within 730 days (2 April 2011) from Appointed Date and scheduled 6-laning date on 912th day (i.e. 2 October 2011) from the Appointed Date. Project milestone II had not been achieved till August 2013 though the scheduled 6-laning date (i.e. 2 October 2011) was over. As per CA, if the project milestones were not achieved in time, the toll collected was to be withheld in separate sub escrow account. However, NHAI did not withhold an amount of ₹ 459.87 crore collected by the concessionaire, M/s. Pink City Expressways Private Ltd. NHAI also sustained loss of interest that would have been earned had the amount been withheld as per Clause 31 of CA.

In Delhi-Agra project the Concessionaire made a false declaration of mobilising at site whereas no machinery and plant were mobilised at two of the construction camps at km 54.000 and 170.000. There was no record of any action taken by NHAI against the concessionaire for failure to mobilise and commence construction of the project. Progress of work against the first milestone due on 27 June 2013 was 'nil'. (Union 36 of 2014 Para 5.8)

Ministry of Civil Aviation (MoCA) is responsible for creation, maintenance and managing the airports. In September 2003 the Union Cabinet approved the restructuring of Delhi and Mumbai airports by establishing joint ventures by forming subsidiaries Delhi International Airport Private Limited-(DIAL) and Mumbai International Airport Private Limited-(MIAL) in 2006.

DIAL- Delhi International Airport Private Limited

The sole bidding criterion for financial bid to select of the JVC partner for Delhi Airport was the revenue share of JV Company with AAI. GMR led consortium was the highest bidder offering 45.99 per cent of gross revenue to AAI. Shareholding pattern of DIAL (Delhi International Airport Limited) is AAI (26 per cent), Fraport AG Frankfurt Airport Services Worldwide (10 per cent), Malaysia Airports (Mauritius) Private Limited (10 per cent) and 54% by GMR Infrastructure Ltd, GMR Energy Limited, GVL Investments Ltd.

The provision of Dual Till in OMDA takes into account only 30 per cent of the revenue generated by non-aeronautical services. It was unfair advantage to DIAL because overall revenue share to AAI goes down and the cost to passenger's increases. In case of Dual Till System revenues from aeronautical as well as non-aeronautical sources are distributed between aeronautical and non-aeronautical services separately. Under Single Till system all the revenue and costs are put together in respect of all aeronautical and non-aeronautical services. Non-aeronautical services are less capital intensive and are considered to be more profitable. Several services that are non-aeronautical under Operation Management Development Agreement (OMDA) are aeronautical services under Airport Economic Regulatory Authority (AERA) Act that came into existence subsequently in 2011. Cargo Handling Service, Ground Handling Services are aeronautical under AERA Act but are non-aeronautical under OMDA.

Further OMDA (favouring the private entity) facilitated outsourcing and contracting out of these services through JVs. DIAL has outsourced most of the non-aeronautical services through the mechanism of JVs. There are 11 JVs in which DIAL has equity share ranging from 26 per cent to 50 per cent and revenue share up to 61 per cent. This had negative impact on the revenue to be shared with AAI.

The State Support Agreement (SSA) allows Right of First Refusal (ROFR) to MIAL for a second airport planned within a 150 km radius of the CSI Airport, Mumbai. This would affect the competitive bidding for the new airport within that radius.

Under the OMDA, DIAL has been given the unilateral right to extend the concession period for another 30 years on identical terms and conditions provided no default had taken place during the 20th to 24th year of the first concession period. This was in variance with decision of the union cabinet in 2003. The cabinet note stated that the concession period could be extended by another 30 years only by mutual agreement. Absence of review clause and re-negotiation before extension of concession period allows the private party to operate the airport for a period of 60 years that too with the terms and conditions frozen in OMDA of which some are more favourable to the private entity.

The original project cost approved by DIAL (Jan 2008) was 8,975 crore. In July 2010, it was 12,857 crore. Final project cost adopted by AERA for arriving at the Regulatory Asset Base (RAB) was 12,503 crore. Out of the capital expenditure only 19 per cent has been promoters contribution and 42 % (5266 crore) came from loans and 12% from security deposits (1471 crore). Promoter's equity has been ₹ 2450 crore out of which 26 per cent (637 crore) is that of AAI and equity of other JV partners was 1813 crore only. There was no effort by private entity for financing the capital cost though OMDA states that JVC shall arrange the financing and/or meeting all financing requirements through suitable debt and equity contributions in order to comply with its obligations. As a post contractual benefit, the DIAL was allowed to charge Development Fee (DF) from the passengers. ₹ 3,415 crore (27 per cent) has come from Airport Development Fees charged on the passengers. DIAL made itself free from financial risk.

Out of 15 Mandatory Capital Projects (MCPs) to be completed by 3 April 2008, 11 MCPs were delayed for periods ranging from 87 days to 236 days. Due to this DIAL was not entitled for any incentive in respect of base airport charges. However, in Feb 2009) Government allowed, 10 per cent increase in the aeronautical charges including landing, parking, passenger service fee (facilitation component only), X-Ray Baggage and Housing Charges at IGI Airport. This was against the provisions of SSA and was an undue favour to DIAL.

AAI initially leased out 4608.9 acres of land for the development of the airport. Subsequently, it leased out another 190.19 acres of land for one-time upfront fee of ₹ 6.19 crore and ₹ 100 per annum for the total leased land. Under the terms of the OMDA, DIAL was allowed to utilize 5% of the total land (i.e. 239.95 acres) for commercial purposes. The potential earning of the land is ₹ 1,63,557 crore and the

current value of the land is ₹ 100 crore per acre. Government allowed DIAL to use 239.95 acres of land for commercial exploitation for onetime payment of 31 lakh (5 percent of ₹ 6.19 crore).

Against a claim of ₹ 250.88 crore towards retirement compensation in terms of provisions of OMDA, DIAL had paid only ₹ 80 crore. Release of the balance amount was delayed by DIAL on the plea that there was no specific provision in OMDA as to the timing of payment of Retirement Compensation to AAI. It attracts penal interest (17 crore). Government directed AAI to recover the retirement compensation without penal interest allowed DIAL to pay it monthly installments spread over a period of 10 years without any contractual obligations. Result is loss of interest amounting to ₹ 58.57 crore calculated at 8 per cent per annum.

(Union 5 of 2012-13)

Mumbai International Airport Private Limited-(MIAL) in 2006.

The sole financial bidding criterion for selection of JV partner for Mumbai airport was the revenue share of JV with AAI. The GVK led consortium emerged the highest bidder offering 38.7 per cent of the revenue to AAI. Shareholding pattern of MIAL (Mumbai International Airport Limited) is AAI (26 per cent), GVK Airport Holdings Private Limited (50.5 per cent), Bid Services Division (Mauritius) Limited (13.5 per cent) and ACSA Global Limited (10 per cent).

Airport charges in CSI Airport, Mumbai are determined on a 'shared till' mode. The costs associated with aeronautical services (including the cost of infrastructure creation as well as its maintenance and operation along with a reasonable return on this investment) are set off against 30 per cent of non-aeronautical revenue to arrive at the targeted aeronautical revenue leading to determination of airport charges at CSI Airport, Mumbai. Nonaeronautical services are more profitable with low cost of creation and operation of assets and high revenues. By following the 'shared till' system, only 30 per cent of non-aeronautical revenue has been set off against the targeted revenue while determining tariff. The benefit of low-cost non-aeronautical revenues is largely retained by MIAL. Revenue from non-aeronautical sources accounted for 64 per cent of total revenue of MIA and registered 304 per cent growth in 2012-13 over 2006-07 revenues. In contrast the growth of aeronautical revenues has been modest growing by 81 per cent over the same period.

The State Support Agreement (SSA) allows Right of First Refusal (ROFR) to MIAL for a second airport planned within a 150 km radius. Audit pointed out that this would affect the competitive bidding for the new airport within that radius.

While deciding on PPP/JV route Government envisaged an initial concession period of 30 years which could be extended by another 30 years subject to mutual agreement and negotiation of terms. When OMDA (Operation, Management Development Agreement) was signed the review clause was absent making it 60 years that too with the terms and conditions frozen in OMDA, some of which were favour of the private entity.

The original transaction documents (OMDA, SSA) of MIAL did not mention cost estimate for the project. The initial estimate of the project cost was ₹ 5,826 crore (2006). These estimates were revised upward by MIAL progressively in 2008, 2010 and finally in 2011 to ₹ 12,380 crore. It would further increase. According to OMDA, MIAL shall arrange for financing and/or meeting all financing requirements through suitable debt and equity contributions. As per the initial financing plan, the project cost of ₹ 5,826 crore was to be financed entirely through equity, internal accruals and debt. There was no evidence of effort to secure source for financing as agreed in OMDA. However, subsequently (though OMDA does not provide for) it was allowed to levy Development Fee (DF) on passengers (stated to cover increase in project cost/to cover the funding gap). With AERA's approval to levy of DF of ₹ 3,400 crore in Dec 2012, DF accounted for 29.19 per cent of project funding. On the other hand the equity stake of the private partners of MIAL at ₹ 888 crore contributed a mere 7.6 per cent. Interestingly even though the project cost doubled its debt structure did not change. MIAL made itself completely free from financial risk.

MIAL had to complete 32 Mandatory Capital Projects (MCPs) by March 2010. One of the MCPs (S-06) was not completed on time and was delayed by two years. Four of them were delayed, one of them by two years. Government allowed the incentive of 10% increase in airport port bases charges though MIAL did not meet the SSA obligation to complete the projects. There is a list of 45 other capital works which included airside works, terminal works and city side development which were necessary for overall execution of the project. Progress was reported in 11 works.

OMDA allows MIAL to utilise ten per cent of the demised premises for commercial exploitation (no-transfer asset). Initially it was 179.8 acres but increased to 196 acres through Supplementary Lease Deed. Revenues from non-transfer assets would not form a part of the 'Target Revenue' used for determining aeronautical charges in terms of SSA.

As per OMDA, no development that is not envisaged in the Master Plan would be allowed to be undertaken. MIAL took up construction of a hotel near Terminal 1C in June 2009 and informed AAI that a Consortium was selected through competitive bidding. AAI will receive only 1.79 per cent of the gross revenue earnings of this.

'Carved out assets' were primarily intended for the use of AAI as per OMDA and could be transferred to MIAL, if required, for aeronautical purposes with the condition that the parties (AAI and MIAL) should negotiate the terms and conditions of such transfer. AAI agreed to transfer 48.15 acres out of carved out assets to MIAL without negotiation of terms and conditions as provided in OMDA.

In the event of MIAL being able to absorb less than 60 per cent of such employees, MIAL was liable to pay Retirement Compensation to AAI for such unabsorbed number of general employees. MIAL was liable to pay Retirement Compensation (1245 unabsorbed employees) as per the provisions of OMDA since May 2009. IT paid ₹ 154 crore (against ₹ 260.86 crore in March 2010) in four installments. Though the delay attract penalty Government allowed MIAL to pay in monthly installments in ten years starting from Nov 2010. The interest lost works out to ₹ 73 crore. (Union 15 of 2014)

Government of Andhra Pradesh undertook extensive development of non-major/minor ports in PPP mode along its coastline since the late 1990s. Andhra Pradesh Infrastructure Policy was notified in Dec 2000. Infrastructure Authority (APIA) was constituted in accordance with Andhra Pradesh Infrastructure Development Enabling Act, 2001 (APIDE Act). GoAP entered into Memorandum of Understanding (April 2007) with GoI and ADB. A PPP Cell in the Finance (PMU) Department was created. Audit in 2011-12 examined the PPP projects of Kakinada Deep Water Port, Krishnapatnam Port, Gangavaram Port, Machilipatnam Port, and Vadarevu and Nizampatnam Ports (Vadarevu, Nizampatnam Port & Industrial Corridor - VANPIC) and also efforts towards development of minor ports of Bhavanapadu, Meghavaram and Nakkapalli.

Audit pointed out deficiencies in the competitive bidding process for selection of developers in Gangavaram and Kakinada Deep Water Port, reflecting adversely on fairness and transparency in selection. In violation of Concession Agreements, GoAP allowed change in the shareholding pattern of the development consortium and/ or port operator in three ports (Krishnapatnam Port, Gangavaram Port and Machilipatnam Port).

There were deficiencies/deviations in revenue sharing and financial arrangements, as well as in the monitoring mechanism adopted by the Department of Ports/GoAP over the implementation of the PPP Projects and the Concession Agreements. GoAP allotted large amounts of lands these ports and allowed them to mortgage it to banks etc., for obtaining huge loans for project development. Multiplicity of non-major Ports along the coastline, along with liberal grant of exclusive rights over large lengths of the coastline (well beyond Port Limits) has virtually rendered the majority of the State's coastline privatised.

One of the port (Kakinada) is given as illustration in the following paragraphs.

AP Industrial Infrastructure Corporation invited (Sep 2001) Expression of Interest (EoIs) for development of Kakinada port for which 10 firms responded and seven firms were shortlisted (Jan 2002) for issue of RFP. Two consortia, led by Adani Exports Ltd. and DVS Consortium (Consisting of Sri DVS Raju, New Wave Securities & Industrial Credits Ltd., Dubai Ports International (DPI), Dubai, West Port Holdings SDN BHD, Malaysia and Jurong Consultants Pte.Ltd., Singapore), submitted bids in May 2002. After evaluation, the project was awarded (July 2002) to the DVS consortium, which incorporated (March 2003) a Special Purpose Company in the name of Gangavaram Port Limited (GPL-SPV). GoAP signed (Aug 2003) a Concessionaire Agreement (CA) with the GPL-SPV for a concession period of 30 years, extendable by two spells of 10 years each. Construction for Phase-I (five berths) valuing ₹ 1677 crore commenced in Dec 2005. Commercial operations were to be commenced from April 2009.

Four parties (including the successful bidder – the DVS consortium) were qualified conditionally for issue of RFP. APIIC requested (Feb 2002) the DVS Consortium to furnish the three previous annual reports of Dubai Ports International (DPI) – the specified port operator for the DVS consortium. The DVS Consortium expressed difficulties in submission and promised to submit a Government certificate that they exceeded all the stipulated financial criteria. APIA decided (Apr 2002) that the letter from the Dubai Port authorities could be considered as sufficient, subject to confirmation of its financial status. Lead member (DVS consortium) had no port experience. The individual (who along with New Wave Securities & Industrial Credits Limited was the lead member of the successful consortium) was in the IT industry for the last 15 years, and had no port experience. APIA changed the definition of lead member to 'an individual and a firm, together satisfying the EoI criteria' and then to 'a firm or an individual along with a firm satisfying the EoI criteria and nominated to act as the lead applicant'. This allowed the DVS consortium to be qualified. Changes in consortium members were to be allowed up to the date of submission of RFP, with the prior approval of APIIC/ GoAP, and the new members should have equal or better credentials. Two members West Port Malaysia and Jurong Town Corporation on whose financial statements the consortium was selected, have withdrawn in May 2002. APIIC did not intimate this fact to GoAP. Allowing such changes in the consortium composition after the EoI short listing rendered the process of short listing at the EoI stage irrelevant. It minimised competition by ensuring that new consortia could not submit proposals.

The CA stipulated that the Port Operator, holding an equity stake of not less than 13 per cent, should continue for a minimum period of five years from the Commercial

Operations Date. However, even before the completion of construction the GPL-SPV requested (March 2006) to permit change of Port Operator from DPI to Integrax Berhad, Malaysia. GoAP approved this in March 2006. Integrax Berhad, Malaysia was further replaced (Nov 2007) as 'Port Operator' by Portia Management Services Ltd., UK. Contrary to the terms of the CA (stipulating 13 per cent shareholding for the Port Operator), Portia Management Services did not have any equity share in the SPV as of August 2011. The CA stipulated that land of 1800 acres and the waterfront within the port limits was earmarked for development of the Port which was handed over by GoAP to GPL-SPV in Aug 2007. GPL-SPV availed of a loan of ₹ 1170 crore from a consortium of 13 banks for Phase-I, by mortgaging lands allotted to it. Though, the land was handed over to GPL-SPV between Nov 2006 and Aug 2007, yet the lease charges were calculated by adopting the fair market value as of Jan 2002 (which pre-dated the CA) resulting in unjust financial gain. In Aug 2008 GoAP de-notified (August 2008) the existing Mutyalammapalem Minor Port and extended the Port Limits of Gangavaram Port by merging the port limits of Mutyalammapalem Port. Such de-notification has led to GoAP foregoing its right to develop this port and amounted to undue favour to the GPL-SPV.

The CA stipulated payment of annual concession fee at 2.1 per cent of the Gross Income for the first 30 years, and at double the rate for the extended spells of 10 years each. However, the CA also provided for non-payment of the Concession Fee, where the GPL-SPV did not earn a Gross Profit; this clause did not exist in the bidding documents, and this change amounted to post-bid favour to the GPL-SPV.

GoAP delayed the appointment of an Independent Engineer (Aug 2004 to Oct 2007) and did not appoint Independent Auditor for a long time. DoP and GoAP failed to monitor compliance with the stipulated Performance Standards.

CA empowered GoAP to inspect facilities with regard to O&M of the Port with prior intimation to the GPL-SPV, and to conduct an annual physical inventory of plants, equipment and accessories provided by the GPL-SPV as part of the Port development. Evidence of such inspection was not available. (AP 3 of 2014 Para 2)

In Nov 2005 Ministry of Power (MOP) designated Power Finance Corporation Limited (PFC) as the nodal agency for the purpose of development of UMPPs through Special Purpose Vehicles (SPVs). During March 2006 to March 2012 PFC floated SPVs and awarded four UMPPs, viz. Sasan in Madhya Pradesh, Mundra in Gujarat, Krishnapatnam in Andhra Pradesh, and Tilaiya in Jharkhand to the identified Developers for 25 years at lowest levelised tariff, which ranged between ₹ 1.196 and ₹ 2.333 per unit of electricity.

Audit observed that the Bid Documents used for calling bids in respect of UMPPs awarded were not vetted by the Department of Legal Affairs. MoP softened certain conditions in the Standard Bidding Documents (SBDs) on the basis of feedback received from the bidders and recommendation of PFC.

As per the bid criteria, a bidding company could take 100 per cent benefit of the technical and financial capability of a Parent or its Affiliates for the purpose of qualification. As per the initial bid document issued in March 2006, the equity holding requirement of such Parent/Affiliate in the bidding company was 51 per cent but after pre-bid conference with bidders, the equity holding requirement was scaled down from 51 per cent to 26 per cent in May 2006. This change violated the basic principle of 'ownership' and 'control' given in Accounting Standard Interpretation (ASI) that defines 'control' as 'the ownership, directly or indirectly through subsidiary (subsidiaries), of more than one-half of the voting power of an enterprise or control of the composition of the Board of Directors in the case of a company so as to obtain economic benefits from its activities'. Model RFQ document of Government of India for PPP projects also prescribes more than 50 per cent shareholding as the criteria.

The normative availability for UMPPs was reduced from 85 per cent to 80 per cent. For the levy of penalty, the base was reduced from 80 per cent to 75 per cent before receiving financial bids.

Equity lock-in requirement for the selected bidder in the SPV was reduced from 12 years from Commercial Operation Date (COD) to 5 years for Krishnapatnam and Tilaiya UMPPs after award of Sasan and Mundra UMPPs. In addition, in all the 4 UMPPs the Developers were permitted to cede managerial control (i.e. equity holding can be reduced from 51 per cent to 26 percent) after two years of commercial operation, even though the quoted tariff was valid for 25 years. This may result in inadequate backing of the sponsoring entity may act as incentive to the Developer to use substandard capital equipment.

Minimum net worth of ₹ 1,000 crore (which is 5 per cent of ₹ 20,000 crore being the project cost) prescribed in the bid documents of all four UMPPs was on lower side when compared to minimum net worth requirement of 15 per cent fixed by Ministry of Finance for PPP project costing ₹ 1,000 crore or more.

As per the minimum technical qualifying criteria stipulated in RFQ document, the Bidding Company or a Consortium Member (including Lead Member) and Affiliate must meet technical requirement of having experience of developing projects in the last

10 years whose aggregate capital costs must not be less than ₹ 3,000 crore. Out of these projects, the capital cost of at least one project should be equivalent to or more than ₹ 500 crore. This was violated.

When compared to these new norms (Central Electricity Authority), land agreed for Mundra and Krishnapatnam was in excess by 1538 acres and 1096 acres respectively. EGOM allowed the excess land to be retained by the Developers instead of utilizing the same for other 'Public purpose'.

Three coal blocks viz. Moher, Moher-Amlohri Extension and Chhatrasal were allocated to Sasan UMPP to meet its coal requirement of 16 Million Tonne per annum. In November 2007, Chief Minister of Madhya Pradesh requested the Prime Minister, to allow RPL to use the surplus coal from the captive blocks of Sasan UMPP in the power plant being set up by RPL at Chitrangi tehsil in the vicinity of these mines. The matter was referred to EGOM and the issue was deliberated in the two EGOM meetings held on 28 May 2008 and 14 August 2008. EGOM (Aug 2008) recommended that RPL be allowed to use the surplus coal from blocks allotted to Sasan UMPP for its other projects where power was sold through tariff based bidding. Accordingly, the permission was accorded. This decision resulted in financial benefit of ₹ 29,033 crore with a net present value (NPV) of ₹ 11,852 crore to the Project Developer. The permission to use surplus coal in other projects of the Developer vitiated the sanctity of the bidding process since it amounts to post bid concessions to the Developer having significant financial implication. (Union Commercial 6 of 2012-12)

## CHAPTER -12

# Controls over grants, loans and other forms of resource outflow

Substantial outflow of the financial resources of the governments are in the form of giving grants, loans, repayment of borrowings, interest payments, investments in various forms, annuities, various forms of cash benefits, pension, subsidies, discharging liabilities arising out of guarantees etc. Compliance audit seeks to provide assurance on to what extent the entities could safeguard these resource outflows from the risk of loss and waste.

These resource-outflows fall under Object Class 4-Grants, etc., with Object Heads 31-Grants in aid general, 32-Contributions, 33-Subsidies, 34- Scholarship/ Stipend, 35-Grants for creation of capital assets and 36-Grants in aid for salaries. Some of them fall under Object Class 6 with Object Heads 36-Investments, 37-Loans and advances, 38- Repayment of borrowing.

Rules governing them in the Union Government are General Financial Rules (GFR), Delegation of Financial Powers (DFPR) and general and specific instructions issued by the Finance Ministry from time to time, Central Government Accounting (Receipt and Payment) Rules etc. Every department is expected to have laid down procedures that are in conformity with the above. There would be special provisions in some departments like Railways, Defence, and Scientific Departments. Ministries dealing with for-profit and not-for-profit entities will be having specific rules and instructions. Rules similar to Union Government exist in every State Government incorporated in their Financial Code, Financial Rules, Accounting Code, Accounting Rules etc. Their Departmental Manuals would have detailed procedures.

To what extent each type of resource 'out-flow' is safeguarded in compliance with applicable rules translates into audit objectives and criteria. Selected number of transactions representative of the total is the audit sample. Instances of non-compliance that are significant and pervasive is the audit evidence of the extent of the failure of the entity to safeguard the resources used for releasing grants, giving loans, various forms of cash payments etc.

The following pages provide audit check list for some of these resource outflows. The checklists are drawn from the provisions in GFR and other Rules of Government of India. It is not exhaustive.

## Grants

Grants-in-aid and Contributions include such types of expenditure as grants to local bodies, religious, charitable or educational institutions and compensation to Government servants for accidental losses and contributions to public exhibitions and fairs. Some grants in the nature of contribution, donation, and assistance from one government to another (Union to State, Union to Local Bodies, and State to Local Bodies). Governments (Union and States) also give substantial funds as grants-in-aid to other agencies, bodies and institutions. They include institutions or organizations set up as Autonomous Bodies under a specific statute or as a society registered under the Societies Registration Act, 1860 or Indian Trusts Act, 1882 or other statutes, voluntary organizations or non-government Organisations carrying out activities which promote the welfare schemes and programmes, educational and other institutions by way of scholarships or stipends to the students, co-operative societies, societies or clubs set up by Government servants to promote amongst themselves social, cultural and sports activities as recreational avenue.

In the treasury mode, after the sanction of funds by the concerned administrative ministry/finance ministry of the Union Government, the RBI is intimated to transfer the funds to the State Government. In the society mode the funds are credited directly to the bank accounts of implementing agencies like DRDAs, Societies, and NGOs.

Usually no conditions are attached to *general purpose grants* from Union Government to State Governments and State Governments to Local Bodies. The grantees do not furnish utilisation certificates. Conditions are attached to *grants with specified purposes* either from government to government or government to bodies or authorities. For all such grants the ministry/department exercises controls over sanction and release of funds and also obtain assurance of their utilisation in the form of utilisation certificates. Audit of grants at the department level is limited to examination of sanction, release of grants and its monitoring the utilisation through utilisation certificates and reports.

However, audit also examines the records of the grant receiving government entities with a view to provide assurance on proper utilisation of grants received by them. SAI could be sole auditor of such entities with the mandate to carry out financial, compliance and performance audits. Where some of these entities may have their own audit arrangements, SAI would be conducting supplementary audit of financial statements. Even for these entities the need for audit by SAI may arise when the controls by the sanctioning agency is inadequate, the state of accounts is known to be unsatisfactory, there are chronic delays in the finalization/ submission/ audit of accounts, arrangements for audit are inadequate, there are persistent losses or reported mismanagement, government stands guarantee for large amounts etc.

Need may also arise for SAI to examine accounts of the grant receiving non-governmental implementing agencies to have an assurance on the proper use of government grants. The following is checklist for audit of grants at the department level.

| Audit Objective<br>Whether adequate controls were exercised by the disbursing authority and the head of the department over sanction, release and use of grants? |
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| *To examine whether*:<br>Department laid down the criteria for eligibility and the procedures to be followed within the department and by the beneficiary entities<br>The applicant applied for the grant in the prescribed form along with required information such as Articles of Association, bye laws, sources of its income<br>Sanctioning authority examined the entitlement of the entity with reference to the laid down criteria<br>The sanctioning authority was competent to sanction by virtue of powers delegated under the Act/Rules<br>The sanction is definite, clearly specified the nature of grant, recurring or non-recurring, installments, purpose of which and time limit for spending<br>Bills were presented by the department to PAO/Treasury in the prescribed form the orders sanctioning the payment must be quoted in, each case.<br>All the conditions associated with the grants were clearly communicated to the entity such as maintaining separate accounts for the grant, administrative component, and assets created out it, the purpose of and procedures for utilisation, periodical reports on utilisation, achievement/performance report, utilisation certificate, provision for inspection by the sanctioning authority etc.<br>Whether moneys were unnecessarily drawn in advance of requirement to avoid lapse of funds. It tends to happen at the end of March to avoid surrender.<br>Grantee executed a bond in prescribed form with sureties that it will abide by the conditions. Any alternative arrangement in absence of the bond made<br>Department obtained required information through reports by the due date; in order to have assurance on the proper use of grant.<br>Utilisation certificates were received by due dates in the prescribed form with the required information on utilisation of grants within the period specified in the sanction and for the specific objective for which they were sanctioned<br>The statement of Utilisation Certificate (UC) is supported with expenditure of the grantee with reference to the sanctions or grants-in-aid received.<br>The amounts of grants or sanctions released by the Government are properly reflected in Utilisation Certificates. |

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| | Opening balances of UC tallied with the closing balances of previous UCs for unit wise /scheme wise grants both for recurring and non-recurring nature. Unutilized grants are allowed to be carried forward were taken into account while regulating the grants for the subsequent year. |
| | Balances of unutilized grants or sanctions are properly reflected in the UC statements. |
| | The unutilized balances reflected in the UCs are tallied with the books of accounts. |
| | Copy of utilisation certificate sent to AG/PAO |
| | Further installments were release only after receiving the audited utilisation certificate and fulfilling other conditions |
| | Grant or part of it was transferred to any other purposes, without prior sanction of the competent authority |
| | Any unused portion of grant was refunded |
| | In case of failure of grantee to comply with the conditions the entire amounts together with interest have been recovered? |
| | Register of Payment of Grants-in-aid was maintained in prescribed form. All sanctions were noted in register under proper attestation and the bills received against such sanctions after their passing noted in the register |
| | The receipt of formal utilisation certificate was watched through the said register. |

Certain grants are sanctioned and released as stipends and scholarships. In case of government scholarships the amounts of scholarship in respect of students awarded are drawn by the Ministries or Departments concerned by presentation of bills in accordance with the rules governing the schemes. They draw the cheques or obtain drafts in favour of the Heads of the Institutions concerned who in turn would disburse the scholarships to the students. The scope of audit of such institutions where they are disbursed would include the examination of records relating to the identity, eligibility of the beneficiary, correctness of the amounts paid with reference to scale, time period and any other conditions, payments to all the beneficiaries during the period add up to the total amount shown to have been spent, unused balance was properly accounted for, prescribed reports were sent to the administrative department etc.

While conducting the audit of the administrative ministry depending on the value and or governing conditions or other similar considerations, the following audit checks are carried out to have assurance that administrative department exercised adequate controls.

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| | *To examine whether:* |
| | The sanctioned scale was not exceeded, there was no excess over the total amount sanctioned for the scholarship, and the scholarships were drawn only for the period for which they are sanctioned. |

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| | The bills were drawn in accordance with the procedure laid down and that necessary certificates showing that the prescribed conditions have been fulfilled, are furnished along with the bill or separately, as may be necessary. |
| | A register in the prescribed form was maintained and scholarship bills were posted. |
| | Payments to the private institutions were made after receiving the bills from the authorities of such institutions in the prescribed form with required information |
| | Government official who presented such bills and drawn the amount was competent (nominated by the sanctioning authority). Any conditions attached to it. If so, the bill bears the certificate of countersigned authority. |
| | The receipt of cheque or draft by the institutions and report of disbursement was watched |

Where compensation was paid to the victims for accidental losses due to effect of floods, cyclones, earthquakes or other reasons audit check involves examination of procedures for drawal of bill indicating the name and designation of the person, amount of compensation, sanction order number. Audit checks include verification of evidence of payment to the beneficiary, the relief was to the extent of sanctioned grant and amounts undisbursed were refunded immediately.

## Loans

Union Government extends loans to State Governments, Union Territories, public sector undertakings, statutory corporations, local bodies, institutions, private individual and others. Similarly State Governments also extend loans. Loans issued by Union Government are governed by the provisions under General Financial Rules, Delegation of Financial Powers, Instructions issued from Finance Ministry from time to time and specific instruction by concerned ministry or department. Similarly State Government also provides for provisions in their Financial Code, Financial Rules, Treasury Code, and Treasury Rules etc. For example a chapter in the Financial Code of J&K deals with loans.

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| Audit Objective<br>Whether adequate controls were exercised by the Head of the Department over grant of loan of loans, its recovery and its utilisation by the loanee entities. | |
| | *To examine whether:* |
| | Government's and department's policy is clear on the objectives and conditions of providing loans, eligibility criteria, procedures for sanction release and recovery |
| | Selected applicants clearly stated the purpose of loan, furnished required documents and information that provides an assurance about the financial condition of the applicant and its ability to use the loans for the intended purpose and its ability repay the loan |
| | If loanees were individuals whether the identity was established and security taken. |
| | Loans were sanctioned in accordance with prescribed criteria by the authority competent to sanction |

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| | Conditions attached to the loan were clearly stated in the sanction order. They include the objectives of loan, terms of repayment and interest, utilisation certificate, maintaining separate books for loan account etc. |
| | Formal agreement of willingness to comply with conditions was made with loanee. In case of loans to parties other than Government Companies adequate security should be taken. Similarly clause with a right to call for accounts was inserted. |
| | Bill was presented to PAO/Treasury in the prescribed form with a copy of sanction order and the agreement with loanee |
| | Crossed cheque received from the PAO /Treasury was delivered to the loanee and his acquittance was obtained. |
| | A loan register was maintained in the prescribed form. Separate page was allotted to each loanee. Sanction orders and details orders were noted in the register. |
| | Loanee complied with conditions for payment of interest such as at the prescribed rate, by due date, to the specified bank account in the specified bank and branch |
| | Loanee complied with conditions for repayment of loan installments |
| | The yearly installments along with the interest therein were correctly realized on due date and penal interest as per prescribed rates (if applicable) has been charged |
| | Broad sheet or similar accounting records were maintained to reconcile the loan amounts. |
| | Utilisation certificates or/and other reports were obtained where the department was required to satisfy itself about the fulfilment of objectives of the loan. They were in the prescribed form and received by due dates |
| | Further loans or further installments were granted when substantial unutilised balances out of the previous loans are still available to the loanee |
| | Decisions of waiver of interest, deferring the payments were taken by the competent authority with valid recorded reasons. Similarly the decision of write off. |

Audit of entity that received the loan would involve examination of to what extent the entity complied with the conditions of loan.

## Guarantees

Under Articles 292 and 293 of the Constitution, the Union Government and the State Governments are empowered to give guarantees in respect of loans raised by others within such limits as may be fixed from time to time by an Act of Parliament or of the State Legislature, as the case may be. Such guarantees constitute contingent liabilities of Government.

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| | *Auditor examines the guarantees to have assurance that:* |
| | The ceilings prescribed by the Legislature are not exceeded; |
| | Any general or special orders of the Governments concerned prescribing the levy of a commission for giving guarantees are duly observed; and |

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| A sound system in place to maintain proper records of the guarantees given along with their terms and conditions. |
| Total amount of such guarantees as well as the amount involved in guarantees, if any, invoked during the year are correctly reflected in the accounts |
| The accounts of the public body or institution whose loan or loans have been guaranteed by Government are subject to audit by qualified auditors |
| Whether sinking funds were constituted for the redemption of loans raised by the Union and State Governments. |
| Whether Credit to these sinking funds is in accordance with the undertakings given by Government and set forth in the prospectus of the loans and that payments are eventually utilised for the purpose for which the Funds themselves were created. |

Scrutiny of the accounts of any Sinking Funds created by such a body or institution in pursuance of a scheme for the liquidation of debt under a statutory provision or otherwise is directed to ascertain that:

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| The scheme of liquidation prescribed as the basis of the Sinking Fund is financially sound and consistent with the principles governing amortisation arrangements discussed earlier in this chapter; |
| The Fund contains the amount that should have been accumulated if the prescribed scheme had been adhered to in respect of both the amounts to be credited to the Fund and the anticipated interest; and |
| The investments of the Sinking Fund are sound and are valued correctly |

## Investment

Rules prescribe that no Drawing Officer should incur any expenditure or enter into liability involving expenditure or transfer of moneys for investment or deposit from Government account unless such expenditure or transfer, as the case may be, has been sanctioned by general or special orders of Government or by any authority to whom power has been duly delegated in this behalf. Government of India earns nearly one lakh crore rupees by way of dividend from its investments in the public sector companies, its banks, financial institutions and RBI.

Apart from investments made by Union and State Governments in Government Companies etc., the auditor would also be examining the investments made by the government entities.

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| With regard to investment of funds forming part of the Public Account of India or of a State, it is to be examined whether: |
| The investments made on account of any regularly constituted sinking or other funds administered by the Union or State Governments are of the category authorised by the |

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| | relevant statutory provisions or the instruments or authority by which the funds are governed. This principle also applies to the investment of cash balances of the Union or any of the State Governments. |
| | Whether there are any ascertained losses connected with the investments or unusual depreciation in their market price should be reported to Government along with such comments as the Accountant General (Audit) may consider appropriate. |

| With regard to investment of funds by government entities like PSUs it has to be examined whether: | |
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| | Sanction, acquisition and disposal of investments are carried out by competent authority |
| | Investments were made in accordance with the legal requirements governing the entity (Acts) as also with its internal regulations. |
| | The investments are in the name of the entity/Government. The title is clear. |
| | Physical inspection of investments was carried out at the year. |
| | Periodical valuation was carried out and disclosed accordingly. The market values of investments may keep on fluctuating. While in the case of some investments, such fluctuations may not be wide, in the case of others, they may be significant. |

## Deposits

Personal Deposits (Personal Ledger Account) are maintained in the treasuries in the nature of banking accounts. They are established either under statutory provisions of the Government or created under any law or rule having the force of law by transferring funds from the Consolidated Fund of the State for discharging liabilities of the Government arising out of special enactments. Civil court deposits, criminal court deposits, revenue deposits DRDA (District Rural Development Agency) are examples.

Personal Ledger Accounts are also opened, in consultation with the Accountant General (A&E) to transfer funds from Consolidated Fund to facilitate execution of schemes/projects. These accounts (unlike the above created under statutory provisions) should be closed at the end of the financial year by minus debit of the balance to the relevant service heads in the Consolidated Fund of the State, the Account being opened again in the following year, if necessary, in the usual manner. Treasuries and departmental offices maintain accounts of receipts and payments in respect of all kinds of deposits.

Local bodies like Zilla Parishads and Panchayats also maintain deposits. Indian Missions abroad are also permitted to maintain certain deposits. Some of the deposits are in the nature of advance to the implementing department like deposit with PWD for executing a public work. Deposits are also maintained by forest departments, public bodies etc. During audit of deposits it is examined to see whether:

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| | Funds are not diverted from the Consolidated Fund and unnecessarily accumulated in deposits, thus affecting the basic discipline of budgetary control; |
| | Deposit accounts are opened only when necessary and strictly according to the prescribed rules and regulations |
| | Credits to, withdrawals from and closure of deposit accounts are supported by the necessary documents and strictly conform to the rules and regulations |
| | Receipts into deposit are duly supported by challans and necessary vouchers are available in support of withdrawals from such deposits. Rules that govern expenditure apply to disbursements under deposit heads as well. Repayments of deposits should be supported by proper vouchers |
| | Accounts were closed at the end of year and closing balances in deposit accounts were correctly carried over from year to year and the correctness of the balance in each account at the close of the year was acknowledged by the person or body concerned where necessary |
| | Deposits that have remained unclaimed for such period(s) as may be prescribed by Government in this behalf and were credited as revenue receipts of Government and properly adjusted to the revenue head in the accounts |
| | Required records in the prescribed format were maintained. They include deposits register, personal ledger accounts ledger, plus and minus memoranda. |

## Reserves and Reserve Funds

Governments create reserve funds for specific purposes. They are fed by contributions or grants from the Consolidated Fund of India, of a State or of a Union Territory, or from outside agencies. With regard to transactions related to reserve funds or reserved, it is seen in audit that:

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| | These transactions conform to the rules or orders framed by the competent authority governing the administration of each Fund; |
| | Transactions are correctly accounted for and the balance standing in the account of each Fund at the close of the year is correct |

Investments made if any from these funds are examined.

## Interest payments and repayment of borrowings

Open market borrowings (other than Treasury Bills) are managed by the Public Debt Offices of the Bank. Issue and repayment of treasury bills of all Central and State Government is dealt by RBI. Loans obtained from autonomous institutions like the Life Insurance Corporation of India, National Cooperative Development Corporation, National Bank for Agriculture and Rural Development, etc., are managed by the departmental officers of Government.

The work done in the Public Debt Offices in respect of the transactions connected with these borrowings is to be test checked by an inspection of the relevant records maintained in those offices. Audit of interest payments on open market loans involves verifying that:

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| | The amount of promissory note is correctly stated in the voucher; and |
| | The amount entered in the voucher as the half-yearly interest in fact represents one half year's interest due on the amount of the loan mentioned in each promissory note; |
| | The total amount due is the half year's interest multiplied by the number of half years as entered in the column provided for the purpose; |
| | The amount shown as being due in the voucher has been correctly computed; |
| | The receipt is properly signed, either by the person named as the holder or by his representative; |

Manual of Instructions for the inspection of Public Debt Offices by the Indian Audit and Accounts Department contains guidelines and procedures for conducting the audit.

The procedure with regard to payment of interest on different forms of Government securities are regulated by the rules and orders contained in this behalf in the Government securities Manual issued under the authority of the Government.

Bills for sums payable to the Reserve Bank, such as bills in connection with the floatation of new loans or management of Public Debt, should be countersigned by an officer of the Ministry of Finance before they are paid.

The Reserve Bank is authorised to debit the Government Account in advance of the submission of consolidated bills for expenses incurred in connection with the floatation of Government loans or payments which it may make to bankers, on account of brokerage; subject to the condition that the Reserve Bank accepts the responsibility in the event of any excess payment being made. The advance so made should be adjusted against the final bill of the Reserve Bank.

During audit of interest vouchers relating to borrowings from institutions like the Life Insurance Corporation of India, National Cooperative Development Corporation and other financial institutions, it should be seen that the payments are covered by sanctions accorded by a competent authority. The correctness of the amounts sanctioned should be verified during carrying out audit of that office.

## Pension

Pension proposals of the retiring employees are processed by the DDO or the designated authority and sanctioned by the competent authority in the department. Pension is calculated with reference to rules governing the qualifying service and pay. Authorisation is done by the AG (A&E)/PAO and disbursed by the DDO through Treasury/PAO. Audit of pensions

are carried in the offices of DDO, PAO/AG (A&E)/Treasury. Audit is with reference to the applicable rules and procedures, the criteria. Audit objective would be whether adequate controls were exercised to ensure that pension was sanctioned and authorised by the competent authorities and drawn and paid correctly.

| To examine whether: |
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| Qualifying service was calculated correctly with reference applicable rules and the entries of date of birth, service, leave and spells of foreign service, impact of disciplinary cases etc., were checked with reference to the entries in the Service Book |
| Pay considered for pension was taken in account correctly with reference the applicable rules, entries related to pay, pay fixation, any impact of disciplinary cases on pay in the service book |
| Any recovery was to be made from gratuity and was recovered |
| Pension and gratuity entitled were sanctioned by the competent authority |
| Pension/gratuity was paid to the person after establishing the identity. |
| Procedures for drawal and disbursal were followed |
| Periodical increase (relief) in pension was correctly given |
| Family pension was calculated correctly with reference to the nominations provided by the government servant and applicable rules on the eligibility of family members. |

## New Pension System

In a new pension system compliance audit of the department involves examining whether:

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| Immediately on joining Government service, the DDOs should obtain from Govt. servant particulars such as scale of pay, date of birth, nominee(s) for the fund, relationship of the nominee etc., in the prescribed form. |
| Permanent Pension Account Number (16 digit) was allotted to the Government servant (Central Government - joined on after 1.1.2004) after obtaining the required information in the prescribed form. |
| Contribution by Government servant at the prescribed per cent (10% of his basic pay, DA etc.,) deducted from the monthly salary bill. No GPF deduction is made. |
| Whenever there was any change in Basic Pay/DA/DP due to arrear of pay, DA revision, 10% of paid emoluments were also to be recovered. |
| No deduction will be made towards GPF contribution from the Government servants joining service on or after 1.1.2004 as GPF scheme is not applicable to them. |
| DDO maintains a separate Pay Bill register for those who joined after 1.10.2005 and also notes the unique 16 digit PPAN in the PBR |

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| | Recovery schedule was prepared in the prescribed format and accompanied the pay bill indicating the Permanent Pension Account Number etc. Information contained therein in the schedule was correct as per recovery made in the bill.<br>Separate schedules are prepared for government's matching contribution<br>After carrying out necessary audit checks as are done in other pay bills the pay bill is passed for payment.<br>The recovery made on account of individual contribution and equal matching Government contributions were compiled to relevant account heads.<br>Verify whether the DDO gets the annual account statement showing opening balance, details of monthly deductions and government's matching contributions, interest earned (if any) and the closing balance for onward transmission to the individual |

## Subsidies

The entire insurance business in the private sector is a cross subsidy. Subsidies in the public sector is also a cross subsidy. Government subsidies aim at (a) providing subsistence/ sustainable livelihood to the poor and vulnerable (b) inducing higher production and consumption (c) correction of market imperfections.

In the public sector the subsidies could be to the producers (farmers, certain industries, exports) which could be on the produce or inputs. Subsidy could be to the consumers (power, water, essential commodities, health, education, transport etc.). Subsidies may be directly provided by the Government or through implementing agencies (governmental or no-governmental). Subsidy may be partial or complete.

Compliance audit of subsidies involves examination of extent of adherence to the guidelines for implementation flowing from the policy of that particular subsidy. Usually it involves providing assurance on the ability of the department to provide the subsidy only to the eligible beneficiaries (transparently identified on predefined criteria) and to provide the correct entitled quantum of subsidy. This responsibility remains same even where implementing agencies are involved. Audit needs to have assurance on department's ability to make the agencies provide the subsidy of entitled quantum to the eligible beneficiaries. Audit also involves assurance on adherence to the procedures relating to sanctions, approval, drawal and disbursal.

## Direct benefits in cash or kind

Governments provide assistance in cash or kind to the poor and vulnerable in the form of food grains, clothes, gas stoves, family planning aids, old age pension, widow pension, unemployment allowance, mid-day meal, nutrition supplement to mother and child, book/uniform/cycles/laptops to school going children particularly girl child etc. Financial outgo of the government in this form is exposed to the risk of loss in the form of benefits reaching ineligible people and not reaching the eligible ones, fictitious beneficiaries, distribution of benefits in incorrect quantities etc.

Audit seeks to provide an assurance on the ability of the department to provide the assistance in cash or kind only to the eligible beneficiaries (transparently identified on predefined criteria) and in correct quantities meant to be supplied. This responsibility remains same even implementing agencies are involved. Audit needs to have assurance on department's ability to make the agencies provide the correct entitled quantities to the eligible beneficiaries. Audit also involves assurance on adherence to the procedures relating to sanctions, approval, transport, storage, drawal, establishing identity of beneficiary and disbursal.

## Suspense accounts

All transactions are ultimately removed either by payment or recovery in cash or by book adjustments are recorded under suspense heads. Unless otherwise permitted by the rules, the use of suspense heads for provisional adjustment of transactions that are ultimately adjustable under ordinary revenue and service heads should be avoided as far as possible. Audit needs to have assurance that (a) the unadjusted balances under these heads continue to represent bonafide assets or liabilities of Government capable of being realised or settled, as the case may be; and satisfactory action towards such realisation or settlement is being taken by the officers responsible; and (b) all balances under suspense heads were reviewed at short intervals, to ensure that no item remains unadjusted longer than is reasonably necessary to bring about its clearance in the ordinary course with due regard to the rules applicable in each case.

## Grant of land, lease, licence, rights and concessions

GFR 28 prescribes that except in pursuance of the general delegation made by, or with the approval of the President, a subordinate authority shall not, without the previous consent of the Finance Ministry, issue an order which - involves any grant of land, or assignment of revenue, or concession, grant, lease or licence of mineral or forest rights, or rights to water power or any easement or privilege of such concessions, or involves relinquishes revenue in any way. Rules and procedure, regarding the demand and recovery of rent of Government buildings and land will be prescribed in the departmental regulations of the departments (GFR 15).

### *Examples*

Rule 209 of General Financial Rules 2005 prescribes the principles and procedures for award of grants-in-aid to any grantee. Rule 212 envisages monitoring of utilization of the grants so released through the mechanism of utilization certificate (UC) to be submitted by the grantee as prescribed in Form GFR 19A. The UCs are required to be submitted by the grantees within twelve months of the closure of the financial year. Audit observed that in 21 Ministries/Departments of Union Government, 44,315 UCs involving ₹ 43,872 crore which were due on 31st March 2014 were outstanding as of January 2015. The position of outstanding UCs relating to 10 major Ministries/Departments were as follows. (Union 1 of 2015 Para 5.4)

| | No of UCs | ₹ in crore |
|---|---|---|
| Health and Family Welfare | 6724 | 16192 |
| Agriculture | 3089 | 12380 |
| Human Resource Development | 3889 | 9954 |
| Youth Affairs and Sports | 7100 | 1439 |
| Social Justice and Empowerment | 10046 | 653 |
| Housing and Urban Poverty Alleviation | 343 | 591 |
| Food Processing Industries | 2704 | 484 |
| Tribal Affairs | 164 | 366 |
| Women and Child Development | 4611 | 313 |
| Culture | 3248 | 245 |

Scrutiny of records in the HRD Department of Higher Education revealed that 2,634 number of UCs aggregating ₹ 1,002 crore were outstanding at the end of Nov 2013 in respect of grants-in-aid released by the Department up to 2011-12. UCs for ₹ 923.54 crore were pending for the last 10 years (2003 to 2012). In Ministry of Textiles, 2,070 number of utilization certificates aggregating ₹ 240.31 crore were outstanding as on 31 March 2012. (Union 1 of 2015 Para 5)

As per rule 208 (vii) of General Financial Rules, 2005, all organisations receiving grants-in-aid of more than ₹ 5 crore per annum, should enter into a memorandum of understanding (MoU) with the Administrative Ministry or Department, spelling out clearly the output targets in terms of details of programme of work and qualitative improvement in output, along with commensurate input requirements. The output targets, given in measurable units of performance, should form the basis of budgetary support extended to these organisations. Test check of Department of Social Justice and Empowerment revealed that during the years 2011-12 to 2013-14 grants of more than ₹ 5 crore were released by the Ministry to its institutes/organisations but the Memorandum of Understanding was not entered into by the Ministry with these organisations. Moreover, the sanction orders also did not specify the requirement of entering into any MoU. (Union 1 of 2015 Para 5.5.8)

As per rule 209 (6) (iii) of GFRs, when recurring grants-in-aid are sanctioned to the same Institution or Organization for the same purpose, the unspent balance of the previous grant should be taken into account in sanctioning the subsequent grant. Further rule 212(1) also envisages that in respect of recurring grants, Ministry or Department concerned should release any amount sanctioned for the subsequent financial year only after Utilization Certificate on provisional basis in respect of grants of preceding financial year is submitted by the Institution or Organization concerned. During the years 2011-12 to 2013-14, the Ministry of Micro, Small and Medium Enterprises released recurring grants-in aid of ₹ 4,508 crore to Khadi and Village Industries Commission, Coir Board and National Small Industries Corporation institutions without taking into account the unspent balance of ₹ 438 crore already available with these institutions. (Union 1 of 2015 Para 5.5.19)

Rule 212 (1) of GFRs, stipulated that in respect of Central Autonomous Organizations, the Utilization Certificate shall disclose separately the actual expenditure incurred and the Loans and Advances given to suppliers of stores and assets, to construction agencies, to staff (for house building and purchase of conveyance, etc., which do not constitute expenditure at that stage). These shall be treated as unutilized grants but allowed to be carried forward. While regulating the grants for the subsequent year, the amounts carried forward shall be taken into account.

Audit scrutiny revealed that during the years 2012-13 and 2013-14, grants-in-aid of ₹ 1,612 crore and ₹ 1,454 crore respectively were released to KVIC and Coir Board. However, these organizations while furnishing the utilization certificates in respect of the grants for the year 2012-13 did not disclose the loans and advances of ₹ 775 crore disbursed as on 31 March 2013 out of the grants so received. The Ministry neither asked the grantee nor ascertained the same from the annual audited accounts of the grantees before releasing further grants of ₹ 1,454 crore during 2013-14. (Union 1 of 2015 Para 5.5.20)

Financial Ru1es of the State Governments prescribed that only so much of the grant should be paid during the financial year as is likely to be expended during that year. Utilisation certificates are to furnished within one year from the date of sanction of grant. In Bihar, Audit observed that 2128 UCs aggregating to ₹ 59,113 crore in respect of Grants-in-aid paid up to 2013-14 were in arrears. In West Bengal out of 200,175 number of cases involving ₹ 52,234 crore, submission of UCs for 193,054 cases involving ₹ 46,975 crore, though overdue, remained outstanding as of March 2013. Of these, 184,193 cases (₹ 41,540 crore) remained outstanding for more than two years. In Maharashtra 106,950 UCs (₹ 68,659 crore) were outstanding as on 31 March 2014. In Uttar Pradesh 436,814 UCs for ₹ 111,348 crore were outstanding as on 31 March 2104.

As per the provisions of the Kerala Financial Code (KFC), before considering a loan application, the sanctioning authority should obtain from the applicant inter alia, details of sources of income and of how the borrower proposed to repay the loan within the stipulated period. M/s Pinarayi Industrial Co-operative Society Limited submitted (Dec 2007) an application for financial assistance for ensuring uninterrupted functioning and diversification of its activities. Director of Industries and Commerce released (Mar 2009) ₹ 2 crore under the head of account 'Loans to existing weaker co-operative institutions having growth potential". Audit pointed out that as per the assessment carried out (Mar 2010) by the General Manager, District Industries Centre, Kannur', the society could not be considered as weak society as it was making profit for the last seven years. Hence, release of the loan to the society was improper. The repayment of

the loan had to commence from the date of completion of one year from the drawal of the loan. As of March 2011, the repayment was still to begin. (KL 2010-11 Para 3.2.2)

Government of Assam (GOA), Planning and Development Department sanctioned (Feb 2010) ₹ 4 crore to Deputy Commissioner (DC), Kamrup under 'untied fund' for setting up a silk 'Raw Material Bank (RMB)' at Sualkuchi Institute of Fashion Technology (SIFT). The RMB was meant for self-employed weavers in the vicinity of Sualkuchi to acquire yarn on credit basis or to collect interest free loans for procurement of yarn from their own source up to a ceiling of ₹ 10,000 per beneficiary. The financial assistance or loan amount was to be repaid by the beneficiaries after the products were sold. 3,975 self-employed weavers belonging to below poverty line owning two to four looms were targeted for assistance. Scrutiny (Mar 2011) of the records of DC, Kamrup revealed that 5,564 kg (₹ 1.27 crore) silk yarn procured were distributed (Jan 2011) to 1,391 beneficiaries/weavers of the three Panchayats of Sualkuchi without entering into any agreement with the beneficiaries for repayment of cost of the raw materials. (AS 2011 Para 2.3.3)

In order to liquidate Non Performing Assets (NPAs), the Uttar Pradesh Financial Corporation (Corporation) evolved a policy of one time settlement (OTS) with borrowers and issued comprehensive Guidelines in March 1999 and modified it from time to time. As per the Guidelines, amount of OTS was to be arrived at on the basis of matrix or realistic realisable value of mortgaged security plus net worth of the Promoters/ Guarantors, whichever was higher. As a result of not linking the OTS amount with the available security of the Promoters/Guarantors, the Corporation settled OTS amount lesser than available security value. The Corporation suffered loss of ₹ 10.44 crore. (UP 2010-11 Para 4.9)

| Name of the borrower | Outstanding amount | Valuation of security (without net worth) | Amount of OTS | (₹ in crore) Difference | |
|---|---|---|---|---|---|
| 2 | 3 | 4 | 5 | 6 (3-5) | 7 (4-5) |
| Panchsheel Beeds Industries | 3.49 | 6.85 | 2.75 | 0.73 | 0 |
| M.B. Oil Mills, Noida | 1.79 | 1.93 | 0.20 | 1.59 | 0 |
| Capital Ice Factory (P) Ltd., Noida | 2.03 | 1.71 | 0.21 | 0 | 1.49 |
| Krishna Crafts (India), Noida | 3.59 | 2.63 | 1.07 | 0 | 1.56 |
| Electrica Electrical (India), Noida | 2.76 | 2.91 | 0.70 | 2.05 | 0 |
| Soti Engineering Industries, Noida | 1.08 | 0.49 | 0.22 | 0 | 0.26 |
| Decent Polymers Pvt. Ltd., Noida | 3.12 | 3.92 | 0.39 | 2.73 | 0 |
| Total | | | | 7.12 | 3.32 |

West Bengal Infrastructure Development and Finance Corporation Limited (Company) is a non-banking financial company engaged in raising money from the market and banks to finance infrastructure projects in the State. Investment policy (Sep 2007) of the Company allowed investment of surplus funds. The Company decided (Dec 2008) to invest ₹ 25 crore in 'UTI-Gilt advantage fund –long term plan' (Gilt funds), a long term debt mutual fund at net asset value (NAV) of ₹ 13.8214 per unit. Immediately after investment, the NAV of the Gilt fund steadily declined. The Company decided (Mar 2009) to hold on to the investment expecting to minimise losses with subsequent appreciation in NAV between Dec 2008 and Sep 2009 and earned ₹ 0.74 crore as dividend from the Gilt fund under dividend reinvestment plan. But NAV of the Gilt fund never reached the level at which the Company entered into the fund. Finally in Jan 2010 the Management redeemed its investment at ₹ 11.83 per unit incurring loss of ₹ 2.93 crore. Audit commented that the Gilt fund was suitable for long term investments. Average maturity of its underlying assets was for six years, whereas, the Company's investment objective was to redeem its investments in MFs within 90 days. As per fund brochures, the Gilt Fund had consistently underperformed. The Company did not factor this fact into its investment decision. (WB 2009-10 Para 3.10)

Economic Development Corporation of Goa, Daman & Diu Limited (Company) (EDC Limited) was formed with the objective to provide financial assistance to small and medium companies. It disbursed total loans aggregating ₹ 1,112 crore up to 2012-13. Of this, principal and interest amounting to ₹ 348 crore were due for recovery as on 31 March 2013. Some of the deficiencies detected in test-check of One Time Settlement (OTS) cases include the following.

The promoters of Styrofoam Cups & Container Private Limited, (SCCPL) defaulted in interest and principal repayments since Nov 1998 and the Company did not take any action to attach and sell the financed unit for a period of six years. Against the total outstanding of ₹ 332 lakh as on Sep 2006, the Company settled for ₹ 165 lakh plus simple interest at 12 per cent on principal balance and waived off ₹ 167.08 lakh.

Super Urethane Products Private Limited, (SUPPL) availed a total of 57.15 lakh (Apr 1985 to Jan 1991). SUPPL paid ₹ 44.15 lakh till the date of attachment (Dec 2003). Against a total outstanding of ₹ 330 lakh, the Company recovered ₹ 80 lakh on sale of assets (Mar 2005) and waived off ₹ 238 lakh.

Shivam Synthetics Pvt. Ltd. (SSPL) defaulted in payments of principal and interest since Feb/Sept 1991. Finally, the Company offered (Sep 2008) settlement of the account under OTS scheme at ₹ 53.25 lakh plus other expenses and waived off ₹ 142 lakh. (GOA 2014 Para 5.2)

The Chhattisgarh State Gazette Notification (March 2010) prescribed the minimum rates of compensation for private land acquired for industrial purpose. As per the Department

of Commerce and Industries circular (March 2012), the minimum rates of premium for Government lands allotted for industrial purpose should be as per paragraph 4.15 (a) of Rehabilitation Policy 2007 (₹ 6 lakh per acre). The amount (premium and lease rent) received from the investor against allotment of Government land should be deposited in Government account through challan. During audit of the records of Chhattisgarh State Industrial Development Corporation (CSIDC), it observed that in 15 cases, Government land measuring 648.561 ha (hectares) was allotted for industrial purposes during March 2010 to December 2010 by CSIDC at rates less than the revised rate of ₹ 6 lakh per acre. Thus, against the chargeable amount of ₹ 98.52 crore, only ₹ 49.27 crore was levied resulting in short levy of ₹ 49.25 crore (CG 2013 Para 2.4.4.4).

Jammu & Kashmir Entrepreneurship Development Institute (JKEDI) and the Jammu and Kashmir Bank Limited implemented Seed Capital Scheme since 2010. The scheme envisages counselling, guidance and training in entrepreneurship and providing of seed capital fund to the willing candidates for starting self-employment ventures, within age group of 18 to 37 years and having minimum qualification of 10+2. Under the scheme, seed capital is to be released in installments. Seed Capital equivalent to 35 per cent of the project cost shall be provided up to a maximum of three lakh in respect of undergraduate/graduate and five lakh in respect of post-graduate prospective entrepreneur, technical qualified persons etc., and ten lakh for group initiatives.

As per para 18 of guidelines of the Scheme, A target of generation of 50,000 jobs had to be realized (₹ 100 crore) by establishment of 5000 units (10 jobs per unit). Records show that a potential of 16,910 jobs had been created by establishment of 2,669 units (Dec 2013). In 85 out of 393 physically verified units (in 5 districts by Audit) it was found that 159 jobs were generated against target of 850.

The physical verification of units of Seed Capital Fund conducted by the Employment Department showed (July 2013) that out of 1410 surveyed cases, 305 units were non-existent/ non-located and 123 units were under established. As per details available in respect of eight districts, subsidy under Seed Capital Fund scheme to the tune of ₹ 7.10 crore was credited/ released in favour of 222 non-existing units. The physical verification of 1301 units of Seed Capital Fund Scheme was also got conducted by Director JKEDI in June/ July 2013 detected 114 units as non-existing/ non-located and 127 as under established. (JK 4 of 2014 Para 2.3.9)

The National Medicinal Plants Board (NMPB) under the Ministry of Health and Family Welfare, Government of India formulated (November 2000) a Centrally Sponsored Scheme of contractual farming of medicinal plants. As per guidelines of the scheme, applicants desirous of availing financial assistance (subsidy) were required to submit the project proposals along with Memorandum of Understanding (MoU) with the buyer of the produce of medicinal plants, bank appraisal report of the projects, land documents

duly verified by the Revenue Department and Registration Certificate obtained from the State Medicinal Plants Board (SMPB)/State Government. Financial assistance to the tune of 30 per cent of the project expenditure or upto a maximum of ₹ 9 nine lakh was to be paid to the selected farmers through Financial Institution (FI) in two equal installments. Fifty per cent of the assistance was to be released to the FI after 50 per cent of its term loan for the projects was disbursed to the farmer. The remaining 50 per cent of the assistance was to be released to the Term Loan Account of the concerned borrower, on disbursement of the second installment of term loan. Before releasing the financial assistance, the officials of NMPB or in their absence officials of the SMPB were to inspect the project area and submit inspection report of satisfactory progress or otherwise of the project.

Scrutiny of records (Oct 2009-March 2010) of the Director, Ayurveda, Punjab and Member Secretary, SMPB, (Director) revealed that the proposals for financial assistance to 14 beneficiary farmers submitted to the NMPB were defective to the extent that (a) the documents relating to the land reported to have been owned by the farmers were not authenticated by the Revenue Authorities of the State Government. These were certified by the beneficiaries themselves; (b) there were no bank appraisal notes in the prescribed format. Only a letter from the State Bank of Patiala, Phase-7, Mohali (which did not bear reference number and date) promising to sanction term loans to the beneficiaries was attached to the proposals; and (c) documents supporting registration of the beneficiary farmers with SMPB/State Government were not furnished with the proposals.

NMPB released (May 2005) the first installment of financial assistances of ₹ 43.35 lakh (in the form of 14 bank drafts) to the Director for disbursement to beneficiaries. On the basis of the inspection reports and utilization certificates, NMPB released (March 2007) the second installment of assistance of ₹ 42.88 lakh to the Director for disbursement to the beneficiaries through their term loan accounts in the bank.

Audit scrutiny revealed that the inspection reports of progress of the projects submitted by the Director to NMPB were fictitious, as no medicinal plants were cultivated in the village Dargab Khalid-Bin-Walid stated in the proposals.

Further enquiry from NMPB revealed that the drafts for the first installment were not received back in that office. Cross verification with the Bank revealed that the amounts reached the bank account of the society (Panchshseel Cooperative Collective Farming Society Ltd. 41, Phase 2, Mohalli, the buyer of the produce of medicinal plants) with whom MoUs were signed by the beneficiaries for the sale of produce (raw herbs) of the medicinal plants. No term loan was sanctioned by the State bank of Patiala to any of the beneficiary farmers.

Thus, failure of the Director to ensure (a) correctness of the project proposals and the inspection reports and (b) crediting of the bank drafts in the term loan account of the beneficiaries and forwarding the utilization certificates for the first installment (reportedly returned the drafts of the installment to NMPB) facilitated fraudulent disbursement of financial assistance of ₹ 86.23 lakh. (PB 2009-10 Para 3.1.1)

Bihar State Minorities Financial Corporation Limited provides loans under different schemes including that of National Minorities Development and Finance Corporation (NMDFC). Under the Micro Credit Scheme, micro credit is extended to the members of Self Help Groups (SHGs), especially the Minority women scattered in remote villages and urban slums who are not able to take advantage of formal banking credit as well as under the NMDFC programmes. Under the Scheme, micro-credit loan up to a maximum of ₹ 25,000 per beneficiary was extended to the poorest among the poor. Under the Scheme, the Company was required to take-up the Scheme on its own or through NGOs identified by the Company. Under the Micro Credit Scheme, the Company without verifying the financial credibility/track record released a sum of ₹ 48.2l lakh to three NGOs on their request for 305 beneficiaries. A sum off 43.50 lakh could not be recovered for over four years. Scheme was discontinued.

Under Post Metric Scholarship Scheme disbursement of ₹ 25 lakh was made in 2010-11 to four non-existent colleges/ institutes without ascertaining their authenticity and without verifying the bonafide of the institutes. The four institutes were named as International Para Medical Institute, RLS College, Rahmat Latif Sah college and Sad Industrial Training Institute; all of them with address, Bailey Road, Raja Bazar. There was no system to maintain District-wise data bank pertaining to schools/colleges/ institutions, their affiliation status, etc.

DWO, Siwan, in violation of the guidelines, undertook disbursement of the maintenance allowance amounting to 31.35 lakh directly to 1337 students during the period 2010-12, instead of disbursement of the same through collges /institutions to the beneficiaries. Similarly, in violation of the said guidelines, DWO, Samastipur sent the cheques of ₹ 8.89 lakh pertaining to maintenance allowance to Block Development Offices (BDOs) for its disbursement to the students. We noticed that neither any confirmation nor any utilisation certificate in respect of the actual disbursements by the BDOs was furnished and as such, the disbursement of ₹ 28.89 lakh could not be verified. (BR 1 of 2014 Para 2.2)

Under the Centrally Sponsored Scheme of Post-Matric Scholarship to Scheduled Tribe (ST) Students, grants-in-aid are released by the Ministry of Tribal Affairs (Ministry) to the State on the basis of proposals submitted by the State Government. The scheme's objective is to provide financial assistance to ST students studying at post matriculation or post secondary stage to enable them to complete their education. Criteria for award

of the scholarship include (a) parent/guardians' income from all sources should not exceed ₹ 1 lakh per annum (up to 2006-07) and ₹ 1.08 lakh per annum (from 2007-08 onwards). (b) The scholarship application should be accompanied by an income declaration by the parents/guardians stating definite income from all sources. (c) Maintenance allowance was payable for 10 months in an academic year.

Scrutiny (March 2010) of records of the Director of Higher and Technical Education, Meghalaya, Shillong revealed the following irregularities:

During 2005-08, post-metric scholarships of ₹ 23.16 lakh was disbursed to 838 ST students whose parent's annual income could not have been less than the prescribed limits of ₹ 1 lakh or ₹ 1.08 lakh. Parents were Government/Bank employees, Members of Legislative Assembly, College Lecturers, Doctors, Engineers, LTC employees, etc.). In certain cases, income certificates were issued in the mother's name where the father was a Government employee. In some other cases where both the parents were Government employees, income certificates were issued for the guardian or sister, thus suppressing the actual income of the parents. Out of 437 applications test-checked, 90 per cent of the income certificates were issued by Members of the Legislative Assembly and the remaining by other unauthorised officers like Deputy Commissioners/ Additional Deputy Commissioners.

The Directorate sanctioned and paid maintenance allowance for 12 months (instead of 10) in an academic year to 41,325 students in 25 colleges during the years 2005-08, which resulted in excess payment of ₹ 1.34 crore.

The students of Shillong Polytechnic were categorised as falling under Group II instead of Group IV and scholarship were paid to them at higher rates resulting in an excess payment of ₹ 53.94 lakh to 1,868 students during 2004-08.

During 2005-09, excess payment of ₹ 17.06 lakh was made to 4,381 science students of Classes XI & XII of 10 colleges due to payment of scholarship at the rate admissible to students of Degree classes.

The laxity of the Directorate in not properly scrutinising the scholarship applications and the failure of the Ministry in not enforcing the criteria led to excess and inadmissible payments totalling to ₹ 2.28 crore. (ML 2009-10 Para 2.2)

India Infrastructure Finance Company Limited (the Company) was incorporated in January 2006 as a wholly-owned company of the Government of India under the Companies Act, 1956 to provide long term finance to viable infrastructure projects under 'Scheme for Financing Viable Infrastructure Projects through a Special Purpose Vehicle called India Infrastructure Finance Company Limited (SIFTI)'.

The project for construction of 135 km stretch of access controlled and elevated Kundli-Manesar-Palwal Expressway was awarded (31 Jan 2006) by Haryana State Industrial and Infrastructure Development Corporation Limited (HSIIDC), the Concessioning

Authority, to KMP Expressways Limited (KMP) for a concession period of 23 years and 9 months. The scheduled commercial operation date of the project was 1 July 2009. Due to change in the composition of KMP, writ petitions were filed (May 2006) by the initial constituents of KMP viz. Madhucon Projects Limited and Gammon India Limited for quashing the award of project. After dismissal (March/April 2008) of the petitions, an appeal and a special leave petition filed by Madhucon Projects Limited and Gammon India Limited with the Supreme Court of India, were also dismissed in May 2008 and June 2008 respectively. Without waiting for the final outcome of the above disputes, a loan of ₹ 380 crore was approved (Dec 2006) by the Company, part financing the project having the total project cost of ₹ 1915 crore.

Audit observed that the loan was sanctioned despite the fact that the stipulated conditions of the then prevailing SIFTI guidelines of the Company were not fully complied with viz., (i) the appraisal was not done by the lead bank and (ii) no guarantee from lead bank was obtained for recovery of loan. As the developer had failed to execute the project, the substitution clause of the agreement was invoked, the earlier developer was removed and the efforts were made by Consessioning authority for locating a new developer (April 2014). Thus, the Company compromised on compliance of SIFTI guidelines and failed to protect its own financial interests. The loan of ₹ 135.25 crore (outstanding amount as on April 2014) extended to the borrower ultimately became a non-performing asset for the Company. (Union 2 of 2015 Para 7.1)

Indian Renewable Energy Development Agency Limited (IREDA), was established (MNRE [Ministry of Renewable Energy]) in March 1987 under the Companies Act, 1956 for the purpose of extending loans to renewable energy projects. IREDA initially a Public Financial Institution was registered as a Non-Banking Finance Company with the Reserve Bank of India in 1998. IREDA has framed Renewable Energy and Energy Efficiency Financing Guidelines for project financing. Fair Practices Code (FPC) framed by IREDA in March 2007 (broadly in lines with RBI guidelines 2006) outline the procedures for verification of loan applications, processing of loan applications, loan appraisal and terms and conditions, disbursement of loans, monitoring and evaluation, release of securities on repayment of loan and interest, grievance redressal mechanism, etc. IREDA fixed its loan exposure norms/limits as 20% for single borrower and 35% for group of borrowers. During the period covered under audit (2008-09 to 2012-13 it sanctioned 219 projects valuing ₹ 13,593 crore of which till March 2013 disbursed ₹ 6,865 crore. They were mostly of wind power (50%), small hydro (25%), co-generation (15%) and solar (5%).

The first installment of loan will be subject to compliance/completion of the conditions such as furnishing of item-wise physical progress of the project; inspection of the project; induction of Nominee Director on the Board of the borrowing company and appointment of Concurrent Auditors/Engineers; furnishing of Chartered Accountant's

certificate covering information like item-wise expenditure already incurred; utilisation certificate of promoter's contribution; and utilisation of amounts already disbursed. The subsequent disbursement/s shall be made on pro rata basis to the promoters' contribution brought in for the project and also taking into account compliance of pending conditions/formalities for earlier disbursements, satisfactory progress of the project; project inspection by IREDA official or its nominees etc.

Out of the 42 cases selected by Audit, it was observed that in 17 cases (40 per cent) IREDA had deviated from the norm(s) prescribed in the financing guidelines. The break up was credit exposure limits exceeded (5), non-creation of mortgage before disbursement (6), promoter's contribution not brought in time (4), Trust and Retention account not created (2), longer repayment period permitted (2), required inspections not conducted (11) and Nominee Director and/or Lender's Engineers not appointed (4).

A term loan of ₹ 21.30 crore was sanctioned (May 2007) to M/s Noble Distilleries & Power Limited for setting up a 8 MW Captive Power Plant based on Waste Heat Recovery Boiler (WHRB) and Fluidised Bed Combustion Boiler (FBCB) in Bellary District, Karnataka. The expected date of commissioning of the project was 31 March 2011. Audit pointed out that (a) for sanction of the loan there was a condition to check that the NPA in the financed sector Energy Efficiency and Conservation (EEC) should have a limit of 15 per cent. However, at the time of sanction, the sector NPA was 48.88 per cent. (b) The second installment of loan of ₹ 4 crore was disbursed (July 2010) without inspection of the project. The borrower was in default since Dec 2010. Lender's Engineer appointed by IREDA (June 2011) found in inspection (July 2011) that the corporate office of the borrower was closed and they were operating from their factory premises. The borrower had also changed its name to M/s Noble Ispat & Energies Limited. The account became non-performing asset (NPA) in December 2010 and the loan was recalled in May 2012.

To encourage investment in the Renewable Energy (RE) sector, MNRE implements different schemes from time to time for grant of financial incentives in the form of capital subsidy and interest subsidy on loans. IREDA released interest subsidy of ₹ 122.88 crore for 110 projects and capital subsidy of ₹ 23.14 crore for 13 projects.

Out of 12 projects selected by Audit (from a total of 123 projects) in five cases, several irregularities were noticed in implementation of subsidy schemes viz. continued passing on of subsidy to borrowers who became ineligible, non-recovery of subsidy and absence of mechanisms to ensure continuity of the project.

Government of India in May 2008 launched the Agricultural Debt Waiver and Debt Relief Scheme (ADWDRS) to address the problems faced by the farming community in repayment of loans taken by them and to help them qualify for fresh loans. Under the scheme, complete waiver of 'eligible amount' was to be provided to Marginal and

Small farmers while a one-time relief of 25 per cent of the 'eligible amount' was to be provided to Other farmers subject to payment of the balance 75 per cent of the 'eligible amount' by the farmer. Agricultural loans meeting the specified conditions were to be covered under the scheme. The scheme was to be implemented by 30 June 2010. Ministry of Finance was the Apex authority responsible for administration and implementation of the scheme. RBI was nodal agency for implementation and monitoring of the scheme for Scheduled Commercial Banks, Urban Cooperative Banks and Local Area Banks and NABARD was for Cooperative Credit Institutions and Regional Rural Banks. State Level Bankers Committee was responsible for consolidating and sending district-wise and state-wise data, of each bank in the state. Lending Institutions were the actual point of interaction with the beneficiaries for the purpose of implementation of the scheme. The Government of India estimated in May 2008 that about 3.69 crore Marginal/ Small farmers accounts and about 0.60 crore other farmers' accounts would be covered under the scheme. The GoI has waived more than 52000 crore related to approximately 3.45 crore Small / Marginal and Other farmers.

Performance Audit was undertaken to assess whether the management of claims for debt waiver and relief under the scheme was in accordance with relevant guidelines and requirements. The audit was carried out from April 2011 to March 2012 both at the Central and State levels and it covered 25 states involving field audit of a total of 90,576 beneficiaries/farmers accounts in 715 branches of lending institutions situated in 92 districts. Advertisements were published in the local newspapers of the district selected for audit for inviting complaints relating to the scheme giving details of audit schedule. These complaints along with the complaints received at Central and State levels were also examined in audit. The audit sample included 80,299 accounts of such farmers who were extended benefit under the scheme, 9,334 accounts of such farmers who were not selected as beneficiaries even though they had received agricultural loans between 1 April 1997 to 31 March 2007 and 943 cases where complaints were received.

There were audit observations relating to 20,756 accounts out of the 90,576 accounts test checked. Based on these audit findings, a draft audit report was issued to the Department of Financial Services (DFS), Ministry of Finance (MoF) in May 2012. MoF stated (June 2012), that 7,242 observations were verified by them and the banks had contested the audit observations in 2,515 cases. In that scenario, Auditors had no option but to re-verify their findings by going back to original records in the presence of Government Officers. The re- verification was a detailed exercise which took almost four months during which initial records and documents submitted by banks relating to 6,371 cases (including the 2,515 cases contested in the MoF reply) were examined and discussed in detail with the representatives of the banks. The result was that 97.52 percent of Audit Observations were found correct and acceptable by the Government.

| Bank | Number of Cases seen | Number of cases objected by audit | Cases disagreed by banks and re-verification done | Results of re-verification | | Final number of audit objections sustained | Percentage where audit objections sustained {(7) ÷(3)} x 100 |
|---|---|---|---|---|---|---|---|
| | | | | Audit objections sustained out of (4) | Audit objection dropped out of (4) | | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| Banks under RBI | 44285 | 9403 | 2643 | 2447 | 196 | 9507 | 97.98 |
| Banks under NABARD | 46291 | 11053 | 3728 | 3410 | 318 | 10735 | 97.12 |
| Total | 90576 | 20756 | 6371 | 5857 | 514 | 20242 | 97.52 |

Major Audit Findings:

Errors of Inclusion at the Beneficiary Level: Out of 9,334 accounts test checked in audit, 1,257 accounts (13.46 per cent) were those which were found in audit to be eligible for benefit under the scheme, but were not considered by the lending institutions.

Errors of Exclusion at the Beneficiary Level: Out of 80,299 accounts granted debt waiver or debt relief, in 8.5 per cent of cases; the beneficiaries were not eligible for either the debt waiver or the debt relief.

Irregular Reimbursement: A Private Scheduled Commercial Bank received reimbursement for loans, amounting to ₹ 165 crore extended to Micro Finance Institutions (MFIs) in violation of the guidelines.

Lack of Proper Documentation: In 2,824 cases, with claims amounting to ₹ 8.64 crore, there was prima facie evidence of tampering, over-writing and alteration of records.

Errors in Calculation of Entitlements: In 4,826 accounts (6% of the test checked accounts) farmers were not extended the benefits according to entitlements. In 3,262 cases, undue benefit totalling ₹ 13.35 crore was extended. On the other hand, in the remaining 1,564 cases, farmers were deprived of their rightful benefits of ₹ 1.91 crores.

Irregular Claims: Lending institutions claimed amounts related to interest/charges which was not allowed under the scheme. In 6,392 cases across 22 states, although the lending institutions had not borne interest/charges of ₹ 5.33 crore themselves.

Issue of Debt Waiver/Relief Certificates: In 21,182 accounts (out of 61,793 test checked accounts), i.e. 34.28 per cent, there was no acknowledgement from farmers or any other proof of issue of debt waiver or debt relief certificates to the beneficiaries. Such certificates entitle the farmers to fresh loans.

Deficient Monitoring: The DFS was completely dependent upon the nodal agencies for monitoring the compliance of its instructions issued from time to time in

implementation of the scheme. The nodal agencies themselves were relying on certificates and data of lending institutions without conducting independent verification of such data and certificates to confirm the veracity of claims. This raised the issue of conflict of interest, since in effect the lending institutions were performing a dual role, first implementing and then monitoring their own work.

The action taken on the audit observations included:

An amount of ₹ 627.68 crore recovered against ₹ 666.72 crore,

In 458 cases, benefits released by lending institutions, where benefits were not given to eligible persons,

In 5411 cases, disciplinary action taken against the staff by the lending institutions,

In 757 cases, responsibility or auditors fixed by the lending institutions,

In 4030 cases of tempering of records, 22 FIRs filed,

₹ 165 crore recovered from the private bank along with penal interest of 55 crore,

₹ 149.79 crore recovered from NABARD on the ground that the interest for the first installment was not covered in the scheme (Union 3 of 2013)

The Karnataka Government Servants (Family Pension) Rules, 2002 provide that when a Government servant dies while in service, his/her family is entitled to Family Pension at double the normal rate or 50 per cent of the last pay drawn by the deceased Government servant, whichever is less, for a period of seven years from the date following the date of death or till the date on which the Government servant would have attained the age of 65 years had he/she remained alive, whichever is earlier. Majority of the pension payments are made through Banks. After crediting the Family Pension amounts to the SB accounts concerned, the Banks forward the claim through the link branch and the claim is settled by the Treasury. During the year 2013-14, Audit observed in 301 cases relating to 32 district treasuries, Public Sector Banks made payment of Family Pension at enhanced rates beyond the period mentioned in the Pension Payment Orders, resulting in excess payment of ₹ 1.90 crore. Further, in respect of 23 treasuries, excess payment of ₹ 0.63 crore was noticed in 121 cases, in spite of excess payment having been pointed out in earlier years in these cases, resulting in cumulative continued excess payment of ₹ 1.32 crore. Failure on the part of the Banks to monitor and adhere to the cut-off date for payment of Family Pension at enhanced rates resulted in the excess payments.

In West Bengal review of treasuries during the year 2012-13 revealed that (a) An amount of ₹ 39.50 lakh was credited to the bank account of the pensioners even after death of the pensioners in 419 cases spread across 25 treasuries. (b) An amount of ₹ 77.05 lakh was paid in excess in respect of family pension due to non-reduction of

basic pension from enhanced rate to normal rate. Such overpayments were made in 96 cases spread across 17 treasuries. (c) An amount of ₹ 20.36 lakh in 20 cases was paid in excess due to irregular grant of dearness relief on the basis of revised pension in four treasuries.

Audit analysed the implementation of New Pension Scheme among for All India Officers serving in the State (with effect from 2004) and State Government employees (with effect from 2013) and observed that (a) State Government did not initiate any steps to recover the contribution from officials and deposit in pension fund along with Government contribution till 2010. State Nodal Officer (SNO) designated (in 2010) was required to obtain the duly filled in PRAN (Permanent Retirement Account Number) applications from the AIS officers through the appointing authority and forward it to National Security Depository Limited (NSDL). Out of 71 AIS officers joined the State cadre since 1 January 2004, PRAN has been obtained for only 14 officials till July 2014. Audit found that ₹ 26.82 crore that was due to be remitted to pension in respect of 12,500 employees was not remitted. (KL SFR 2014)

In 176 cases (out of 185 test checked in six districts in Odisha), 8484 acres of private land was acquired at ₹ 511 crore by the Land Acquisition Officers (LAOs) on the requisitions filed by IDCO on behalf of 12 promoters of industries and one PPP project, under Section 4(1) and Section 6(1) of LA Act. It implied that the acquisitions were being made for 'public purpose' by Government at Government cost. In Audit it was found to be incorrect. The entire cost of acquisition was paid by the promoters companies. In such case the acquisition had to be made under Chapter VII of the LA Act, which prescribed the procedure for acquisition of land for companies for restricted purpose.

Similarly, the Department misused the emergency provision under section 17(4) in many instances depriving the likely land-losers of the opportunity to be heard in 85 cases 4967 acres valuing 165 crore (₹ 900 market value in 2012).

Fixing of market value of land on lower side by LAOs tended to help the land buyers, most often industries, at the cost of land-losers, largely farmers. Under assessment of compensation by ₹ 224 crore was noticed in 35 LA cases for acquisition of 4000 acres of land for 10 entrepreneurs/industries due to erroneous fixation of market value of land. The LAOs ignored highest sales statistics close to the date of publication of notice in many instances. There was under-assessment of additional compensation by ₹ 9.76 crore in 18 cases in test checked districts.

Audit also noticed that 1142 acres of Government land (approximate present market value: ₹ 567 crore) and 4151 acres of acquired private land (approximate present market value: ₹ 2065 crore) remained unutilised by the entrepreneurs after expiry

of prescribed period and no action was taken to resume the land to the Government or returning the same to the original land- losers, very often farmers. Utilisation of allotted land for unintended purposes was also noticed. (OD 2011 Para 2.1)

Mumbai Metropolitan Region Development Authority (MMRDA) decided (Dec 2007) to lease out land measuring 5,900 sq m situated in GN block at Bandra-Kurla Complex for educational or medical purposes by calling for bids and fixed the reserve price @ ₹ 1.53 lakh per sq m. MMRDA invited (July 2008) bids and received only one bid for the plot from Taleem Research Foundation (TRF) of the Essel Group of Industries whose offer price was ₹ 1.55 lakh per sq m.

TRF had submitted insufficient documents relating to its experience in the field of education and financial capacity to construct the building. However, TRF was given (Aug 2008) a chance to rectify the deficiencies noticed in the bid and on receipt (Sept 2008) of the same the bid was accepted. Audit pointed out that reserve price was fixed at ₹ 1.53 lakh per sq m instead of ₹ 5.04 lakh per sq m at current market rate (2008). Adoption of lower rates resulted in short fixation of reserve price by ₹ 3.49 lakh per sq m and loss of lease premium was ₹ 206 crore. (MH 2 of 2013 Para 6.4.4)

More examples can be found at (Union 1 of 2015 Para 5.5; HP 2009-10 Para 3.1; AP 2 of 2013 Para 4.2; PB 2011 Para 2.1.18; CG 2011 Para 1.6; CG 2013 Para 2.4.4.4; KL 3 of 2012 Para 4.5; HR 2012 Para 2.2.1; MP 2008-09 Para 2.1.5; TN 2011 Para 2.1.21 and KA 2011 Para 5.6.8

## CHAPTER -13

# Compliance Audit Planning

Functions of the Government are organised into Departments. A Ministry may consist of one department or more. A Department includes its secretariat, its subordinate offices, attached offices and autonomous bodies. It would also be having administrative control over its statutory corporations, public sector undertakings. A department as a whole along with its sub-ordinate entities would be responsible for delivery of a service for which it is created. Departments can be grouped into economic services, social services, general services and revenue services.

Each Department is headed by a Head of Department, Secretary or Principle Secretary. They are also called Controlling Officer. They are delegated with powers for sanction, approval, spending, etc., relating to the operations, activities of the Department & its offices. They are also responsible for keeping an account of all expenditure and receipts and thus called Chief Accounting Officers. Heads of Department have powers to declare any Gazetted Officer subordinate to them as Head of the Office and delegate certain powers. Such subordinate Gazetted Officers are empowered to draw bills and make payments on behalf of the Central Government. Thus they are Disbursing Officers or Drawing and Disbursing Officers (DDOs). Depending on the size of a subordinate office, head of the office and DDO may be two different officials. There can be more than one Head of the Department in a Department. The highest authority for example Secretary of the Atomic Energy Department is overall Head of the Department. Heads of its research entities, industrial units, and autonomous bodies are also designated as Heads of Department. Similarly, there can be more than one Controlling Officer in which case the highest authority is referred to as Chief Controlling Officer.

Compliance audit plan traditionally revolved around selecting a number of DDO. The end product of this compliance audit of a DDO is an inspection reports (IR) which contain a variety of audit observations that focus on individual cases of irregularity or non compliance; some of which may, in terms of materiality or impact, called draft paragraphs merit inclusion in the C&AG's Audit Reports as paragraphs. Draft Paragraphs, though bring out instances of significant deviations in compliance represented exceptional deviations from the norm and found to be statistically insignificant for drawing systemic conclusions on the functioning of a department or organization.

Multitude of genuine observations in inspection reports whose threshold money value is less than what is prescribed for draft paragraph get neglected and buried over a period of time.

Though in theory the audit process is well defined, in practice DDO centric audit can become an intensive search for potential draft paragraphs. In the scheme of things paragraphs that have no potential to become draft paragraphs are treated as not important, though as a whole they can present a picture of extent of the compliance of the entity. The compliance audit output under DDO approach did not translate into an assurance to the stakeholders on the overall compliance of the department.

Department Centric Planning can help to overcome the above shortcomings. For drawing department wide conclusions, a fair number of auditable units in a department can be taken up for compliance audit in an integrated manner with a department wide perspective. Audit of one department requires a set of audit parties. A set could be 2 to 5 parties depending on the availability of manpower, size of the department, its expenditure, number of units (DDOs/Autonomous Bodies) etc. A set of 3 parties can audit 45 to 65 units in a year. One of the audit parties in each set would be the Lead Audit Party with the overall responsibility of audit by coordinating activities of say other two to four Field Audit Parties. They would conduct compliance audit of the entire department by selecting a number of units and subordinate entities of the department.

## Subject matter and audit objectives

Compliance Audits seeks/provide assurance on the ability of the entity (department and its units) to safeguard all its resources at all times. The scope of compliance audit assignments may be a particular resource, a particular stage or all the resources at all the stages. From point of view of controls put in place by the Government to safeguard the resources, the subject matter of compliance auditing can be viewed as follows.

| | |
|---|---|
| 1 | Controls over preparation of budget, seeking approval for budget and use/release of budget |
| 2 | Controls over cash, cheques and general controls over disbursement and receipts |
| 3 | Controls over pay, allowance, service matters |
| 4 | Controls over establishment and contingencies |
| 5 | Controls over procurements of goods (material and equipment) |
| 6 | Controls over procurement of services |
| 7 | Controls over creation of infrastructure through public works department |
| 8 | Controls over creation of infrastructure through private participation |
| 9 | Controls over other forms of resource outflow- grants, giving loans, repayment of loans taken & interest on loans taken, annuities, subsidies, cash benefits, cash transfers, various forms of investment |
| 10 | Controls over resource inflows - Raising loans, receiving grants, issue of bonds, shares, other market instruments, revenue sharing, production sharing arrangements, disinvestment, privatization, sale of public assets/resources |

Audit Objectives for compliance audit can be articulated as follows.

1. To what extent preparation and submission of the budget leading to demand for grant is in compliance the applicable rules and procedures
2. To what extent the entity is in compliance with rules and procedures applicable over drawal of money, remittance of receipts and handling of cash and cheques?
3. To what extent the entity could safeguard the financial resources used towards pay and allowances of the employees in compliance with applicable rules.
4. To what extent the entity is compliance with the rules and procedures applicable to the expenditure on contingencies
5. To what extent the entity could safeguard its financial resources on procurement of inputs (material and equipment) in compliance with the applicable rules.

   Inputs is to be purchased as per requirement; to be procured in economic fair transparent manner by attracting best possible bids; contract conditions safeguard the interests of the government; contract conditions are effectively implementation and enforced

   To what extent the received material and equipment is safeguarded in compliance with the applicable rules when received, on their storage and safe custody, on their issue from stores to users and their use for the intended purpose.
6. To what extent financial resources of the entity are safeguarded on procurement of service inputs in compliance with the rules applicable.

   Services to be purchased as per requirement; to be procured in economic, fair, transparent manner; contract conditions safeguard the interests of the government; contract conditions effectively implementation and enforced particularly with reference to quality of service.
7. To what extent the entity could safeguard its financial resources while creating infrastructure or assets in compliance with the applicable rules and procedures on:

   Estimating the requirement of infrastructure for current and future needs; identifying the 'works' and their technical, environmental and financial feasibility; on administrative approvals and expenditure sanction; bidding process to identify the most economic and suitable contractor; tender evaluation and award of contract; execution of contract to complete the work; on financial transactions and their accounting throughout the execution; utilisation of created infrastructure/asset for the intended purpose; and its safety, upkeep and maintenance
8. Audit objectives of PPP project among others include adherence to principles/rules/ guidelines governing the bidding process, post award implementation in compliance with the agreement etc.

9. To extent of outflow of resources from the entity is in compliance with rules and procedures applicable for sanction, approval and release of grants, loans, equity, repayment of loans, annuities, cash benefits, benefits in kind, subsidies etc.
10. To what extent the inflow of resources (other than regular budget) is in compliance with the rules and procedures. Resources include receiving grants, raising loans, raising resource by issue of shares, bonds etc., receiving interest/dividend due, disinvestment, sale, revenue sharing, production sharing etc.

Depending on the scope of the audit and the subject matter, each audit objective may have sub-objectives. Acts, Rules, regulations, procedures, instructions governing that set of transactions/activities are the criteria. As explained elsewhere compliance involves not only examination of compliance with the rules but also about adequacy of rules the safeguard the resources. Audit should be able to identify them and suggest cost effective remedy. There can be situation where rules are seemingly complied in letter but not spirit. Audit should be able to analyse the reasons for pseudo-compliance and suggest accordingly.

Carrying out *substantive testing* (audit) simultaneously *along with review of internal controls facilitates* to exploit the full potential of internal control framework in its entirety. Evaluating similar type of transactions or activities against a check list that captures the related controls is the first stage. Detailed examination of instances of deviations, deficiency, etc., forms the second stage. Analysis or assessment of extent of such instances in the sample that is covered is the third stage. It overcomes the problem of commenting on isolated deficiencies. It captures incidence and pervasiveness, i.e., extent of a particular deficiency in the Department across its units.

Compliance audit of tax departments (revenue audit) would obviously have different set of audit objectives and criteria.

Audit would be meaningful only if it the current year transactions & accounts are brought within audit coverage. During the Audit Year, let us say 2015-16, Compliance Audit would aim at test checking transactions of 2015-16. It is better if the audit activity for the year starts in June 2015 and ends in May 2016. The test check sample for the audit parties visiting the DDOs in June 2015 would be limited to April 2015 and also March 2015 drawn in April. The span of months that can be test checked will expand progressively during the course of year. For example Audit Parties visiting the DDOs in January 2016 can chose sample from April to Dec 2015. For the parties visiting DDOs in April and May 2016 transactions of January to March 2015 would be available. The availability of vouchers for Central Audit parties in main office would follow the same pattern. Leads provided by Central Audit Parties can be used by Field Audit Parties.

- During May 2015 The Lead Audit Party would visit the office of the Head of the Department and prepare detailed plan for compliance audit of the Department. Lead Audit Party would communicate the contents of the plan to its sister field audit parties and the central audit wing by the end of May 2015. - Entry conference may take place before start of Field Audit. Audit would start from June 2015.
- Field Audit Parties would continue to audit the DDOs allotted to them from June 2015 to May 2016. Audit would be with reference to the Audit Objective outlined above. It could be all the ten audit objectives or some of the audit objectives, but consistently across the department.
- Lead Audit Party would also commence the field audit in June 2015. It has the responsibility to coordinate with its sister field audit parties and periodically consolidate the audit findings. Lead party and its sister field audit parties may have one or two midterm meetings. Lead Party would revisit the CCO and the office of the Head of Department end of May 2016.
- In June 2016 the Lead Audit Party in coordination with its sister field audit parties is responsible for preparation of Combined Inspection Report and Management letter to be issued to the Secretary of the Department.
- In June 2016 The Lead Audit Party in coordination with CAP would also assist AG in Audit of Finance and Appropriation of the Department it audited.
- The Lead Audit Party may be busy for another month to finalise the report. - This Lead Audit Party once freed from its responsibility by the end of July would join (as sister field party) the Field Audit Parties of another Department planned for Audit in 2016-17.

Role of Lead Audit Party would be more demanding. Even the Field Audit Parties had to carry out a systematic audit checks against selected sample to maintain consistency across the DDOs. All DDOs in the Department should be subjected to minimum standards of audit scrutiny.

## Reporting the Audit Findings

Findings arising out of audit of DDOs will continue to be issued as IRs. Deficiencies of similar nature across the department may be aggregated to prepare a Consolidation Inspection Report (CIR) or Departmental Appreciation Note. Each type of audit finding (audit observation) in the CIR is indicative of failure of a control. Particular control may exist in theory but is not adequately exercised in practice. A control may be out rightly violated or

circumvented. Existing control may be theoretically inadequate or a particular deficiency may indicate that no control exists for such purpose. The check list prepared by the Lead Team for the purpose of field audit should capture all the important controls in three streams separately. General review of files and test check of transactions in the field audit would be with reference to the check list, step by step. If incidence and extent of a particular deficiency is low, it would mean that particular control exists and was exercised well.

Findings in the CIR would be with the reference to the audit objectives framed for compliance audit of the Department. It is about extent of non-compliance under each audit objective. In how many transactions out of how many audited transactions there were significant deviations. For each audit objective, whether the department as a whole was compliant or partially compliant or non-compliant? Non-compliance or partial-compliance is substantiated by narrating the audit observations. With reference to the entire set of audit objectives, whether there is an assurance that the Department was able to reasonable well safeguard its resources. We can assign weightage in multiples of 3 to each audit objectives with total coming to 99 and measure this on a scale of 100 (treating 99 as 100). Weightage for each audit objective could be different. Within the audit objective we can have weightage for each criterion (each rule/procedure) in multiples of 3 and measure it on a scale of 99 (treating 99 as 100). A system like this would help to objectively measure the extent of compliance of each transaction to the set of criteria under an audit objective.

The set of compliance audit objectives and set of criteria under for each objective together should provide a suitable frame work for compliance audit of the department. The documented audit process should provide evidence the extent of substantive testing carried out. Audit findings should be able answer the audit objectives. Overall audit objective of compliance audit of the department is provide an assurance on to what extent the Department was able to safeguard the resource by complying with the Rules laid down for the purpose.

## Audit Plan of the AG office

All the departments in the State can be audited in a cycle of three years, where one third of departments can be audited in one year. However, the Finance Ministry (revenue departments etc.) need to be audited every year. Department of local bodies also need to be audited every year. Number of units that can be audited under each department depends on the availability of manpower.

Let us assume that the following (next page) is the list of departments, number of DDOs/ units, expenditure and revenue in a year for a State Government.

| | | | **Demand for Grants-Departments** | **₹ in crore** | | **Number** |
|---|---|---|---|---|---|---|
| Segments | | NO | ECONOMIC SERVICES | Revenue | Capital | of DDOs |
| A | E.S-AGRICULTURE | 1 | Agriculture and Cooperatives | 1,245 | 1 | 221 |
| | | 2 | Animal Husbandry, Diary & Fisheries | 230 | 8 | 188 |
| | | 3 | Horticulture, Sericulture & Agri-related | 46 | 0 | 66 |
| B | E.S INDUSTRY | 4 | Heavy industries, Mines, Minerals | 61 | 4 | 131 |
| | | 5 | Medium small industries, SEZs | 15 | 10 | 19 |
| | | 6 | Handloom, handicraft, agro industries | 272 | 2 | 86 |
| C | ES---INFRA STRUCTURE | 7 | Irrigation-major/minor – public works | 1,012 | 3,232 | 228 |
| | | 8 | Roads, bridges, buildings Public works | 2,421 | 1,588 | 177 |
| | | 9 | Transport-roadways, ports- water ways | 613 | 15 | 42 |
| D | ES-OTHERS | 10 | Power/Energy | 2,899 | 426 | 39 |
| | | 11 | Tourism and others | 124 | 4 | 6 |
| | | 12 | Communication, IT, R&D, S&T | 176 | 8 | 114 |
| | | | SOCIAL SERVICES | | | |
| E | SS-EDUCATION | 13 | Primary, secondary education | 6524 | 0 | 291 |
| | | 14 | Higher, Technical education, Training | 2205 | 0 | 713 |
| | | 15 | Sports, Art, Culture, Youth Affairs | 101 | 0 | 57 |
| F | SS—HEALTH | 16 | Primary Health, Family Welfare | 1570 | 262 | 492 |
| | | 17 | Secondary Health, Drug control | 200 | 4 | 169 |
| | | 18 | Water Supply, Sanitation | 682 | 515 | 4 |
| G | SS-WELFARE | 19 | Women and child welfare | 496 | 110 | 142 |
| | | 20 | SC/ST/BC/Minorities Welfare | 4996 | 1243 | 1422 |
| | | 21 | Employment/Labour/Consumer Protection | 241 | 0 | 284 |
| H | SS-OTHERS | 22 | Food Security-PDS/civil supplies | 289 | 0 | 458 |
| | | 23 | Housing, (may be others like pensions) | 4290 | 0 | 75 |
| | | 24 | Environment, Ecology, Forest | 221 | 158 | 91 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | LOCAL BODIES | | | |
| *I* | LOCAL BODIES | 25 | Urban/Municipal Bodies | 4,781 | 0 | 67 |
| | | 26 | Zilla Parishads District Panchayats, | 220 | 0 | 26 |
| | | 27 | Panchayats (Taluks-224, Village Panchayats-13,819) | 478 | 0 | 224 |
| | | | GENERAL SERVICES | | | |
| *J* | GS - GENERAL SERVICES | 28 | Home/Police, Jails, Fire Services | 1,735 | 133 | 396 |
| | | 29 | General other Admin, Stationary, printing, information etc. | 912 | 0 | 1014 |
| | | 30 | State Legislature, Governor/ /Law/Courts, elections | 546 | 0 | 1154 |
| | | | REVENUE SERVICES | | Revenue | Units |
| *K* | REVENUE SERVICES | 31 | Sales Tax/VAT/GST , ET | | 24,918 | 60 |
| | | 32 | State Excise | | 63 | 20 |
| | | 33 | Taxes on vehicles, | | 2,003 | 43 |
| | | 34 | Stamp duty, registration, | | 3,666 | 60 |
| | | 35 | Mines, Minerals etc. | | 2,019 | 26 |
| | | 36 | Other revenue | | 1,788 | - |
| Similar departments (animal husbandry, dairy, fisheries) are clubbed for the sake of convenience | | | | | | |

In the table there are 30 spending (expenditure) departments and 6 revenue departments in the State Government. They are grouped into 11 segments from A to K.

| | | | | | |
|---|---|---|---|---|---|
| Economic Services | 12 | departments in | 4 | segments | *A,B,C,D* |
| Social Services | 12 | departments in | 4 | segments | *E,F,G,H* |
| Local Self Govt Bodies | 3 | groups in | 1 | segment | *I* |
| General Services | 3 | departments in | 1 | segment | *J* |
| Revenue Services | 6 | Departments in | 1 | segment | *K* |

- Economic Services have 12 departments in 4 segments; Social Services have 12 departments in 4 segments. Local bodies is a separate segment in three groups (correspond to departments); If Local bodies are treated as a part of Social Services the sub-total would be 5 segments & 15 departments. General Services have 3 departments in 1 segment; revenue services have 6 departments in 1 segment.
- All the Departments in 9 segments ***A*** to ***H*** & ***J*** can be audited once in a year in a three-year audit cycle. Plan does not provide of

audit of the same Department during next two year. There could be exceptions where AG/PD may have to audit any of the unit of a Department at any point of time for valid reasons.

- Segment ***K*** (revenue) can have its own audit cycle of 3-years where one third or one fourth units of all revenue service departments are audited every year.
- Segment ***I*** (local bodies) can have its own 3-year audit cycle where one third or one fourth of the local bodies (all three tiers) are audited every year. Audit of local bodies can be integrated with social sector audit vertically with reference to devolution of powers. Social sector development can be compared horizontally district-wise or region wise.

Ten (10) sets of audit parties are required to conduct audit one department from each segment **A** to **H** and **J.** Two (3) more sets of audit parties are required for audit of segment **K** revenue services. Two (2) more sets are required for audit of segment **I** local bodies. Total requirement would be fifteen (15) set of parties.

Depending on the availability of manpower each set may have 2 to 5 audit parties. Review of manpower statistics relating Sr.AO/AO and AAO men-in-position in the States indicate that in 18 States there is an audit capacity to deploy in the range of 45 to 120 audit parties (two Audit AGs) in a year. Each party can audit 15 to 20 units per year and one set of 3 parties can audit 45 to 60 units per year. Rest of the 11 States (one AG Audit) have a total of 10 or more parties except perhaps Arunachal and Mizoram.

The following table would indicate that all departments in all the segments would get audited in a cycle of three years.

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1st year | *A*-1 | *B*-4 | *C*-7 | *D*-10 | *E*-13 | *F*-16 | *G*-19 | *H*-22 | *I*-(33%) | *J*-28 | *K*-(33%) |
| 2nd year | *A*-2 | *B*-5 | *C*-8 | *D*-11 | *E*-14 | *F*-17 | *G*-20 | *H*-23 | *I*-(33%) | *J*-29 | *K*-(33%) |
| 3rd year | *A*-3 | *B*-6 | *C*-9 | *D*-12 | *E*-15 | *F*-18 | *G*-21 | *H*-24 | *I*-(33%) | *J*-30 | *K*-(33%) |

Revenue departments and local bodies need to be audited every year but number of units in a year can be limited to a maximum of 33% to derive the same assurance.

The following table would indicate that the number of DDOs that can be covered by deploying 15 sets of audit parties is substantial.

| | ***A*** | ***B*** | ***C*** | ***D*** | ***E*** | ***F*** | ***G*** | ***H*** | ***I*** | ***J*** | ***K*** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of sets<br>Total 15 sets | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 2 | 1 | 2 |
| units covered in each year if each set has 2 audit parties | 30 to 45 | 30 to 45 | 30 to 45 | 30 to 45 | 30 to 45 | 30 to 45 | 30 to 45 | 30 to 45 | 45 to 90 | 30 to 45 | 30 to 45 |
| units covered in each year if each set has 3 audit parties | 45 to 60 | 45 to 60 | 45 to 60 | 45 to 60 | 45 to 60 | 45 to 60 | 45 to 60 | 45 to 60 | 90 to 120 | 45 to 60 | 90 to 120 |
| units covered in each year if each set has 5 audit parties | 75 to 100 | 75 to 100 | 75 to 100 | 75 to 100 | 75 to 100 | 75 to 100 | 75 to 100 | 75 to 100 | 150 to 200 | 75 to 100 | 150 to 200 |

Audit Plan proposed above is with reference to audit of a State Government. Plan thus prepared is the Audit Plan for carrying out compliance audit of the State Government Departments though in some states the work may be distributed between. This needs coordination between them and flexibility in deploying the audit parties.

Audit Plan suggested above is meant only for compliance audit. Audit Plan of the State as whole would be separately providing audit resources for performance auditing and financial auditing assignments.

Such planning for Union Government Departments needs coordination between the PDs/DGs responsible of audit of Departments of particular Sector. Audit plan of Economic Service Departments of Union Government would require coordination among DG (ESM) and MABs. Coordination among DG (CE) Delhi, PDs/DG (Central) is required for audit plan of Social Sector and Revenue Sector Departments.

## CHAPTER -14

# Compliance Auditing of Receipts (Revenue) – Introduction

Governments mobilise financial resources to meet the public expenditure needs. It is undertaken by governments in three ways: through levy of taxes, through generation of non-tax revenues and by borrowing. Subject matter of compliance auditing in the public sector includes this revenue generation and resource mobilisation functions of the Government and its entities.

The receipts on revenue account include tax-revenue and non-tax revenue. Non-Tax revenue refers to receipts of the government from all sources other than those of tax receipts. The non-tax revenue of the government includes revenue receipts from sources such as return on assets in the form of dividend and profits, interest, fees, fines and receipts collected in the exercise of sovereign functions, regulatory charges and licence fees, and user charges for publicly provided goods and services. Capital receipts include borrowings that create debt and recovery of loans or proceeds from sale of assets which are non-debt creating. Unlike revenue receipts, the capital receipts of the government create liability and are redeemable or reduce financial assets.

The tax departments under the jurisdiction of the Finance Ministry are responsible for mobilisation of tax resources by administering tax laws and rules. Non-tax receipts and capital receipts are collected by Finance Ministry or spending department depending on the nature of the receipt. Non-tax revenue collected by spending departments can be grouped into those from economic services, social services, general services and financial services. Economic services sector departments/ministries generate substantial amount of non-tax revenue receipts.

All revenues received by Government by way of taxation (tax revenues) and other receipts flowing to Government in connection with the conduct duct of Government business (non-tax revenues) are credited into the Consolidated Fund. Similarly, all loans raised by Government by issue of Public notifications, treasury bills, and loans obtained and all moneys received by Government in repayment of loans and interest thereon are also credited into this Fund. All expenditure incurred by the Government for the conduct of its business including repayment of internal and external debt and release of loans to States/Union Territory Governments for various purposes is debited against this Fund.

All moneys received on account of revenues or receipts or dues of the Government shall, without undue delay, be paid in full into the Government Account. Under certain conditions, subject to certain rules, the spending departmental units are permitted to retain certain receipts (as deposit, as bank account) without remitting to the consolidated fund and use it for meeting the expenditure. A number of public sector entities that are autonomous, for profit, not-for-profit retain the revenue collected by them to meet their expenditure. They operate their accounts in accrual or modified accrual basis. They also mobilise additional resources by investing, borrowing etc.

Public Account accounts for flows for those receipts where the government is merely acting as a banker. Examples of those are provident funds, small savings and so on. These funds do not belong to the government. They have to be paid back at some time to their rightful owners. In the intervening period it is used by the government for public spending.

Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 stipulates that it shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the *Consolidated Fund of India and of each State* and of each union territory having a legislative assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon. Chapter 6 (c) of Regulations on Audit and Accounts, 2007 elaborates the provisions of the Act on audit of revenue and receipts.

As per Section 16 of C&AG DPC Act, the Comptroller and Auditor General has to audit all receipts which are payable into the Consolidated Fund of India. Revenue would include any income of the nation derived from any source, to be credited into the Consolidated Fund of India. The power of the Comptroller and Auditor General to conduct a revenue audit flows from Article 149 of the Constitution of India.

> 'Article 149 mandates the C&AG to perform such duties and exercise such powers in relation to the accounts of the Union. Accounts would include a record of money received and spent by the Union. While enacting the Comptroller and Auditor General (Duties, Powers and Conditions of Service) Act, 1971, vide Section 10, the Parliament has prescribed the manner in which power contemplated by Article 149 shall be exercised by the C&AG in relation to compiling and keeping accounts and vide Section 13 has prescribed the manner in which the expenditure shall be audited and vide Section 16 has prescribed the manner in which the receipts have to be audited.'.

The Supreme Court in April 2014 (Delhi High Court in the case WP(C) NO. 3679/2010 on 14th Jan 2014.) while deciding on the scope and powers of the C&AG with regard to audit of revenues in general and non tax receipts in particular held as follows:

'CAG's examination of the accounts of the Service Providers in a Revenue Sharing Contract is extremely important to ascertain whether there is an unlawful gain to the Service Provider and an unlawful loss to the Union of India, because the revenue generated out of that has to be credited to the Consolidated Fund of India. The subject matter, with which we are concerned, as already indicated, is spectrum, a natural resource, which belongs to the people, therefore, people of this country, through Parliament should know how its natural resources have been dealt with by the Union, State or its instrumentalities or even by UAS licence holders. Instances are not rare, where even the Executive, at times, acts hand in glove with licence holders, who deal with the natural resources, hence, necessity of proper parliamentary control over the resources. Section 13 read along with Section 16 makes it clear that the expression to audit all transactions so also audit of all receipts, payable into Consolidated Fund of India would take in not only the accounts of the Union and of the State and of any other authority or body but also to audit all transactions which Union and State have entered into which has a nexus with Consolidated Fund, especially when the receipts have direct connection with Revenue Sharing'.

Public sector entities should have arrangements for identifying, collecting and recording all amounts due to them promptly and in full. Revenue that is due to the government need to be safeguarded from the risk of loss due to short collection and non-collection arising out of incorrect valuation, incorrect pricing, incorrect calculation, incorrect interpretation of applicable rules, norms, procedures. The reasons could be oversight, omission or acts of commission. In order to safeguard resources that are due, the Government lays down the rules and procedures governing mobilisation of resources.

Compliance auditing of tax revenue seeks to have assurance that the concerned tax departments have accurately assessed, levied and collected the revenue that is due to the government. On one hand they enforce the compliance of tax laws and rules and on the other hand they comply with the procedures that lay down how to enforce such compliance.

Compliance audit of non-tax revenue generation is explained in the next chapter. Compliance auditing of tax revenue is explained in subsequent chapters. Readers are expected to be familiar with the subject matter for revenue audit available in the Chapters 9 to 14 in the text book titled Public Expenditure, Revenue and Resource Management.

# CHAPTER -15

# Compliance Auditing Non-Tax Revenue

Non-tax sources are theoretically defined as payment made to the government for which there is a quid pro quo, in contrast to a tax. In practice it is not so. There are some that are compulsory and requited, that include penalties (other than penalties on non-compliance of taxes) and fines. Another category consists of voluntary and requited payments such as revenue earned by sale of usage rights, admission fee and royalties and rental payments received by the government. It includes revenue earned from the resources owned by the government such as forest etc., and income earned in the form of interest and dividend.

Non-tax revenue could be administrative revenue in the form of fees, fines etc., or could be commercial revenue in the form of charges for the services or goods, sale or lease of tangible and intangible assets.

Most of the spending departments levy and collect non-tax revenue. Spending departments/ ministries can be grouped into economic, social and general service sectors to identify their non-tax revenue receipts. Economic services sector departments/ministries generate substantial amount of non-tax revenue receipts.

| Revenue/Fiscal | Economic | | Social | General |
|---|---|---|---|---|
| Dividend on investments<br>Interest on loans<br>Recovery of loans, advances | Mining,<br>Industries<br>Electricity<br>Roads, Bridges<br>Ports<br>Transport | Posts<br>Telecommunication<br>Irrigation<br>Agriculture & allied<br>Forest<br>Land | Medical & Health<br>Education & allied<br>Water supply<br>Sanitation<br>Housing, Labour<br>Broadcasting | Police<br>Public works<br>Pension contributions<br>Printing<br>Supplies |

Subject matter of compliance auditing of non-tax revenue includes receipts/ revenue levied, collected and remitted to consolidated fund and also revenue collected and retained for use by the autonomous bodies, public sector undertakings, corporations and bodies authorised to do so.

Revenue collection or resource mobilisation activity can be viewed in four stages; planning, preparedness, implementation and reporting.

| *Management of Non-Tax Revenue* | *Safeguard of non-tax revenue* | *Accounting* |
|---|---|---|
| Planning, Preparedness to implement, Implementation and Reporting-non-tax revenue (fee, charges, royalty, rent, receipt etc.) by entities that charge for its services (electricity), which trade (warehouse) which sell (mineral), which regulate (pollution control) or all other entities where receipts are incidental | Compliance of entities with rules and procedures on assessment, collection and remittance (tax revenue and revenue receipts)<br>Also how the entities enforced compliance applicable to those who should pay and who pay | Accounting of receipts in the concerned books of accounts, their compilation, their consolidation |

Audit objective would be to examine to what extent the entity correctly assessed, levied, collected and remitted. The criteria would be the related rules and procedures. The determination of charges for the service largely depends upon the degree of publicness of the goods. If the goods and services provided by the government were purely public in nature, it would be difficult to recover their full cost. In 'quasipublic' services (road, bridges), the unit cost of providing the services depends upon the amount of funds the society is willing to pay and the form of financing of the service. The willingness to pay for the service will depend upon the usefulness of the service (electricity, water) - the more useful the service; the higher will be the willingness to pay by the society.

## *Examples*

Sale of 2-G Spectrum

The New Telecom Policy 1999 lifted the restrictions on the number of service providers for the Basic Service Providers (BSPs) and Cellular Mobile Service Providers (CMSPs) and made it open for participation by all bidders who satisfied the conditions of the Department of Telecom (DoT). The policy also required all operators who were under the fixed licence fee regime to migrate to a revenue sharing regime. The Union Cabinet based on the recommendations of Group of Ministers (GoM) on Telecom matters (constituted in Sep 2003) approved the policy for licensing of Unified Access Services (UAS). After considering the recommendations submitted by Telecom Regulatory Authority of India (TRAI) on 27 Oct 2003, Cabinet Guidelines for issue of licenses under UAS were issued on 11 Nov 2003. Thereafter licences were issued only under UAS.

In October 2003 TRAI envisaged full implementation of the new regime to be completed in two phases. Phase I was the first step of migration of existing licensees to the Unified Access Service Licensing (UASL) Regime. This was to be followed by a second phase of a fully Unified Licensing Authorisation Regime having all telecom services under one licence. This was for grant of licences to new operators. However, the benefits of Phase-I were to be extended to new operators. Spectrum was to be delinked from licenses.

| | |
|---|---|
| - All the existing BSOs and CMPSs were given option to migrate to UASL regime; BSOs to pay the difference of entry fee paid by them and as paid by the fourth CMTS operator in 2001; CMTS operator at nil entry fees.<br>- 51 new UAS licences were awarded between 2004 to March 2006 at the entry fee determined in 2001.<br>- 122 new UAS licences awarded in 2008, also at the same entry fee of 2001. | -One-time entry fee before signing the licence agreement.<br>- A fixed percentage of Adjusted Gross Revenue (AGR) as annual licence fee.<br>- A fixed percentage of Adjusted Gross Revenue (AGR) of mobile services as annual spectrum charge |
| Approvals were issued in 2007-08 for dual technology (for using both CDMA and GSM) in 35 service areas at the entry fee equivalent to the migration fee fixed in 2001. | One-time entry fee equivalent to migration fee for UAS based on 2001 entry fee of CMSPs was charged for allowing DT in 2007. Revenue sharing as for UAS 2003. |

Audit pointed out that DoT did not work towards achieving the objective of Unified Licensing. It implemented only Phase-I that too in an arbitrary manner ignoring the concerns raised by the Finance Ministry, Prime Minister and the Law Ministry. DoT without framing guidelines for UASL continued to receive the applications for new licences. DoT issued UASL guidelines in Dec 2005 and at that time also spectrum was not delinked from licence as intended through the 2003 policy.

As per guidelines issued for UASL (2005), telecom licences were to be issued on continuous basis without any restriction on the number of entrants in a service area and applications were to be processed within 30 days of submission. Allocation of radio-spectrum and grant of wireless licence was subject to availability and in case UAS licensee was not allocated spectrum due to non-availability, the Licensee was required to endeavour to roll out services using wire-line technology. DoT did not process the applications for issue of UAS licence within stipulated period and delayed inordinately. In 2004-05, 14 out of 15 applications for grant of UAS Licences were delayed by 608 to 969 days. In 2005-06, all 9 applications were delayed by 232 to 421 days. All 29 applications for issue of new UAS Licence received in 2006-07 were not processed till October 2007 without assigning any reason/justification on records and without sending any communications to the applicants.

Keeping applications pending, DoT sought recommendation from TRAI in April 2007 on the issue of limiting the number of access providers in each service area. TRAI, in its report (28 Aug 2007) recommended 'no cap' on the number of licences. Disregarding this, DoT on 24 Sep 2007 DoT issued a Press Release stating that applications for issue of licences would be accepted only up to 01.10.2007. This led to a sudden spurt in applications. In addition to pending 167 applications another 408 more applications were received in next 8 days making the total 575. DoT on the orders of the then Minister considered only applications received up to 25 September 2007 for issue of LOI. The Applications received would be decided on FCFS (First come) basis. The 2-G spectrum would be sold at 2001 price.

DoT had not taken into consideration the concerns of Ministry of Finance, Prime Minister on discovering the price of spectrum and concerns of the Law Ministry on the bidding process.

DoT through a Press Release in the afternoon of 10 Jan 2008 informed that Companies who had submitted applications on or before 25/09/2007 to depute their authorized representative at 3.30 PM on 10 Jan 2008 to collect response(s). DoT found 121 applications from 16 applicant Companies eligible and issued Letter of Intent (LoI). DoT issued UAS licenses to be effective from 25 Jan 2008. DoT did not follow its own policy of FCFS and issued licences arbitrarily to applicant who did not meet the Dec 2005 DoT Guidelines. Audit pointed out that DoT issued 85 licenses to 13 applicant Companies who used fraudulent means for getting UAS licenses and thereby access to spectrum. They were allowed by DoT to suppress facts, disclose incomplete information and submit fictitious documents. Of them 13 applicants were even ready with Demand Drafts (DDs) drawn on dates prior to the notification of cut-off date. An applicant also submitted the Performance Bank Guarantee (PBG) and Financial Bank Guarantee (FPG) of the Punjab National Bank prepared on 10 Jan 2008.

Unitech Group (Uninor) (real estate companies Unitech Builders & Estates Pvt. Ltd, Hudson Properties Pvt. Ltd, Nahan Properties Pvt. Ltd, Aska Projects Ltd, Volga Properties Pvt. Ltd, Adonis Projects Pvt. Ltd) suppressed/ misrepresented the facts. Similarly Allianz Infratech Private Limited (Merged with Etisalat DB Telecom Private Limited), Shipping Stop Dot Com (India) Private Limited (later on changed to Loop Telecom Private Limited), Datacom Solutions Private Limited (later changed to Videocon Telecommunications Limited), Swan Telecom Private Limited (Now Etisalat DB Telecom Private Limited -Reliance), S Tel Private Limited, Azare Properties Limited

Revenue received from 122 new UAS licences awarded by DoT at 2001 price was ₹ 9,014 crore. Audit pointed out that when compared to the price offered by S Tel in Dec 2007 in some other context, the revenue that could have been realised from these licences was ₹ 38,950 crore. When compared with the subsequent sale value of equity by Unitech etc., the revenue that could be realised was ₹ 40,442 crore. When compared to the reserve price for 3G fixed by TRAI the revenue that could have been realised was ₹ 1,02,498 crore.

Audit pointed out that the process of award of 35 Dual Technology licences (DT) to existing operators also lacked transparency and fairness. DoT extended undue benefit to Reliance Communications Limited (four companies) and undue advantage to Swan Telecom. Application of Reliance to use GSM technology was processed with undue haste in 2008 (similar applications (Tata Teleservices etc.) remained pending till 2010). Revenue received on awarding 35 Dual Technology licences by DoT at 2001 price was ₹ 3,372 crore. Audit pointed out that when compared to the price offered by S Tel in Dec 2007, the revenue could have been ₹ 17,945 crore. When compared with the subsequent sale value of equity by Unitech etc., the revenue could have been ₹ 15,132 crore. When compared to the reserve price for 3G fixed by TRAI the revenue that could have been realised was ₹ 37,154 crore.

DoT allotted spectrum beyond the upper limit to 9 operators including Bharati, IDEA, and Vodafone etc. Realisable revenue on allotting spectrum beyond the contracting quantity of 6.2 MHz in these cases would be ₹ 36,993 crore. (Union 19 of 2010-11)

Auction of captive coal blocks

In the interest of increasing the supply of coal in India for power generation, manufacture of iron, steel and cement etc., Government of India during the period 1993 to 2010, allocated 70 coal mines or blocks to both PSUs and private companies. Audit observed that Secretary Coal on 28 June 2004 initiated the proposal of allocation of coal blocks through competitive bidding. The note to Minister of State, Coal and Mines highlighted that "...since there is a substantial difference between price of coal supplied by Coal India and coal produced through captive mining, there is a windfall gain to the person who is allotted a captive block..... It was, therefore, felt necessary by Ministry of Coal (MOC) to adopt a selection process which could be acceptable as demonstrably more transparent and objective. Auctioning of blocks was considered as one of the widely practiced and acceptable selection process which was transparent and objective". Subsequently a Cabinet Note in these lines was initiated.

In meeting taken by the PMO on 27 May 2005, it was decided that MOC would amend the Cabinet Note to take into account the concerns of the State Governments, where the coal blocks were located. It was decided that pending amendment of the Coal Mines (Nationalisation) Act, 1973 and Mines and Minerals (Development and Regulation) Act, (MMDR Act) 1957, MOC would continue to allot coal blocks for captive mining through the extant Screening Committee procedure till the new competitive bidding procedure became operational.

Since 1993, allocation of coal blocks made by the MOC was based on the recommendations of an Inter-Ministerial Screening Committee under the chairmanship of Secretary (Coal). The criteria included specifying the period for implementation of the mine plan duly backed by a bank guarantee, specifying provisions for cancellation of the allocation for non-adherence to milestones laid down for coal production and providing for monitoring of the progress by the MOC and by the Coal Controller.

The discussion on competitive bidding for allocation of coal blocks within the Government went on for several years. The MMDR Amendment Act was passed in 2010. The amendment in the MMDR Act, rules for auctions by competitive bidding of coal mines were notified only in February 2012. During the intervening period Ministry held meeting with stake holders to discuss the modalities of competitive bidding and draft bid documents. Till such time (March 2011) 194 coal blocks were allocated by MoC for captive mining.

Audit pointed out that the process followed by the Screening Committee lacked transparency, objectivity and competition. Minutes of the Screening Committee did not indicate how each applicant for a particular coal block was evaluated. There was nothing on record in the minutes or in other documents on any comparative evaluation of the applicants for a coal block which was relied upon by the Screening Committee.

Audit attempted to estimate the financial impact of the benefit to the coal blocks to the private companies. Audit scope excluded PSUS and Joint Ventures of PSUs are excluded and Ultra Mega Power Projects as they were based on tariff bidding. The calculations indicated that financial gains to the private companies was to the extent of ₹ 1,85,591 crore. Audit stated that a part of this financial gain could have been tapped by the timely action on competitive bidding. (Union 7 of 2013)

| Particulars | Extractable Reserves of OC (in million tonne) | Average Sale Price of all grades of CIL OC Mines for 2010-11 (₹ per tonne) | Average Cost Price of all grades of CIL OC Mines for 2010-11 (₹ per tonne) | Financing Cost as stated by MOC (₹ per tonne) | Net Gain (₹ per tonne) | Financial Benefit (₹ in crore) |
|---|---|---|---|---|---|---|
| Opencast Mines allocated to Private Parties | 3,970 | 1028.42 | 583.01 | 150 | 295.41 | 117,276 |
| Mixed Mines allocated to Private Parties where Mining Plans are available | 1,010 | 1028.42 | 583.01 | 150 | 295.41 | 29,853 |
| Mixed Mines allocated to Private Parties where MPs are not available | 1,302 | 1028.42 | 583.01 | 150 | 295.41 | 38,463 |
| Total | 6,282 | | | | | 1,85,591 |

Audit adopting the following methodology:

Out of 75 private allottees, 57 were allotted blocks with OC/ Mixed (partly OC and partly UG) mines. The financial impact of the benefit to the private allottees has been estimated confining to Open Cast (OC)/ OC reserve of Mixed mines only. In absence of reliable data regarding operating cost of UG mines by private parties, the Under Ground mines have been excluded from the computation of financial benefit.

Geological Reserve (GR) figure for each coal block was taken from Mine Plans (MP) where available. In other cases figures available from the Status Report prepared by Coal Controller's Organisation or website of MOC have been considered. Extractable Reserve (ER) was taken from MP. Where MPs are not available, the ER has been considered at 73 per cent of Geological Reserve (GR) in cases of QC blocks based on the Expert Committee Report on Road Map for Coal Sector Reforms. In Mixed mines, where MPs were not available, the OC extractable reserve has been considered at 37 per cent of GR on conservative basis. Average per tonne cost of production of all grades of coal produced in open cast mines of CIL and its subsidiaries pertaining to the year 2010-11 as per Final Cost Sheet have been considered. Sale price has been taken on average basis of all grades of coal produced in (open case) OC mines of CIL for the year 2010-11 as per Final Cost Sheet. As per MOC, the Financing Cost ranges from ₹ 100 to ₹ 150 per tonne over and above CIL's cost of extraction. Therefore, an additional financing cost of ₹ 150 per tonne has been considered.

Total extractable reserve of a coal block could be extracted over the lifetime of a block as per its mining plan. In the absence of this data, Audit has taken the currently available audited figures (sale price, cost price, and financing cost) of Coal India Limited as reference values in order to arrive at financial gain to allottees on indicative basis.

Dual Freight Policy with regard to Iron Ore

With the primary objectives of lowering the cost of transport of 'Iron ore' for domestic producers and to keep freight charges for export of Iron ore in sync with its rising international spot market prices and garner high freight revenues in the event of increase in international price of Iron ore, Indian Railways introduced (May 2008) the Dual Freight Policy (DFP). Transportation of 'Iron ore' was categorised into two classes on the basis of end use viz. 'domestic consumption' and 'other than domestic consumption (export)'. Transportation of iron ore meant for exports attracted higher freight rate.

Audit examined related records for the period from May 2008 to Sept 2013 covering 83 out of 97 main loading points at 7 Zonal Railways and 180 out of 198 unloading points across 15 Zonal Railways. Records included rake allotments, Central Excise duty returns, Annual Accounts of consignees etc. Audit pointed out the following lapses on the part of Railway official that led to widespread misuse of the benefit.

Railways accepted indents of 225 consignees without obtaining prescribed documents and allotted & booked 'Iron ore' in 2079 rakes charging freight at domestic rates. This led to freight evasion of ₹ 957.74 crore. Acceptance of partial documents and allotting rakes (5083 over 5 Zones) and booking iron ore in respect of 218 consignees at domestic rates by Chief Goods Supervisor/Chief Goods Clerk/ Sr. DCM, led to freight evasion of ₹ 2,309.06 crore. The booking of 190 rakes for 49 consignees who submitted invalid documents resulted in freight evasion of ₹ 108.42 crore. Audit found discrepancies such as Affidavit without RR numbers and/or dates or with dates much earlier than or after RR date, signature of deponent not present in affidavit, Forwarding Note not endorsed for domestic use etc., in 5041 Railway Receipts (RR) in respect of 205 consignees. Penalty of ₹ 10,583 crore (four times of the freight) was leviable.

At 108 unloading points in 15 Zones, out of 20516 RRs, in 15889 RRs either Affidavit or Indemnity Note or both were not submitted or documents submitted were found deficient resulting in freight evasion ₹ 4,508.61 crore.

Audit examined Excise Returns in respect of 188 Iron and Steel Manufacturing Units out of 303 from Central Excise Department and compared with the total quantity of 'Iron ore' transported at domestic consumption rate by these Consignees obtained from CRIS data. The quantity shown as received in Excise Returns by the consignees was less than the quantity transported by rail by 71.22 lakh MT in case of 61 in Iron and Steel Manufacturing Units. Diversion of iron ore which was transported at domestic consumption rate, before entering the factory premises attracted a penalty of ₹ 5,096 crore, which was not levied. (Para 2 Union Railways 14 of 2015)

Doordarshan Revenue

In terms of provisions of Guidelines issued by the Directorate General (DG), Doordarshan (DD) in May 2004 regarding telecast of TV programmes under Doordarshan 'Sponsorship Scheme', actual duration of any programme should not exceed 22 minutes 30 seconds for a 30 minutes slot, including opening and closing credit lines and recapitulating summary of previous episodes. The Guidelines further stipulate that any excessive use beyond the limits would be charged at commercial rates i.e. Spot Buy Rate (SBR) as per Doordarshan Commercial Rate Card. The SBRs as per the rate card were ₹ 1500 to ₹ 8000 depending on the time of telecast and type of programme. Test check of 12 sponsored programmes telecast during September 2008 to August 2009 through Doordarshan Kendra (DDK), Kolkata revealed that in 402 episodes the actual duration of telecast exceeded the prescribed telecast time per episode by 11298 seconds. Audit noticed that although the DDK, Kolkata had recorded the excess duration in the 'Preview Register', no charges were levied on the concerned producers/agencies for excess use beyond the limits. The charges payable in this regard amounted to ₹ 59.49 lakh as per SBR applicable. (Union Report No. 33 of 2011-12)

Electricity charges

The West Bengal State Electricity Distribution Company Limited (Company) classifies consumers as Low & Medium Voltage (L&MV) having contract demand less than 50 KVA and as High Voltage (HV) having contract demand more than 50 KVA. The Company was required to install appropriate checks and balances in its consumer billing software, so as to automatically convert L&MV consumers persistently drawing beyond the threshold limit of 50 KVA, to HV category, so as to avoid revenue loss.

Test check of consumer billing records in 19 divisions (Apr 2009 to Dec 2009) revealed that L&MV tariffs continued to be applied in case of 99 consumers across eight divisions 20, in spite of these consumers drawing power ranging from 52 KVA to 238 KVA for periods ranging from three to 43 months, thereby attracting higher tariff rates applicable to HV consumers. This led to loss of additional revenue worth ₹ 1.53 crore from Apr 2007 to Dec 2009 from these consumers. (WB 2009-10)

In Uttar Pradesh, the consumers having load of one kW with restriction of consumption of energy up to 150 units has been categorised as *lifeline consumers*. Lifeline consumers shall be billed at the rate of ₹ 1.90 per unit up to 100 units and at ₹ 2.50 exceeding 100 units up to 150 units and fix charges at the rate of ₹ 50 per kW. If consumption exceeds 150 units in any month billing was to be done at the rate of ₹ 3 per unit up to 200 units and at the rate of ₹ 3.30 per unit if it exceeds 200 units. Consumers *other than*

*the lifeline consumers* were required to be billed at the rate of ₹ 3.00 per unit up to 200 units and at the rate of ₹ 3.30 per units for units exceeding 200 for all loads.

Audit noticed from scrutiny of databank relating to the period May 2008 to March 2010 deficiencies in application control resulted in loss of revenue from incorrect billing. In the case of life-line consumers, for example in 14331 cases where the consumption exceeded 150 units and remained up to 200 units, the rate of ₹ 3.00 per unit was not applied resulting in short assessment of ₹ 19.36 lakh. Similarly, in 307289 cases where the consumption exceeded 200 units, the rate of ₹ 3.30 per unit was not applied resulting in short assessment of ₹ 66.57 lakh.

In the case of other than the lifeline consumers, in 169757 cases of provisional billing relating to the period from May 2008 to March 2010 energy consumption was assumed at the rate of 80 units per kW and energy charges was applied at the rate of ₹ 120 per 80 units instead of at the rate of ₹ 3 per unit as per the rate schedule. This resulted in short recovery of energy charge of ₹ 561.39 lakh. In 200558 cases of billing the OLB system did not correctly apply the rate of ₹ 3.30 per unit where consumption exceeded 200 units. This resulted in short assessment of energy charges of ₹ 32.87 lakh. (Para 2.3 UP Commercial 2009-10)

The Madhya Pradesh Power Trading Company Limited (Company) is responsible for trading of Power on behalf of three Power distribution Companies of the state of Madhya Pradesh. The Company agreed (April 2010) for sale of power to Lanco Power Trading Limited, Gurgaon (Purchaser) on firm basis at the pre-determined rates for the specified contracted quantum of power on monthly basis. As per the agreement between the parties, the Purchaser had to provide weekly revolving letter of credit (LC) equivalent to 30 days of energy billing in favour of the Company and the LC shall be available for all unpaid dues towards energy charges, compensation dues, penalty, open access charges and surcharge. Also if the Purchaser failed to schedule (purchase) 80 per cent of energy approved by the Regional Load Despatch Centre on monthly basis, it shall be liable to pay compensation at ₹ 2 per Kilowatt hour (Kwh) for the shortage quantity within 15 days from the date of receipt of invoice. Further, surcharge at the rate of 15 per cent could be levied in case of failure to pay the compensation in time for the period of delay. Audit scrutiny (May 2011) revealed that the Purchaser failed to purchase the power as stipulated in the agreement during the period July 2010 to March 2011. MP Power Trading Company failed to collect the dues from Lanco amounting to ₹ 65.51 crore. (3.6 MP 2 of 2013)

Highway toll collection

National Highways Authority of India (the Authority) executed the work of construction of Allahabad Bypass Road from 158.00 Km to 243 Km of NH 2 at a total cost of 1502 crore. The project was completed on 15 Oct, 2009. In accordance with the National Highways Fee (Determination of Rates and Collection) Rules, 2008, (toll rules), in case of public funded projects the collection of toll shall commence within 45 days from date of completion of the project. Delay in decision making by NHAI and Ministry of Road Transport and Highways (MoRTH) resulted in signing agreement with the toll collecting agency on 31 July, 2012. This resulted in revenue loss of ₹ 150 crore. (Para 14.1 Union 19 of 2013)

Sale of public sector entities

The Government of Uttar Pradesh (UP) decided (June 2007) to sell 35 sugar mills under Uttar Pradesh State Sugar Corporation Limited (UPSSCL) and Uttar Pradesh Rajya Chini Avam Ganna Vikas Nigam Limited (UPRCGVNL). Sale of 10 operating mills of UPSSCL and 11 closed mills of UPRCGVNL were completed in October 2010 and March 2011 respectively.

In July 2009 UPSSCL appointed S. R. Botliboi (SRB) and K. R. Bedmutha (KRB) as Asset Valuers for valuation of 11 operating mills of UPSSCL with directions to submit their valuation reports for each of sugar mill as per four methodologies suggested in the guidelines. On 10 Feb 2009 IFCI was appointed as disinvestment Consultant/ Advisor with the responsibility of examination and presentation of valuation reports submitted by the Valuers, to the CGD (Core Group of Secretaries on Disinvestment). The CGD was responsible for making final recommendations for Reserve Price to Cabinet/CCD after due deliberations.

Audit pointed out the following irregularities in the valuation of 10 operating sugar mills of UPSSCL at different stages of the valuation process:

Reduction in the value of land by 3 to 30 per cent by the Advisor on the ground of disputes over the land despite the fact that this factor had already been considered by the Valuers (₹ 90 crore);

Additional discount of 25 per cent on land and buildings allowed by the Advisor on the grounds of restricted land use, large size of land etc., and application of DCF method and more weightage to it for valuation (₹ 243.48 crore)

Valuation of plant and machinery as scrap though operational (₹ 82.08 crore)

Clubbing of land of old/non-operating mill with that of new mill (₹ 223.72 crore)

The above resulted in reduction of valuation of 10 sugar mills of UPSSCL by ₹ 639 crore and lowering of Expected Price. Audit observed that the Advisor received the

recommendation on the valuation of the mills on 20 Aug 2009 at 11.00 AM from Valuers and revised the methodology of valuing on the same day at 06.30 PM stating that revision was based on the deliberations of the meeting with the CGD.

Audit pointed out the following irregularities in the valuation of 11 closed sugar mills of UPRCGVNL different stages of the valuation process.

Valuation of Land of closed sugar mills was much lower than that assessed in 2007-08 by the Valuers during first attempt of disinvestment,

Undue reduction of five per cent in the valuation on account of stamp duty, registration fees etc. (discount on stamp duty registration was ₹ 10.16 crore),

Further unjustified reduction of ten per cent on account of large size of land and non-marketability ₹ 19.29 crore), and

Valuation of Plant and Machinery at lower scrap value (₹ 43.20 crore)

Thus, in respect of ten operating mills of UPSSCL and 11 closed mills of UPRCGVNL, there was reduction of ₹ 840 crore in valuation and Expected Price.

The criteria laid down by the Government were (a) Reserve Price should not be fixed by the Government before the bidders submit their financial bids, so that there is no chance of the bidders knowing the Reserve Price fixed by Government. (b) The Government should not have knowledge of the price bids submitted so that the fixing of the Reserve Price is not influenced by such knowledge. Government violated them and arrived at Expected Price rather than Reserve Price. Government further reduced the Expected Price by providing for Transaction Development Cost (₹ 5.25 crore) and Contingent Liabilities (₹ 24.10 crore). Government disclosed the Expected Price to the bidders on 26 Aug 2009, i.e. before submission of Request for Proposal. After the receipt of EOI-cum-RFQ from Bidders, the Government introduced Swiss Challenge Method (SCM) in the bidding process on 30 July 2009 stating that SCM would be adopted if the value of highest bid is less than the Expected Price. Audit commented that there was lack of competition in the bidding process. Audit pointed out that there were several apparent indications like common Directors and Shareholdings, same address and consecutive serial number for covering letter of bank guarantee indicating participation in bidding by Related Companies. These actions resulted in receiving consideration far below than the Expected Price of 14 mills (including 3 operating mills) out of 21 mills sold. In six cases, the bid prices received were marginally above (1.86 per cent to 9.87 per cent). Only in one case the bid price was 22.93 per cent higher than the Expected Price. In respect of three mills of UPSSCL only ₹ 166.85 crore could be realised against Expected Price of ₹ 291.55 crore. In case of UPRCGVNL only ₹ 91.65 crore was realised from 11 mills against total Expected Price of ₹ 173.63 crore. (PA UP 2010-11)

Revenue from production sharing contracts

In 1999 Government of India formulated a policy called the New Exploration Licensing Policy (NELP) under which Oil and gas Exploration blocks in onshore and offshore were to offered private parties. In March 2002 it invited for 27 blocks and signed 23 that included 9-Deepwater, 6-shallow and 8-onland. By 2015 Government signed about 300 production sharing contracts. In a production sharing model the contractor undertakes the initial exploration risk. If the field is not found productive the contractor bears the risk. If found productive the contractor (operator) recovers the exploration and development cost called cost recovery component (investment) and shares the profit from commercial production of petroleum thereafter, called profit petroleum

Government receives a share of petroleum profit apart from royalty and licence fee based on investment multiple (IM). IM ratio slabs, on the basis of which profit petroleum split is decided, are stipulated in the (Production Sharing Contract) PSC, and are based on the bid made by the Contractor during the process of award of the block. Usually, higher the IM ratio, higher is the Government share. Contractor also receives tax incentives. There will be a management committee (MC) with members from both sides to safeguard the commercial interest of two parties.

Audit findings of PSC KG-DWN-98/3 awarded to Reliance Industries Limited indicated that in this model operator has incentive to inflate exploration and development costs, manipulate the IM in his favour (retain the IM in the lower slabs or to delay movement to the higher slabs) and thus maximise his revenue at the cost of revenue due to the Government.

After exploration of phase-1 the contractor/operator had to retain only the contract area and relinquish the remaining area before entering the subsequent phases of exploration. Ministry of Petroleum and Natural Gas (MoPNG)/Director General Hydrocarbons (DGH) allowed the contractor/operator to retain the entire area of 7645 sq.km and treat it as 'discovery area'. As per PSC provisions the Operator cannot do any further exploration activity in the discovery area. MoPNG/DGH allowed operator to do further exploration activities in the 'discovery area' at an expenditure of US$ 427.03. Audit pointed out that this had to be recovered from the revenue of the commercial discoveries already made in the block by the operator. Operator was not eligible to dig appraisal wells in this area. Still it did and claimed cost recovery of US$160.81 million and got it. Further MoPNG/DGH did not disallow US$ 118.99 million on four exploration wells that did not result in commercial discovery resulting in undue benefit to the operator.

The Operator was required to drill, connect and put on stream 22 wells in the contract area as per approved phase I. Operator did this only on for 18 wells. In some of the cases audit pointed out that Operator incurred expenditure before MC approval citing delays in approval. Audit had recommended for disallowance/adjustment of cost recovery amounting to US$ 690.70 million comprising of: expenditure related issues (US$ 386.83 mn), revenue issues (US$ 250.93mn) and accounting issues (US$ 52.94 mn).

They include the following.

Operator awarded a contract relating to Engineering, Procurement, Installation and Construction (EPIC) of offshore facilities to a vendor that included concessions of Euro 200 million (approximately) that was not to be allowed as cost. Dry docking facility for Floating Production Storage and Offloading facility (FPSO) was contracted for ten year. Its extension to 15 years for one-time compensation of US$ 17.36 million was not in order. To the same vendor operator paid compensation of US$ 45 million to the vendor for early mobilization of the vendor's commissioning team and expediting deliveries of top side modules etc., though there was no provision in the agreement which entitled the vendor to any such compensation.

The Operator did not consider long-term hiring of drilling rigs and availing the firm rate advantage of long-term hiring, despite having adequate drilling prospects and the market having scarcity of deep-water drilling rigs. This resulted in additional expenditure of approximately US$ 88.77 million.

The Operator awarded four contracts relating to construction of Onshore Terminal (OT) on cost-plus basis. In such a case, payment of compensation was to be made to the vendors only on the 'cost' incurred by vendor plus a mark-up on such costs. The Operator also paid the vendor ₹ 1110.90 million as mark-up compensation on the value of 'free-issue material' such as cement, steel, etc. supplied by the Operator.

The Operator is charging, from its consumers, gas price at the rate of US$ 4.340 per mmbtu which includes the gas price of US$ 4.205 per mmbtu and marketing margin of US$ 0.135 per mmbtu. However, the operator has not included the marketing margin as revenue of the Block for the purpose of Cost Petroleum, Profit Petroleum and Royalty. Cost Recovery of US$ 235.20 million (90 per cent) has not been adjusted in the recovered cost up to 2012-13.

Parent Company Overhead (PCO) of US$ 40 million charged by the Operator for cost recovery up to the financial year 2007-08 under Section 2.6.2 of Accounting Procedure of PSC was disallowed by the Management Committee (MC) in 2008-09, on the ground that Operator (RIL) has no parent company. However, Contractor has reclassified and claimed these expenditures amounting to US$ 101.41 million (up to 2011-12) under Corporate Office Support (COS).

The pricing mechanism for Crude from MA oilfield had not been finalized and approved by MoPNG and the sales were being treated as provisional by the MoPNG. However, the Operator was treating the sales as firm and final. Marker has not been fixed so far leaving scope for ambiguity in pricing. The pricing and sale of Condensate has not yet been approved by the GoI and is being sold at a discount value below Dated Brent. The difference between the sale value of Dated Brent and KG-DWN-98/3 Condensate amounted to US$ 33.93 million during the period July 2010 to March 2012.

(Union 19 of 2011-12 and 24 of 2014)

## CHAPTER -16

# Compliance Auditing of Tax Revenue–Union

Tax payers and potential taxpayers are the ones who comply or ought to comply with the tax laws and rules. Tax revenue departments enforce the compliance of tax laws and rules. Tax departments make the tax payers and potential tax payers comply with the tax laws and rules. Compliance auditing of tax revenue seeks to examine the extent to which the tax revenue department is able to enforce the tax laws and rules and thus safeguard the resources that are being mobilised. Tax departments would have laid down operating procedures and rules on how to enforce the tax laws. Examination of tax officials' compliance with these operating procedures meant to help in enforcing tax laws is also the subject matter of compliance audit of tax revenue. The cost of tax collection is met through the expenditure from its Demand for Grants approved by the legislature. Compliance with the spending rules like all the expenditure departments is also the subject matter for compliance auditing of revenue department. This is referred to expenditure audit of tax department.

Activities of a Tax Revenue Department can be viewed in four stages; planning, preparedness, implementation and reporting.

| *Tax Administration* | *Safeguard of Tax Resources* | *Accounting* |
|---|---|---|
| Planning (tax base, tax rate, elasticity)<br>Preparedness to implement tax policy and Execution (Tax Administration) by way of identifying tax payers, tax assessment, levy and collection of and reporting. Income Tax, Central Excise, Service Tax, Customs Duties- Union; Sales Tax (VAT), State Excise, Motor Vehicle Tax, Stamp Duty etc.- States. | Controls (over assessment, levy and collection of tax revenue) that seek to ensure that enforcement of tax payer's compliance (across the tax base) with the tax laws is consistent, uniform and correct. Seeking to safeguard the money that is due to government. | Accounting of receipts in the concerned books of accounts, their compilation, their consolidation |

Taxation apart from mobilising the resources for public spending is also used as fiscal instruments to influence economic activity and achieve social goals. We can translate the aims and objective a tax department into three broad Audit Objectives.

A. Is the tax policy fair, equitable and progressive?
B. Is the tax administration efficient and effective in mobilising the resources?
C. Is the resource utilisation (cost of collection) of tax department economical?

Tax administration is about tax officials enforcing the compliance of tax laws and tax rules by following the laid down procedures and professional standards. Tax administration, theoretically revolves around (a) identification of tax payers/ potential tax payers, (b) assessment of their taxable income/sale, both revealed and concealed (c) levy of tax after working out the tax/duty and (d) collection of tax/duty.

However, day to day tax administration is a little simpler. Majority of the existing taxpayers assess the tax due from them on their own or with the help of a tax practitioner. It is called self-assessment. They pay the tax amount and file the tax return (voluntary compliance). Much of the tax is paid in advance. These returns are processed in an automated system, called summary assessment. The system identifies the amount to be refunded or additional amount to be collected with reference to the information provided by the tax payer in the tax return.

A small sample of tax returns is subjected to detailed scrutiny/assessment by the designated tax assessment officers. They examine the records in detail, if necessary by seeking additional information and carrying out investigation. This brings out income if any which has hitherto not been taxed due to interpretation or concealment. The sample to be subjected to detailed assessment is generated through IT system that examines all available transactions of the tax payer by applying several risk factors. Assessing officers carry out detailed assessment/ scrutiny of selected tax returns wherein the assessee or his representative is given the opportunity to explain the details given in the return and support his claim based on the documents and other evidence. The details of the hearing given and the documents are mentioned are recorded in the assessment file. The Assessing Officer issues a Assessment order. A demand or refund notice is issued to the assessee.

The Assessing Officer also issue various ancillary orders like rectification order correcting any apparent mistakes, order giving effect to appeal order, penalty etc. Re-assessments are done with approval of appropriate authority in cases where it is noticed that there are some mistake in the earlier processing. The proceedings of the re-assessments are similar to the scrutiny assessment but limited to the issues involved in the re-assessments. Commissioners review a sample of assessment orders issued by Assessing Officers of his jurisdiction. If the review shows that there is any escapement of revenue due to not making any addition or wrong deduction, the Commissioners can reopen the assessment for fresh assessment of the case. The assessing officer is empowered to exercise discretion subject to the provisions of the Act and judicial pronouncements in discharge of his functions. Audit usually does not question the discretionary powers unless there is clear evidence of inconsistency in application of Rules.

Detailed assessment is a deterrent mechanism to ensure that the assessees disclose the income/sale correctly or face the risk of paying of penalty and prosecution if there is any failure to properly disclose income in the return. Depending on the requirement tax officials

carry out investigation, search and seizure operations. This is followed by the preparing an appraisal report and assessment order. Tax violators may even be prosecuted for various acts of omission or commission as prescribed in the Act subject to a fair trial.

Tax laws also provide for dispute resolution and an appellate mechanism. An aggrieved assessee can appeal to the Commissioner (Appeals), to Tax Appellate Tribunal, to the High Court and the Supreme Court.

Revenue administration discharges both assessment and non assessment functions including (a) identifying the potential tax payer, (b) educating tax payers, tax practitioners, (c) facilitating and promoting voluntary compliance (d) summary assessment, (e) identification of high risk tax areas and payers, (f) detailed scrutiny/assessment, (g) investigation, search, seizure, (h) prosecution of offenders and (i) recovery of tax arrears fallen due; they are broadly grouped into assessment functions and non-assessment functions.

The purpose of the compliance auditing tax revenue is to derive an assurance that tax department has identified potential tax payers; correctly assessed, levied and collected the tax due while by correctly allowing exemption, deduction, incentive, remission and rebate etc.

## INCOME TAX

Readers are expected to be familiar with the contents of Chapter 9 – Income Tax Revenue in the Public Expenditure, Revenue and Resource Management.

Compliance audit seeks to have an assurance on to what extent the income tax officials are able to make the income tax payers and potential tax payers comply with Acts, Rules, notifications/ instructions/circulars issued by Central Board of Direct Taxes to safeguard the revenue due to the Government Compliance Audit examines the application of following Acts, Rules and other binding directions relating to computation of total income taking into account the type and status of assessee, sources of income, entitlement of tax incentives, levy of applicable rate of tax and collection.

- Income Tax Act, 1961,
- Income Tax Rules, 1962
- Finance Acts and explanatory memoranda related to the Finance Act
- Notifications/ instructions/circulars issued by CBDT
- Judicial pronouncements

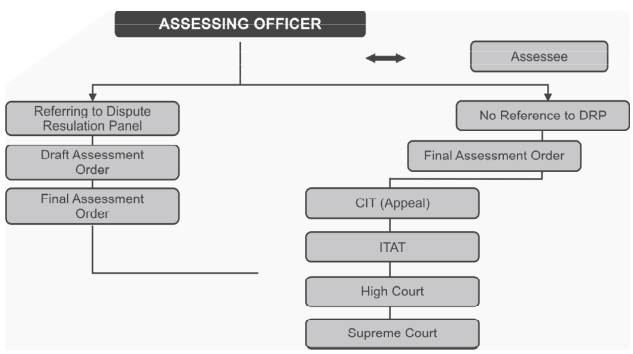
It is interesting to notice that most of the revenue (about 80%) is collected through voluntary self-assessment in the form of Advance Tax, Self-Assessment Tax, Tax deducted at Source (TDS), Tax Collection at Source (TCS). The table (next page) depicts various component of Corporate and non-corporate (Income Tax) Tax.

| Non-corporate assessees' collections | | | | | | | | | | (₹ in crore) |
|---|---|---|---|---|---|---|---|---|---|---|
| **Financial Year** | **TDS** | **Advance Tax** | **Self Assessment Tax** | **Regular Assessment Tax** | **Surcharge and Cess** | **Other tax receipt** | **Total Collection** | TDS to Total Collection (%) | Pre-assessment collection (% of Total Collection) | Regular Assessment Tax (% of Total Collection) |
| **2010-11** | 100,356 | 28,275 | 13,831 | 9,922 | 5,498 | 750 | 158,632 | 63.26 | 89.81 | 6.25 |
| **2011-12** | 106,705 | 42,640 | 14,016 | 11,482 | 5,120 | 1,420 | 181,383 | 58.83 | 90.06 | 6.33 |
| **2012-13** | 136,173 | 43,327 | 20,739 | 8,544 | 6,000 | 2,002 | 216,785 | 62.81 | 92.37 | 3.94 |
| **2013-14** | 165,104 | 47,172 | 25,271 | 12,102 | 7,629 | 2,475 | 259,753 | 63.56 | 91.45 | 4.66 |
| **2014-15** | 171,248 | 54,332 | 29,025 | 11,585 | 8,924 | 11,373 | 286,487 | 59.78 | 88.87 | 4.04 |
| **Corporate assessees' collections** | | | | | | | | | | (₹ in crore) |
| **2010-11** | 68,313 | 184,263 | 23,056 | 41,916 | 16,846 | 20,872 | 355,266 | 19.23 | 77.58 | 11.80 |
| **2011-12** | 91,974 | 208,886 | 13,632 | 40,030 | 24,309 | 19,285 | 398,116 | 23.10 | 79.00 | 10.05 |
| **2012-13** | 74,481 | 232,467 | 18,731 | 53,874 | 16,804 | 23,790 | 420,147 | 17.73 | 77.52 | 12.82 |
| **2013-14** | 83,443 | 245,350 | 18,852 | 60,426 | 24,175 | 29,605 | 461,851 | 18.07 | 75.27 | 13.08 |
| **2014-15** | 87,858 | 272,193 | 23,025 | 68,604 | 26,514 | 34,778 | 512,972 | 17.13 | 74.68 | 13.37 |

Income tax returns (electronic) received are summarily processed under section 143(1) of the Income Tax Act electronically at department's data centre (CPC-Central Processing Centre) located at Bangalore. The system examines whether the information in the return is internally consistent, any arithmetical mistakes and compares the information in the return with data collected and maintained by the department. After such summary processing an order under Section 143(1) is issued to the assessed giving details of the income and the tax determined and calling on the assessed to pay the differential income tax, if any. Same time excess tax paid is also refunded. Since erstwhile manual checks exercised by the department under section 143 (1), are now automated, Audit seeks to have an assurance on the functioning of the system.

*Scrutiny Assessment/detailed assessment*

A small per cent of the returns filed are selected annually for detailed scrutiny by using predetermined criteria. Selection is through a Computer Assisted Selection System (CASS) based on various predetermined parameters prescribed by the CBDT as well as based on the risk parameters locally decided by the concerned Prl CCIT/CCIT.



Detailed scrutiny (assessment) is a detailed examination of the books of accounts and other records of the assessees to verify whether the returns are filed properly, all incomes have been correctly disclosed, the deductions and exemptions are legally available to the assessee and correctly computed and the tax is correctly calculated and paid. This is a deterrent mechanism to ensure that the assessees disclose the income correctly or face the risk of penalty and prosecution if there is any failure to properly disclose income in the return.

Audit teams/parties examine a sample of assessment records to see whether taxable income and applicable tax was worked out correctly taking into account the incentives, deductions, exemptions, rebate, relief, carry forward, set-off, pricing, valuation etc. Audit teams correlate the information available in the documents. Some of the basic documents are:

Assessment Orders under different Sections of the Act;

Computation of income by assessee and Income Tax Department;

Return of income;

Annual Accounts including schedules and notes to the accounts thereto (including Ledgers and Journals, if available)

Tax Audit Report (TAR) given by the Accountant (Form No. 3 CD) and annex

Any other reports given by the Accountant as per the provisions of the Act

Details of information as to the income and expenditure furnished by assessee;

Information called by the Assessing Officer under section 142 or 133 etc.

Report of Transfer Pricing Officer, if any

Report of valuation cell or any other report by the department or government authority

Appraisal report (assessed due to search and seizure procedure or survey)

Past years Assessment Records, if necessary

Documents relating to TDS, advance tax and self-assessment tax

Agreements e.g., Sale Deed, Purchase Deed, Partnership Deed, Lease Deed, Deed for Amalgamation etc.

Depreciation schedules

Details of brought forward losses under various heads of income and amounts set-off in previous assessment years and

Any other information furnished by the assessee during the assessment proceedings

Assessments are audited in the office of the DCIT/ACIT/ITO based on the work distribution. Audit selects cases as per entries made in the Demand and Collection registers (D&CR). In this register all orders issued during a financial year are entered serially as per the date of order. The order issued relating to scrutiny assessment, rectification orders i.e. order issued to rectify apparent mistakes in the assessment order, order giving relief due to appellate orders and penalty order are entered in this register. Once the case records are furnished the assessments are scrutinized in audit. The case records contain the assessment

order, penalty proceedings/orders (if any), computation of income, copy of the return filed by the assessee, the tax audit report (3CD), the Annual Accounts and various submission given by the assessee. The following types of general checks are normally exercised in the audit of scrutiny assessment/re-assessment:

Legal compliance: whether assessment order is in conformity with the legal interpretation of the provisions of the Income tax act or rules as given by the jurisdictional ITAT, High Court or Supreme Court. Intention of the legislation can be seen from the explanatory memoranda of the concerned Finance Act by which the particular provision of the Section was introduced or modified.

Consistency in approach: whether department is consistent in its approach to the assessment. It is seen from the stand taken by the department on the persistent issues in the last years' assessment record. The change in stand can only be justified based on the new facts of the case or any legal pronouncement in the assessee's own case or in the similar case.

Correct claims: whether department has allowed only allowable and correct claim as per its record to the assessee. Audit examines the earlier years' assessment folders to ascertain the amount of set off of losses, MAT credit given in the order and in computation of tax.

Mistakes of facts: Whether any wrong facts are taken into account for computing the income. It is verified with reference to the information filed along with the Return of Income (RoI) and submission made later on.

Omissions during the proceeding: whether all additions and disallowance given in the assessment order are taken into account in the final computation of income; all facts and explanation received during the assessment proceedings are factored in while finalizing the assessment. Whether there are any totalling mistakes and calculation mistakes in the assessment order, returns or computation of the taxes/ interest/penalty.

Rectification orders, re-assessments are also examined in the similar lines. Audit also verifies the records of the Addl CIT/JCIT to see that proper direction are given to the assessing officers under Section 144A of the Act on the aspects to be verified during assessment and records to be maintained. In search cases the assessment is done for the period of six years. Audit examines whether disclosures of additional income made by the assessee and/or additional amount of income proposed to be added in the Appraisal report given by the Investigation wing after the search operations has been properly considered during the assessment proceedings. Audit verifies whether all the additions proposed in the appraisal report have been verified by the assessing officer and speaking order is given for the addition or for not making additions. For not making addition, there should be evidence of consultation with the Investigation wing and recorded/documented deliberations.

Scrutiny of Corporate Assessees- check list

**Income and Expenditure**

*Business expenditure*

Under the Act, expenditure not being capital expenditure or personal expenses of assessee laid out for business purposes is allowable expenditure.

Whether all expenditure including the Capital or Revenue Expenditures have been correctly classified and allowed/disallowed?

In the case of investment companies, whether sale of shares, held as stock in trade is offered as business income or claimed wrongly as capital gains?

Whether provisions for unascertained liability is not claimed as an expenditure? whether credit for all receipts that have become due during the relevant previous year has been taken; Expenses debited to the account pertain to relevant previous year only.

*Depreciation*

Whether the assets are actually owned by the assessee and used for the business/ profession?

Whether depreciation has been claimed as per the rates prescribed in the Income Tax Rules 1962?

While allowing depreciation on building, whether depreciation on land was correctly disallowed?

Whether depreciation on additions made to the assets are clearly bifurcated as less than 180 days and more than 180 days and depreciation has been restricted to 50% of the prescribed percentage for assets used for less than 180 days?

For the purpose of allowance of depreciation, whether the actual cost of the asset acquired was rightly reduced by the amount of capital subsidy (if any), duty of excise or additional duty leviable under section 3 of the Customs and Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules?

In case of leasing transactions, whether depreciation has been disallowed to lessor in respect of assets given on finance lease?

In the case of amalgamation/demerger etc., of a company whether unabsorbed depreciation has been regulated in accordance with provision of section 72A?

For allowance of additional depreciation, whether the assessee has been engaged in manufacturing activity? Whether additional depreciation has been claimed only on new plant & machinery purchased and used during the year? In case additional depreciation is claimed for less than 180 days in the previous year, remaining portion of additional depreciation can be claimed in the next year w.e.f. 1/4/2016 only.

Whether the information on brought forward depreciation loss has been duly furnished in Form 3 CD Report?

Whether brought forward unabsorbed depreciation has been correctly set off against the current year income?

Whether grant clause of the Public Private Partnership Agreement was properly interpreted? Whether the asset created under PPP model was allowed depreciation to the actual owner as per the Income Tax Act?

In the computation of income u/s 115JB, whether the method and rates adopted for calculating the depreciation were the same in respect of the profit and loss account prepared and laid before the AGM of the company in accordance with in accordance with the provisions of Companies Act, 2013?

Whether any disposed assets are still being shown in the schedule of assets and depreciation has been wrongly claimed thereon?

*Capital gains*

Whether to compute the capital gain, benefit of cost of indexation was given only in cases of Long Term Capital Assets?

Whether capital gain/loss arisen on the disposal of the asset on which depreciation has been allowed is treated as short term capital gain/loss irrespective of the period of holding of this capital asset by the assessee?

Whether correct rate of tax was applied to the capital gain aroused from STT paid security and STT not paid securities?

Whether in case of slum sale tax is levied as per the rate applicable to the short term capital gain?

In case of value of land or building or both is less than the value decided by the stamp valuation authority, whether tax was levied by taking value decided by the stamp valuation authority as sales consideration?

*Unexplained investment*

Whether income from undisclosed sources or unexplained nature has been brought to tax e.g., cash credit u/s 68, unexplained investments u/s 69, unexplained money u/s 69A and unexplained expenditure u/s 69C?

Whether any loss is not set off from such income?

*Carry forward and set-off of losses*

In cases of any carry forward & set off of business loss and unabsorbed depreciation it is seen whether:

The loss has not been carried forward for more than 8 assessment years immediately succeeding assessment year for which loss was first determined.

No loss is allowed to be carried forward unless the assessee has filed the return of loss voluntarily within due date or within time as may be allowed by the department.

Loss set off during the year was actually allowed to be carried forward during previous assessment.

Carried forward business loss of previous year is not set off against income under other heads.

Deductions under chapter VIA are admissible only to the extent of income available after set off of unabsorbed loss, depreciation, investment allowance etc., of earlier years. When business income is nil or loss, no deduction under chapter VIA is admissible.

**Incorrect allowance of deductions/ exemptions/Rebate**

Whether the exemptions/deductions under various sections have been correctly computed and allowed?

Whether assessee has valid registration to claim the specific deduction as prescribed in the concerned section?

Whether the deduction was claimed beyond the stipulated period?

Whether profit derived from Export is properly worked out for allowing deduction u/s 10A? ('Profits derived from Exports' = Profits of the business x ETO/TTO where ETO = Export turnover excluding expenses incurred in foreign exchange towards (i) freight, telecommunication charges and insurance attributable to export of the articles, etc., outside India, and (ii) provision of technical services outside India.)

Where the undertaking initially located in a Free Trade Zone or Export Processing Zone, was subsequently converted into a Special Economic Zone (SEZ). Check whether the period of 10 AYs is reckoned from the PY during which the undertaking originally commenced manufacture in the Free Trade Zone/Export Processing Zone but not from PY in which it was converted into a SEZ?

Whether deduction u/s 10B claimed beyond AY 2011-12?

Whether the export proceeds are received in India within 6 months from the end of the PY, or within the period extended by competent authority?

Whether the assessee has furnished Report of an Accountant in Form 56F certifying that the deduction has been correctly claimed?

*In case of deduction u/s 10A, it is to check whether: -*

The undertaking had begun manufacture, production of articles, things, computer software, after 01/04/2003, in any SEZ.

Has the undertaking begun manufacture/ production of the articles, software, after the PY relevant to the following AYs, in the following cases:

| | |
|---|---|
| Free Trade zone | 01/04/ 1981 or after |
| Hardware/Software Technology Park | 01/04/1994 or after |
| Special Economic Zone | 01/04/2001 or after |

*Whether deduction claimed is higher than deduction in r/o profits derived from exports to the extent of the business as follows :*

The 5 consecutive AY beginning with the AY relevant to PY in which the production begins- 100%; next 2 AYs -50%

Last 3 AYs -eligible profits to be debited to the P&L Account and transfer the same as 'SEZ Re-investment Allowance Reserve Account' in the Balance Sheet not exceeding 50% of the profits.

Whether the undertaking was formed by splitting up, or reconstruction of an existing business, or by transfer of used plant or machinery, to a new business?

Whether the assessee has claimed deduction u/s 80IA or 80IB against the profits in r/o which the assessee has claimed deduction u/s 10A or 10B?

Whether the income of the assessee include loss in respect of units covered by provisions of section 10 A & 10 B which has been set off against current profits of other business.

*In cases where weighted deduction u/s 35(1) or 35(2) or 35(2AB) on account of expenditure on scientific research is claimed, following audit checks are exercised:*

Whether the assessee carries on scientific research and the research relates to the assessee's business?

Whether the expenditure incurred is in the nature of revenue and capital other than expenditure incurred for acquiring land?

Whether any expenditure incurred including capital incurred for in house research relates to its business relating to pre-commencement of business within three years before the commencement?

Whether the expenditure has been certified by competent authority and permission for in-house research facility obtained from the competent authority?

Whether capital expenditure incurred for research in the previous year?

Whether the surplus (i.e., sale value) of the capital asset or deduction allowed whichever is less, has been offered for taxation on sale of such capital asset.

Whether the expenditure claimed under these sections is not claimed under any other section in the Act?

Whether claims under various sections of chapter VIA are in accordance with section 80 AA and 80 AB viz. that deductions are claimed on net income (after expenses) and not on gross income?

*Under the section 80IA/80IB of the Act where gross income includes any profit derived from an industrial undertaking the assessee is entitled to deductions specified in the provisions of the Act. With reference to this the following audit points may be seen:*

It should be a new undertaking (not been formed by reconstruction/splitting of existing one). Not more than 20% of plant & machinery should be old.

Separate accounts for the unit are maintained.

The undertaking has gone into production during the prescribed period in the concerned provision.

The undertaking has employed more than 10 workers if using power and more than 20 workers if unit is running without aid of power.

The undertaking is not manufacturing ineligible items as specified in schedule XI.

Other income should be excluded for working out deduction.

Undertaking is actually engaged in manufacture or production. Non-manufacturing units are not entitled to deduction.

**Others**

*Arithmetical mistakes in computation of income and tax*

Whether there were any arithmetical inaccuracy in the return of income (RoI), annual accounts and documents attached with the return?

Whether incomes earned from all sources have been considered and incomes under all heads e.g. Salary, Business Income, Capital Gain, House Property & Other Sources have been computed correctly with reference to the provisions of the Act?

Whether all the disallowances discussed in the body of the assessment order have been taken into account in the computation of total income?

Whether any addition/disallowance required to be made on the basis of Tax Audit Report, Annual Accounts, Notes on the Accounts and significant accounting practices has been correctly made?

Whether residential status of the assessee has been correctly determined and the total income of the assessee has been computed correctly having regard to residential status?

To link up past records and see if any addition/disallowance is required to be made on account of any of the following situation:

Addition made in previous assessment years on issue relevant to the current year.

Method of valuation not accepted in the previous year requiring adjustment of values of opening stock and closing stock.

Brought forward losses, allowances and depreciation not correctly shown in the return.

Admissibility of deductions under chapter III or VI which runs into multiple years.

Effect of the appellate decision having cascading effect.

In case where RoI filed showing loss, whether disallowances are reduced from the loss?

Whether the full amounts of income or receipts corresponding to the amount of TDS claimed are offered for assessment?

Whether TDS certificates are valid and relate to the assessment year for which such income is assessable i.e., in the prescribed format with all the columns duly filled?

Whether the return is filed within the time period?

Whether items deducted in the Computation of Income have actually been claimed as per the P&L Account?

Whether interest on refund, if any, received in the previous year has been included in the taxable income? Similarly whether interest paid on the Income Tax is not claimed as an expenditure?

In the case of allowance of bad debt whether the amount was included in the income of the assessee in the earlier years?

Whether set off of losses assessed under one head has been correctly allowed set off against the income assessed under other heads?

Whether the provisions relating to TDS have been followed and the expenditures have been correctly regulated where TDS has not been deducted or after deduction, not paid to the Govt. Account in due time (there should be effective correlation between TAN & PAN and the AO should obtain required information from TDS certificates)?

*Levy of interest*

Has the mandatory interest u/s 234A, 234B and 234C been levied correctly with reference to the period of default and amount?

Whether, in a case of reassessment or re-computation of income u/s 147/153A, interest u/s 234A and 234B has been calculated up to the date of reassessment or re-computation?

Whether interest for delay in payment of tax demand u/s 220(2) was levied for the default period?

In cases where refund was adjusted against demand of earlier years whether interest u/s 220(2) was levied?

Application of tax rate and surcharge

Whether the rate of tax has been applied correctly?

Whether surcharge/education cess and penalty, if leviable, has been added to the tax on the total income determined on assessment (including a case of Block assessment)?

*Refunds*

Whether the interest u/s 244A is paid where refund was more than 10% of the assessed tax?

Whether belated claims were admitted only on satisfaction of the conditions for condonation of delay and the approval of the competent authority was taken while entertaining a belated claim?

The Board directed in January 1977 that refunds should be granted within a month of receipt of appellate orders. Whether effect to appellate orders was granted within this period? Further, it may also be seen that in cases where while rectifying the assessments done for giving effect to appellate orders, whether the amount refundable has been determined after correct adjustment of refund granted earlier.

It may be checked that where tax is erroneously deducted at source, only refund is granted and not interest, as interest on refund in such cases is inadmissible.

Whether interest was paid u/s 244A on self-assessment tax? Interest is not payable on self-assessment tax as such tax is not paid in pursuance of a notice of demand.

Whether interest under section 234D levied in case excess refund issued was later withdrawn?

*Income under special provisions including MAT*

Whether minimum alternate tax has been levied on book profits calculated under section 115JA (AY 1997-98) and 115JB (AY 2001-02) respectively?

Whether Book Profit u/s 115JB is calculated as per the provisions of section allowing the addition and deduction as provided.

Whether MAT credit u/s 115 JAA is disallowed for the period prior to assessment year 2007-08 and MAT credit is restricted to the difference of tax payable under MAT and normal provision?

MAT is applicable to Limited Liability Partnership from AY 2012-13 onwards and for other than corporate assessees from AY 2013-14 onwards as per provisions of 115JC.

Mistakes in assessment while giving effect to appellate orders

Whether the orders of the Appellate Authorities and Settlement Commission have been correctly effected to?

If AO is asked to re-examine the matter, whether such re-examination was done within the reasonable time?

Whether decision of filing appeal is taken as per the existing instruction of the Board?

### *Examples*

Computation of income

Section 143(3) provides that AOs have to determine and assess the income correctly. Different types of claims together with accounts, records and all documents enclosed with the return are required to be examined in detail in scrutiny assessments. CBDT has also issued instructions from time to time in this regard.

In Tamil Nadu, CIT-III Chennai charge, AO while completing the assessment of Tele Data Marine Solutions Limited for AY 2009-10 after scrutiny in May 2013, at income of ₹ 6.95 crore, erroneously added ₹ 4.93 crore only on account of 'Transfer Pricing Upward Adjustments' as against upward adjustment of ₹ 91.12 crore proposed by Transfer Pricing Officer III Chennai under section 92CA (3). The mistakes resulted in under assessment of income by ₹ 86.18 crore involving tax effect of ₹ 29.29 crore. (Para 3.2.2.3 of Union 3 of 2015)

Business expenditure

Section 43B provides for deduction towards certain expenditure only when the same has actually been paid in the previous year on or before the due date of filing return of income. In Maharashtra, CIT-X Mumbai charge, AO while completing the scrutiny assessment of Indian Oil Corporation Limited for AY 2008-09 in December 2010 at income of ₹ 10,284.77 crore, allowed deduction of ₹ 377.55 crore on account of loss on sale of investment. As the investment made in bonds issued by Government of India was capital in nature, the sale or redemption of the bonds was required to be disallowed. The incorrect allowance of expenditure resulted in under assessment of income of ₹ 377.55 crore involving short levy of tax of ₹ 128.33 crore. (Para 3.3.4.1 of Union 3 of 2015)

Depreciation

In Maharashtra, CIT-7, Mumbai charge, M/s Vizag Seaport Pvt Ltd for the AY 08, claimed and allowed depreciation of ₹ 17.53 crore on 'Project Berth' at the rate of ten per cent treating the same as building which was not in order. The 'Project Berth' belonged to Vishakhapatnam Port Trust and as such the assessee was not the owner of the berth and therefore not entitled for depreciation. Omission to disallow the depreciation on asset not owned by the assessee resulted in under assessment of income of ₹ 17.53 crore involving potential short levy of tax of ₹ 5.90 crore. (Para 3.2 (b) of Union 20 of 2014)

Deduction exemptions

Section 10 provides for deduction to industrial undertakings on profits and gains derived from the export of articles or things or computer software subject to fulfillment of the prescribed conditions. Further, as per proviso to section 92C(4), if total income having

regards to arm's length price is enhanced, no deduction under section 10A shall be allowed in respect of increased quantum of income.

In Maharashtra, CIT-2, Mumbai charge, AO completed assessment of Tech Mahindra Ltd for AY 2007-08 after scrutiny in February 2011 at income of ₹ 128.05 crore after allowing deduction of ₹ 578.70 crore under section 10A. Assessee made upfront payment of discount of ₹ 524.94 crore to British Telecommunications PLC and debited the same to P&L A/c. On reference Transfer Pricing Officer recommended for adjustment of it under Arm's Length Price. AO didn't make the said adjustment stating that assessee has disallowed this suo-moto. Assessee in its computation claimed the deduction u/s 10A ignoring this disallowance. The mistake resulted in excess allowance of deduction of ₹ 457.36 crore involving short levy of tax of ₹ 153.95 crore. (Para 3.3.3.1 of Union Report 20 of 2014)

Carry forward set off of losses

Section 72 provides for carry forward and set-off of business loss up to eight succeeding assessment years with respect to assessment year for which the loss was first computed. In West Bengal, CIT-IV Kolkata charge, AO while completing assessment of Electrical Manufacturing Company Limited, for AY 2009-10 after scrutiny in December 2011 at nil income after allowing set-off of loss from income of ₹ 26.06 crore, allowed carry forward of business loss of ₹ 42.66 crore. As business loss of ₹ 34.29 crore only was available for set off, loss of ₹ 8.23 crore only should have been allowed to be carried forward. The mistake resulted in excess carry forward of business loss of ₹ 34.42 crore involving potential tax effect of ₹ 11.70 crore. (Para 3.3.2.3 of Union report 3 of 2015)

Capital gains

In Andhra Pradesh, CIT-Central Hyderabad charge, AO completed the assessment of Summit Communications Private Limited, for AY 2009-10after scrutiny in December 2011 at income of ₹ 33.73 crore. Assessee transferred 18 lakh shares to Unicon for sale consideration of ₹ 39.09 crore and sale proceeds were credited to assessee's bank account. While computing Capital Gains (STCG), sale proceeds of ₹ 22.07 crore was considered instead of correct amount of ` 39.09 crore. Further the assessee was allowed indexed cost of acquisition although the period of holding of shares was less than one year resulting in short computation of capital gains by ₹ 17.02 crore. The mistakes resulted in short computation of STCG by ₹ 17.99 crore involving tax effect of ₹ 8.25 crore. (Para 3.4.4.1 of Union 3 of 2015)

Unexplained investment

Section 68 provides that if assessee offers no explanation about the nature and source of any sum credited in the books of the assessee, the sum so credited may be charged to income tax as income of the assessee.

In Tamil Nadu, CIT-VI Chennai charge, AO completed the scrutiny assessment of S4 Carlisle Publishing Services Private Limited for AY 2008-09 in December 2010 at income of ₹ 29.32 lakh. As per the Balance Sheet of the assessee for period ending March 2008, the sums of ₹ 10.67 crore and ₹ 11.85 crore were shown towards 'share premium account' under liabilities and 'investment in S4 Carlisle Publishing Services Inc.' under assets respectively. No explanation has been provided for credit in the share premium account and the share premium account was utilised to invest in as subsidiary company which is not admissible under section 78 of Companies Act. As share premium account was utilised for investment in companies which is not the main business of the assessee, the sum of ₹ 11.85 crore was required to be treated as unexplained credit under section 68 and brought to tax. Omission to do so resulted in income of ₹ 11.85 crore escaping assessment involving tax effect of ₹ 3.45 crore. (Para 3.4.6.1 of Union 3 of 2015)

Minimum Alternate Tax (MAT)

Section 115JAA allows carry forward of MAT credit to an assessee when tax payable under normal provisions is more than tax under special provisions. However, such credit shall be limited to the difference of tax under normal provisions of the Act and tax under special provisions of the Act.

In Maharashtra, CIT-III Mumbai charge, AO completed the assessment of Videocon Industries Limited for AY 2008-09 after scrutiny in March 2011 at income of ₹ 647.55 crore under normal provisions and ₹ 1,103.50 crore under special provisions of the Act. The assessment was reassessed (February 2013) at income of ₹ 602.15 crore under normal provisions and further rectified in March 2013 at income of ₹ 534.76 crore under normal provisions. AO erroneously allowed set off of MAT credit of earlier year of ₹ 86.74 crore as against the allowable MAT credit of ₹ 56.74 crore being difference of tax under normal provisions and tax under special provisions of the Act. The mistake resulted in excess allowance of MAT credit of ₹ 30.00 crore involving short levy of tax to the same extent. (Para 3.3.3.1 of Union 3 of 2015)

Levy of interest

In Maharashtra, CIT-LTU Mumbai charge, AO completed scrutiny assessment of Tata Consultancy Services Limited for AY 2008-09 in Feb 2012 at income of ₹ 3,114.47 crore. While computing tax demand, AO did not levy interest for default in payment of advance tax although the advance tax paid by assessee was less than 90 per cent of assessed tax. The mistake resulted in non-levy of interest of ₹ 161.77 crore under section 234B. (Para 3.2.3.1 of Union 3 of 2015)

Refund interest

Section 234D provides for levy of interest on refund if refund is granted in excess to the assessee. In Maharashtra, CIT-II Mumbai charge, AO completed the assessment of

Larsen & Toubro Limited for AY 2008-09 after scrutiny in Nov 2012 at income of ₹ 3,369.63 crore which was subsequently rectified in February 2013. AO did not levy interest on excess refund of ₹ 158.43 crore issued to assessee earlier although no refund was due as per scrutiny assessment. The mistake resulted in non-levy of interest of ₹ 23.95 crore under section 234D. (Para 3.2.4.1 of Union 3 of 2015)

Mistakes in assessment while giving effect to appellate orders

Under section 254, an aggrieved assessee can appeal to the CIT (Appeals) against the order of AO who shall comply with the directions given in the appellate order. Further appeal is also permitted to be made on questions of fact and law to ITAT.

Any mistake in implementation of an appellate order results in under assessment/over assessment of income. In Maharashtra, CIT-II Mumbai charge, AO while giving effect to the ITAT's order in June 2010 in case of State Bank of India for AY 1995-96, did not recalculate deduction on account of provision for doubtful debts under section 36(1)(viia) although total income was revised to ₹ 769.59 crore (June 2010) as against ₹ 1,069.51 crore determined in scrutiny assessment (March 1998). The mistake resulted in excess allowance of deduction of ₹ 15.00 crore under section 36(1)(viia) involving short levy of tax of ₹ 6.90 crore. (Para 3.2.6.1 of Union Report 3 of 2015)

## CENTRAL EXCISE

Readers are expected to be familiar with the contents of Chapter 10 – Central Excise Revenue in the text book titled Public Expenditure, Revenue and Resource Management.

The purpose of the compliance auditing Central Excise revenue is to derive an assurance that tax department has identified potential tax payers; correctly assessed, levied and collected the tax due while correctly allowing exemption, set-off etc.

Compliance Audit examines the application of Acts, Rules etc., relating to valuation of excisable goods, computation of their assessable value, classification of goods, exemptions, availing and utilisation of CENVAT credit, rebate/refund, non/short levy of interest on belated payment of tax/ duty, relating to collection, refunds, penalty etc. The Act and Rules are:

Central Excise Act (CEA), 1944

Central Excise Tariff Act (CETA), 1985

Central Excise Valuation (Determination of Price of Excisable goods) Rules 2000

Central Excise (Removal of Goods at concessional rate of duty for manufacture of excisable goods) Rules, 2001

Central Excise Rules, 2002

CENVAT Credit Rules, 2004

Central Excise (Determination of Retail Sale Price of Excisable goods) Rules, 2008

Important records (some in electronic form) examined in audit are:

- List of registered assessees with their details
- Register of units availing SSI exemptions
- Register for Scrutiny and Revenue Realization and Assessment register
- Records/information on selection and observation/rectification on preliminary scrutiny
- Records/information on selection and observation/rectification on detailed scrutiny/ assessment
- Demand Show-cause Notice (DSCN) control register and SCN registers
- Provisional Assessment Register along with relevant files of the assessees containing Bonds with Security/Surety etc.
- ER-1 Returns with copy of PLA, CENVAT credit etc., in respect of all the assessees. E.R-1 is for manufacturing units (not for SSI units). Personnel Ledger Account (PLA) is used to maintain the entries of (payment) deposit and payment of duty from this amount throughout the year. If the input is less then payable duty then assessee has to deposit and enter PLA register
- ER-2 & 3 returns and declaration of dealers registered under the range. E.R.-2 is for 100% Export oriented unit and E.R.-3 is for SSI units
- ER-4, 5, 6 & 7 returns as submitted by all the earmarked assesses. E.R.4 is annual return filed by an organization that may have more than one registered unit. This return gives information that can be verified from the balance sheet and figures that can be checked with the invoices of the organization, and details of trial balances, and the inventory control system (presently covers units paying annual revenue of over ₹ 1 crore). ER- 5 is Annual return for principal inputs consumed in making finished goods (presently covers units paying annual revenue of over ₹ 1 crore). ER- 6 is Monthly return for principal inputs consumed in making finished goods and for providing details of scrap and waste cleared or destroyed (presently units paying annual revenue of over ₹1 crore), ER-7 is the Annual Installed Capacity Statement
- Quarterly Return Form is for the Registered Dealers (CENVAT Credit Rules)
- Export registers including export under claims of Rebate/Refund/100% EOU/SEZ and related documents, verification reports of Rebate/Refund along with returns in Annexure-19/20 as the case may be, submitted, if any, by the exporters; reports on foreign currency receipt/realization against exports, if any.
- Register containing details of Bond/LUT etc., furnished by the Assessee/exporters including end-use based Customs Bond.
- Records & Returns relating to availing the procedures under the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001
- Confirmed/Unconfirmed Demand Registers & 335J registers
- Records in respect of Call Book cases, relating to Remission/abatement of duty

It is the duty of manufacturers (with exception of cigarettes) to assess their tax liability, pay the tax and file monthly/quarterly tax return with the details of his business such as personal ledger account, suppliers invoice etc. Tax officials carry out 'preliminary scrutiny' of returns filed by the assesees to ensure timely submission of the return, timely payment of duty, arithmetic accuracy of the amount computed as duty and identification those who have stopped filing (stop-filers).

Filing of returns and preliminary scrutiny by the tax officials is automated (ACES-Automated Central Excise and Service Tax). Tax officials conduct the preliminary scrutiny by having an access to ACESS through their unique user IDs (SSOIDs). Audit teams/parties would be given access with SSOIDs.

Scrutiny of a return and preliminary scrutiny involves tax officials verifying whether information contained in the return is complete, prima facie valid and internally consistent. Audit verifies correctness in classification of goods, determining taxable value, and availing of CENVAT credit on inputs, capital goods, and services.

The following is the check list to have an assurance that preliminary scrutiny of self-assessment (ER1/ER3) and was carried out adequately by the tax officials.

Are all the CETSH (Central Excise Tariff Sub Heading) numbers classifying the goods, mentioned in the return prima-facie valid?

Are the rate(s) of duty prima-facie correct, with reference to the 8-digit classification(s) and description of goods provided in the return?

In case any of the products appearing in the return attracted different rates of duty within the same month, are such details separately mentioned?

Are the notification number(s), date(s), and serial numbers shown in the return prima facie correct, with reference to the 8-digit classification(s) and description(s) of goods shown in the return?

*If any of the above is wanting, whether tax official sent back the returns and obtained the complete and correct information*

In any of the exemption claimed by the assessee, were the conditions in the notification fulfilled*? If not, the difference in duty was demanded through a notice.*

Are the duties/amounts due and payable correctly calculated with reference to the rate(s) of duty and assessable value(s) shown in the return?

Where the rate of duty is specific, is the amount of duty payable correctly calculated with reference to the quantity of goods cleared?

Whether debits made from the credit account and the current account adds up to the 'total duty paid' as shown in the return?

*If there was arithmetical mistake in any of the above three, a deficiency memo was issued, to make good the shortfall in duty payable.*

Whether copies of challans through which duty was paid been submitted with the return? *If not copies of challan were obtained.*

Does the opening balance of CENVAT credit indicated in the return tally with the closing balance indicated in the return for the previous month/quarter? *If not reasons for inconsistency were reconciled in consultation with the assessee.*

Was the (opening balance + total credit availed) – (credit utilized for payment of duty on goods + credit utilized when inputs or capital goods are removed as such + credit utilized for payment of duty on services) = closing balance of CENVAT credit? *If not they were reconciliation with the assessees' records.*

Was the duty payment made within the due date for the period of delay? *If not, interest was collected by issue of notice.*

If any assessee is unable to readily send self-assessment, under certain conditions with the approval of the competent tax official, for the time being he can submit provisional assessment. Tax officials examine, adjudicate such assessments and arrive at the final tax/duty to be paid. Audit examines them by exercising the following checks.

Whether the provisional assessment was covered by bond and security/surety? *In case bond and security amount are insufficient, the same was obtained from the assessee*.

If a bank guarantee is given for the bond, is it valid? In *case the bank guarantee has expired, it needs to be immediately validated*.

Is the provisional assessment pending beyond 6 months*? If pending has the matter been brought to the notice of the Commissioner with reasons for seeking extension may be recorded.*

In adjudication issues of valuation, classification and effective rate of duty (date), CENVAT were correctly dealt with and orders were implemented? *For any deficiency demand notice is issued and action is taken to recovery duty.*

**Audit of detailed scrutiny cases**

After subjecting all the returns to the preliminary scrutiny, a sample (2% to 5%) is selected to carry out detailed scrutiny. For this purpose the assessees may be asked to produce his original records. Certain criteria are used for selecting this sample (automated). The parameters are (%) change (+) over last return in duty paid in the value of exempted clearances (other than export); (-) in per unit assessable value for each CETSH, (-) in value of clearances to EOUs, (+) in value of clearances of partially exempted goods as a proportion of total value of clearances, (+) change in the ratio of CENVAT utilization to total duty payment, (+) in ratio of credit availed from first and second stage dealers to total credit availed etc. Large units are subjected to mandatory detailed scrutiny.

Assurance on the *Quantity of product manufactured* is obtained by examining installed capacity and actual production, normal input/output ratio, raw material consumption and production figures of last 3 years, cost reports, records of daily production, and reconciliation of production with figures in stock register for excisable products; scrap shown as generated; with reference to other factors such as packing material/containers consumed; waste generated; charges paid to labour contractors etc., comparing production figures shown in excise records with those shown in Annex to the Balance Sheet and comment.

Assurance on *quantity of product cleared from premises for sale* is obtained by comparing the clearance figures reported in the monthly returns report with internal MIS returns/sales figures in the annual report/cost audit report/income tax/sales tax/banks statements, supply of spares and accessories and their value in the total value charged to duty, pricing pattern followed by the company in respect of clearance to related persons/ depots/ consignment agents etc.

Assurance *on valuation of goods* is obtained by verifying copies of agreements with major buyers, additional payments received on account of escalation clause in the agreement, verification of some debit notes with the factory gate invoices relating to goods, comparing the stock transfer rates effected, verifying freight paid on goods cleared was charged to duty as per law, verifying whether retail prices were declared on the packages (under the Weight and Measurement Act) and duty was charged on basis of MRP price after deduction of correct abatement, calculating backward from MRP and arriving at the assessable value, verifying how sales returns were accounted for, if assembled at site installation and erection charges were included in the assessable value, discounts allowed were actuals and there was no flow back of additional consideration to the assessee on this account, cross check of details of sales of excisable goods with the sales book figures appearing in final accounts and Income Tax returns, cross check the sales figures with the figures shown in sales tax returns, assessable value of goods manufactured on job work basis was correctly determined.

Assurance *on classification of goods* is obtained by verifying details of intermediary products, joint products, by-products, components, wastes, scraps and compare with description in CETSH- Central Excise Tariff Sub-Heading.

Assurance on *CENVAT credit on inputs/ input services* is obtained by verifying whether proper records of inputs used in goods manufactured in the factory are maintained; of common inputs used for exempted and dutiable goods/services are maintained; verifying credits in CENVAT credit account maintained by the assessee both in respect of quantity and amount of credit on inputs and input services and comparing with duty/ taxpaying documents/ commercial records; reconciling one month's invoices with debit entries in CENVAT account; goods on which credit is taken were actually received and used for manufacture or are still

available in stock a (facts are verifiable from private records); verifying whether credit taken was admissible under the rules; credit on rejected/returned goods was reversed; no credit is taken on inputs used in exempted final products; certificates in lieu of duty paying documents are genuine; intra-company transfer of inputs was not effected to pass on the un-availed credit to sister units; clearance and receipt of inputs/ semi-finished goods to job workers for further processing was properly accounted for; proper procedure was followed for inputs sent directly from the supplier to the job worker; carry forward of unutilised credit is correctly taken.

Assurance on *credit of duty paid on capital goods* is obtained by verifying whether credit was taken against prescribed duty paying documents; credit on capital goods was taken on goods actually received; capital goods were not exclusively employed for production of non-excisable goods or providing exempted services; credit was reversed on capital goods rejected/ returned; clearance of capital goods was on payment of duty equal to credit taken in CENVAT Account; certificate in lieu of duty paid on all goods issued by department officers was correct; all waste and scrap is duly accounted for; capital goods sent for exhibition were received back.

Auditor verifies whether the assessing officer has exercised the following checks with regard to classification, valuation, availing CENVAT in ER1/ER3 cases.

Description of the goods by the assessee was commonly known in market/trade parlance by calling for sample. *If necessary assessing officer (AO) asked for sample invoices of main commodities manufactured to verify the description of goods.*

Classification of goods declared was with reference to product catalogue/ leaflet literature/ purchase order/chemical composition/drawing/ test analysis report or any other information. *If necessary AO called for product catalogue/leaflet literature/purchase order/chemical composition/ drawing/test analysis report or any other relevant information examined compared with the invoices*

Eligibility of the exemption/s conditional exemption availed was examined. *If necessary AO called for product details end use particulars, contract documents or any other document that may be required to verify the correctness of the exemption availed.*

In respect of commodities subject to specific rates of duty the quantity code conforms to unit quantity adopted in the clearance invoices. *If necessary AO obtained a sample invoices and verified.*

In case of SSI units, the computation of aggregate value of clearances up to the period was verified. *Value of clearances as given in the previous return (for the same financial year) was compared.*

Whether the goods have been cleared on a 'sale' basis? A *sample sales tax document was examined to confirm whether there was sale.*

In case of sale of goods, for delivery at any time other than the date of removal, assessment was done. *If necessary sample invoices were verified.*

In case of sale of goods for delivery at a place other than the factory gate the correct abatement towards transportation was claimed. *If necessary sample invoices and sample transport documents etc. were examined.*

In case clearances do not involve sale but goods are cleared to consignment agents/ depot, valuation is in accordance with Central Excise Valuation Rules 2000? *Invoice of consignment agent/depot were verified with reference to factory clearance invoices.*

Whether valuation is according to Central Excise Valuation Rules 2000? *AO called for certificate of chartered/cost accountant and verified the validity of the certificate and compared the value declared with that of value adopted in the previous period.*

In respect of sales to or through related person, the value of goods was determined under the Central Excise Valuation Rules 2000. *If necessary sample sale invoices of related person to unrelated buyers was verified.*

In case of valuation based on MRP, the MRP declaration on the sample packages was verified. *Packing materials/labels indicating MRP along with invoices were verified*

In case of more than one MRP being indicated on the package, the duty is paid on the highest MRP. *Sample invoices were called and verified.*

Inputs/ semi-processed material sent for job work outside were returned to factory within 180 days. *If not, duty liability on semi-finished goods was worked out and duty was determined on such clearance.*

CENVAT was verified through cross tally with the receipt of goods and services. *AO called for the list of inputs, capital goods and input services to determine eligibility.*

In respect of capital goods, 50 per cent of credit was availed. *AO verified by calling for list of capital goods received by the assessee during the period of the return.*

If inputs or capital goods are cleared as such the amount equivalent to credit taken was reversed or paid. *Fact ascertained from the returns.*

Separate records were maintained by assessee with reference to the bills of materials, etc. in case exempted goods are cleared.

TR-6 challans through which duty was deposited were verified?

Auditor verifies whether the assessing officer has exercised the following checks to have assurance on in ER-2 cases (hundred percent export-oriented undertakings in respect of goods manufactured, goods cleared and receipt of inputs and capital goods).

Was duty paid consignment wise?

CETSH of goods manufactured given correctly in the ER2 return

Was the classification adopted in agreement with the orders of the adjudicating authority?

Was unit of quantity mentioned correctly?

Exemptions fulfil the conditions in the notification

Was the rate of duty correct with respect to the CETSH?

Duty payable correctly calculated with reference to the rate of duty and assessable value shown in the return

The unit cleared goods in DTA after obtaining necessary permission from the Development Commissioner (SEZ or EOU)

Whether the debits made in Personal Ledger Account and credit account add up to duty payable. For any short payment, SCN was issued.

All the details of inputs and capital goods received without payment of duty were indicated correctly. If necessary details were verified with input and capital goods documents called from the assessee.

Whether opening balance of CENVAT credit tallies with the closing balance of the previous month.

Whether the (opening balance + total credit availed) + (credit utilized for payment of duty on goods +credit utilized when inputs or capital goods removed as such + credit utilized for payment of duty on services) + other miscellaneous payments = (is equal to the) closing balance of CENVAT credit. If necessary input-credit documents, input/ capital goods such as, clearance documents, and invoices of taxable service rendered were verified.

Whether the inputs are procured as per the LOP (letter of permission) list approved by the Development Commissioner.

Check whether the details of other payments have been indicated correctly.

Goods procured under CT-3 were really required for production of export of goods and correctly accounted for.

Whether the goods procured were cleared on payment of duty to DTA. Was the DTA unit required to hold an import licence to procure the inputs such as those of the 100 per cent EOU? Whether the DTA unit had fulfilled the requirements under the Exim policy for import of goods before the goods (inputs) are cleared on payment of duty by the 100 per cent EOU

Whether the re-warehousing certificates were issued for all the consignments procured during the month. All the goods, concerned certificates were examined before re-warehousing.

In case of clearance of goods for export under bond, such details have been mentioned separately. Whether verified it by calling export clearance documents, copy of bond, etc.

Was the self-assessment memorandum complete? If not, revised return duly incorporating complete self-assessment memorandum was obtained.

Wastage norms for the item fixed by the Development Commissioner were adhered to by assessee.

Dealer registered with Central Excise can purchase and sell goods and maintain inventory. He could be the first stage or second stage dealer and can avail CENVAT credit. Audit also seeks to have an assurance on the detailed assessment of dealers done by assessing officers.

Whether all the declarations as required in the form were correctly filled.

Invoices issued were serially numbered.

Was the dealer actually conducting business in the goods declared as traded?

Description of the goods purchased and sold by the dealer was same as shown in the purchase invoices

Classification of goods declared was same as shown in purchase invoices.

Was the dealer a relative of the supplier manufacturer? Was there is any difference in value of goods sold.

If dealer was selling goods which are assessed to duty under Section 4A of the CEA 1944 was the price higher that MRP. Was the dealer tampering with the MRP? Whether the invoice issued by the dealer tallied with the manufacturer's invoice for any discrepancy.

Are the goods traded by the dealer such as that may allow for repacking, relabeling from bulk purchased for retail sale? Does the activity amount to manufacture?

Total duty declared by the manufacturer of the goods was calculated correctly and the proportionate credit was be passed on correctly by the dealer

Dealer maintained the register (serially page numbered) to account all his purchases and sales invoices.

Any supplementary invoices were received by the dealer during the quarter. Was the duty incidence been passed on by the dealer to his customers? Why the supplementary invoice was raised by the manufacturer.

Was the quantum of sale of goods in terms of total sales value consistent with the income tax returns filed by the dealer? Income tax returns were called for and sale figures of dutiable excisable goods were reconciled.

Only the received (available) credit was passed on by the dealer. It was verified with reference to opening balance of unutilised duty credit.

The invoices received by the dealer are genuine. A sample is verified with by tracing them to the originating Range office.

When the tax authorities during scrutiny or otherwise, find that self-assessment in not in order and assessee fails to provide the records or information that were asked for 'Best Judgement' method is used to raise demand based on collateral evidences.

### *Examples*

Audit points out short-levy or non levy of tax arising out of misinterpretation by the assessing officers on issues of valuation, exemption, CENVAT credit/debit, misclassification of goods and also non-levy of interest and penalty.

Valuation

As per section 4(1) of Central Excise Act, 1944, the assessable value of excisable goods is normally the transaction value. The Board vide its letter dated 30 June 2000 clarified that cash discount or prompt payment discount would not form part of the transaction value unless such discount had actually been passed on to the buyer of the goods, which was further reaffirmed by Board's Circular dated 1 July 2002.

M/s Birla Tyres Ltd., in Bhubaneswar-1 Commissionerate, engaged in the manufacture of tyres, tubes falling under chapter 40 cleared 22,87,916 nos. of different sizes of tyres, tubes and flaps to M/s Tata Motors Ltd. It paid duty after reducing the purchase order value by 1.45 per cent to 2.53 per cent towards bill discounting charges. The bill discounting charges were payable by the buyer to the bank as bank charges on the basis of agreement between the assessee and the buyer. Since the deductions from the purchase price were paid by the buyer to the banker as bank charges on behalf of the assessee, it was an inadmissible deduction from the assessable value as it was not in the nature of cash discount/prompt payment discount and had not been passed on to the buyer. The bank charge was paid by the buyer on behalf of the assessee. This resulted in short levy of duty of ₹ 22 crore during 2008-09 to 2009-10. (3.1.2 Union 28 of 2011-12)

Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, stipulates that where the excisable goods are not sold by the assessee, but are used for consumption by him or on his behalf in the manufacture of other articles, the value shall be 115 per cent (110 per cent from 5 August 2003) of the cost of production or manufacture of such goods.

M/s Wockhardt Ltd., in Surat-II Commissionerate, cleared bulk drugs viz., ranitidine hydrochloride to its sister concern unit i.e. M/s Wockhardt Ltd., Chikalthana for manufacturing of other goods on payment of duty based on valuation at maximum price fixed under Drugs Price Control Order (DPCO) instead of deriving the value on cost basis. Duty was paid at ₹ 690 per tonne instead of ₹ 1,300 per tonne between February 2004 and June 2005 and ₹ 625 per tonne instead of ₹ 2,280 per tonne between July 2005 and January 2007. This resulted in short levy of duty of ₹ 51.26 lakh. (6.3. Union 20 of 2009-10)

M/s Patil Steel Wire Pvt., in Hyderabad-IV and M/s Vacmet packaging Pvt. Ltd., in Lucknow Commissionrates, engaged in the manufacture of various excisable goods cleared goods to its sister concern paying duty on the assessable value arrived at on cost data

without adding 10 per cent of the profit margin. This resulted in undervaluation of goods of ₹ 4.55 crore with consequential short levy of duty of ₹ 76.94 lakh during the period of April 2006 to March 2009. (2.2 Union 23 of 2010-11)

Section 4 (1) of the Central Excise Act, 1944 (effective from 1 July 2000) stipulates that where the duty of excise is chargeable on any excisable goods with reference to their value, such value shall be the transactions value of the goods sold by the assessee and the price is the sole considerable for sale. Further, section 4 (3) (d) of the said Act defines transactions value to mean the price actually paid or payable for the goods, when sold, and includes in addition the amount charges as price, any amount that the buyer is liable to pay to or on behalf of the assessee, by reason of or in connection with the sale, whether payable at the time of sale or at any other time.

M/s APR Packaging Ltd. Ashti (now M/s BILT Ashti), in Nagpur Commissionerate, manufactured copier paper and maplitho MS paper' in reel form and cleared on payment of duty to its own cutting centers for conversion into sheet form. From these cutting centers, the goods were sold to unrelated buyers at higher value than the value at which excise duty was paid at the factory gate, Difference in value was ranging from ₹ 1,350 to ₹ 2,050 per tonne. Since the goods were sold at the cutting centers, the transaction value of the goods took place at the cutting centers and hence duty was leviable on the transactions value charged from the unrelated buyers. This resulted in short payment of duty amounting to ₹ 49.43 lakh during the period from October 2005 to June 2007. (2.4 Union 23 of 2010-11)

Ayurvedic and Homeopathic preparations falling under chapter 33 (Cosmetic or Toilet reparations) are assessed to duty under section 4A, as these were notified under section 4A. M/s Herbo Foundation Pvt. Ltd., Bamunimaidan, Guwahati in Guwahati Commissionerate engaged in manufacture of 'Himani Navaratan Hair Oil' and 'Himani Gold Turmeric Cream', cleared these products under Section 4 of Central Excise Act, 1944 between April 2008 and December 2009 on transaction value of ₹ 268.72 lakh. The MRP affixed on packages of those products indicated that these products were ultimately classified under chapter 33 and sold as cosmetic or toilet preparations to the customers at the printed MRP of ₹ 808.14 lakh and corresponding assessable value after under section 4A was higher than the value at which the duty was paid. Thus, there was short payment of duty of ₹ 42.06 lakh during the period April 2008 to December 2009. (2.3 Union 23 of 2010-11)

## Exemption

A notification dated 1 March 2006 exempts excise duty on all goods supplied against international competitive bidding if goods are exempted from the duties of customs, when imported into India. Further, customs notification dated 1 March 2002 (as amended on 26 May 2006) exempts customs duty and additional customs duty on

thermal power plant of a capacity of 700 mega watt (MW) or more, for setting up mega power project in North East States and J&K; or thermal power plant of a capacity of 1000 MW or more, for setting up mega power project in other remaining states. The said customs notification also exempts hydel power plant of a capacity of 350 MW or more for setting up mega power project in the above mentioned nine states or hydel power plant of a capacity of 500 MW or more for setting up of mega power project in other remaining states.

M/s Larsen and Toubro (ECC Division) Pithampur, in Indore Commissionerate, engaged in the manufacture of towers and structures, cleared four plants of 250 MW each on different dates between November 2006 and March 2008 for M/s Jindal Power Ltd., Raipur, Chhattisgarh for setting up O.P. Jindal Super Thermal Power Plant, Raigarh. The assessee did not pay duty at the time of clearance availing of exemption under the aforesaid exemption. Audit observed that the thermal power plant cleared from the factory was not of 1000 MW capacity and accordingly the eligibility condition of the customs notification was not satisfied. Accordingly, these plants of 250 MW were not exempt from duties of customs and, therefore, were also not eligible for exemption from excise duty. This resulted in incorrect grant of exemption of ₹ 6.99 crore which was recoverable with interest and penalty. In a similar case M/s Crompton Greaves Ltd., in Bhopal Commissionerate, availed incorrect exemption of from duty of ₹ 2.70 crore. (2.1 Union 12 of 2009-10)

Notification dated 1 March 2003 provided small scale industry (SSI) exemption to a manufacturer, on the clearance of goods for home consumption up to the aggregate value of ₹ one crore during the current financial year subject to the condition that the aggregate value of all excisable goods for home consumption did not exceed ₹ three crore in the preceding financial year. Paragraph 4 of the notification also stipulates that the goods manufactured in rural area under other assessee's brand name will have to be included for the calculation of prescribed limit for clearances during current year as well as for previous year.

M/s Jaywin Remedies and M/s Chemonix India Pvt. Ltd., in Ahmedabad III Commissionerate, had not clubbed their clearances of branded goods and own goods in the current financial year though it was required to be clubbed as both the units fell within the rural area during the period from 2001-02 to 2005-06. The assessees were ineligible for the SSI benefit as the clubbed value of clearances in the current as well as previous years exceeded the prescribed limits. This resulted in incorrect availing of exemption of duty of ₹ 70.02 lakh, which was recoverable with interest. (Para 4.4 Union 20 of 2009-10)

Under a notification dated 14 November 2002, specified excisable goods produced by a unit located in notified areas of Jammu and Kashmir were exempt from that portion of duty which was paid by the manufacturer in cash provided the unit is set up or has undergone substantial expansion on or after 14 June 2002.

M/s Sun Pharmaceutical Industries Jammu, in Jammu and Kashmir Commissionerate, engaged in manufacture of allopathic pharmaceutical preparations, imported (April 2005) 4,950 kilogram sodium flurbiprofen dihydrate (bulk drug) from China. These bulk drugs were sent (April 2005) to sister concern M/s Sun Pharmaceutical Industries Ltd., Ahmednagar (Maharashtra) for conversion to flurbiprofen BP on job work challan, without intimating the department. No records were available to substantiate the receipt of raw material in Jammu factory. The sister concern (job worker) after conversion, returned only 3,395 kilogram of flurbiprofen BP to the assessee during May and June 2005. This was shown cleared (May – June 2005) by the assessee on the sale invoices, which did not bear any vehicle numbers, in the same condition and under the same batch numbers under which it was processed by the job worker, without carrying out further processing/manufacture at his factory, to another sister concern M/s Sun Pharmaceutical Industries Ltd., Madhurakantam, Kanchipuram (Tamil Nadu) on the assessable value of ₹ 1.49 crore with excise duty of ₹ 23.90 lakh. The assessee was allowed refund of duty of ₹ 23.90 lakh. Since no manufacturing process was undertaken in the assessee's factory, refund of duty was incorrect and was recoverable with interest.

The same assessee imported (May 2005) 2,700 kilogram of bulk drug 3 chloro-5-acetyl iminodibenzyl from China and carried out similar activity and was irregularly given refund of ₹ 36.67 lakh. Again the assessee in October carried out similar activity and irregularly given refund of duty of ₹ 26 lakh. The total duty in these three cases aggregating to ₹ 73.86 lakh was refunded incorrectly and was recoverable with interest and penalty. (4.5 Union 20 of 2009-10)

Notification dated 31 July 2001 provides exemption on specified goods cleared from the industrial units in Kutch district of Gujarat. The exemption notification provides exemption to the extent of the original value of plant and machinery installed in the factory on the date of commencement of commercial production. The Ministry clarified that the subsequent investment should be ignored.

M/s Euro Ceramics Ltd. Bhauchau (Kutch), in Rajkot Commissionerate, had original investment of ₹ 24.06 crore in plant and machinery and installed capacity of 3,580 tonne to manufacture vitrified tiles, on the date of commencement of commercial production i.e. on 5 October 2003. Subsequently, the assessee expanded the capacity of plant and machinery by investing ₹ 97.28 crore during the years 2004-05, 2005-06 and 2006-07. The assessee was allowed the benefit on the expanded capacity of 79,971 tonne of vitrified tiles during the year 2005-06 and 2006-07 which was not correct. This resulted in excess grant of exemption of ₹ 10.20 crore. (2.3 Union 12 of 2009-10)

By a notification dated 1 March 2003, as superseded by notification dated 1 March 2006, and 1 March 2007, vacuum and gas filled bulbs of retail sale price not exceeding ₹ 20 per bulb are exempt from duty, in excess of the duty at the rate of eight per cent ad valorem. The Central Excise Tariff Act, 1985 classifies the vacuum and gas filled bulbs of retail

sale price not exceeding ₹ 20 per bulb under the heading 8539.29.10 whereas such bulbs of retail sale price exceeding ₹ 20 per bulb or set of bulbs not sold individually are classifiable under the heading 8539.29.90 and attract duty at the rate of 16 per cent ad valorem.

M/s Surya Roshni Ltd. (Lighting Division) Malanpur, in Indore Commissionerate, cleared ₹ 1.40 crore sets consisting of three bulbs (2+1 free scheme) in a single package set with the retail sale price of ₹ 24 (100W) and ₹ 22 (60W) per set against actual retail sale price of ₹ 36 and ₹ 33 per set respectively, which was crossed on the sets and also disclosed the fact on the sets that 'units not for sale individually'. The assessee availed of exemption under the aforesaid notification. Since the retail sale price of multi pack sets of three bulbs were ₹ 24 and ₹ 22 per set and individual sale of bulb was restricted, availing of the exemption by classifying the three bulbs set (a single pack) under heading 8539.29.10 instead of 8539.29.90 was incorrect. This resulted in incorrect grant of exemption of ₹ 1.63 crore during the period from 2005-06 to 2007-08 which was recoverable along with interest. (2.5 Union 12 of 2009-10)

CENVAT

Under CENVAT credit scheme, credit is allowed for duty paid on 'specified inputs/capital goods' and Service Tax paid on 'specified input services' used in the manufacture of finished goods. Credit can be utilised towards payment of duty on finished goods subject to the fulfilment of certain conditions.

Rule 6 (2) of CENVAT Credit Rules, 2004 enunciates that a manufacturer who avails of CENVAT credit of common inputs/services and manufacturers both dutiable and exempted goods, has to maintain separate accounts for receipt and issue of inputs/ services for both categorization of final products. However, if the manufacturer opts not to maintain separate accounts, then he shall pay an amount equal to ten per cent of the price of the exempted final products.

M/s Simbhaoli Sugar Ltd., (distillery unit), in Meerut, in Meerut II Commissionerate, engaged in manufacture of dutiable goods, i.e., denatured spirit, carbon dioxide, fusel oil etc., and non-dutiable goods i.e. country liquor, rectified spirit etc., availed CENVAT credit of Service Tax and paid on input services (viz. courier services, telephone and mobile service, repair and maintenance service, commission agent, website maintenance etc.) which were used in manufacture of both dutiable and non-dutiable goods and separate accounts were not maintained. The assessee cleared non-dutiable goods worth ₹ 226 crore in 2007-08 but did not pay 10 per cent amounting to ₹ 22 crore. The same is recoverable with interest. (3.1 of Union 23 of 2010-11)

As per Rule 2(k) of CENVAT Credit Rules 2004, input means all goods used in the factory by the manufacturer of the final product but excludes any goods which have no relationship whatsoever with the manufacture of a final product.

M/s Grasim Industries Ltd under Commissionerate of Central Excise in Indore availed CENVAT credit of duty paid on angle, nut, bolt, channel, electrode, plates, sheets, etc., to the tune of 34.64 lakh during 2011-12. As these items cannot be considered as inputs, availing of CENVAT credit on these items was incorrect and was recoverable along with interest.

A manufacturer or producer of final products or a provider of taxable service can take credit of the Service Tax paid on any input service received by the manufacturer of final product or by output service provider in terms of Rule 3(1)(ix) of the CENVAT Credit Rules 2004. Credit cannot be availed on non-taxable service. Mining of mineral, oil or gas services came into the tax net with effect from 1 June 2007.

M/s Jindal Steel and Power Ltd., in Raipur Commissionerate, engaged in the manufacture of iron and steel products, availed services relating to extraction of coal from private coal mines and paid ₹ 23.16 crore to various registered private service providers. The assessee availed credit of Service Tax paid amount to ₹ 2.60 crore during the period July 2005 to May 2007. Audit pointed out that the credit was wrongly availed for Service Tax paid during the period when Service Tax was not payable. (3.4 Union 23 of 2010-11).

M/s Tata Sponge Iron Ltd in Bhubaneswar-11 Commissionerate, engaged in manufacture of sponge iron, availed CENVAT credit of ₹ 2.11 crore on iron ore concentrate purchased during April 2008 to March 2009. Since the iron ore concentrate was exempt from duty, availing CENVAT credit on the concentrate by the assessee was irregular. The CENVAT credit of ₹ 2.11 crore availed irregularly was to be reversed along with interest and penalty. (Union 8 of 2014)

Rule 20 of Central Excise Rules, 2002 read with notification no. 46/ 2001-C.E. (N.T.) dated 26 June 2001, extends the facility of removal of any excisable goods from factory of production to warehouse without payment of duty for export. CBEC vide Circular No.581/18/2001-CX, dated 29 June 2001, as amended from time to time, has categorically emphasized that goods meant for export can be diverted for home consumption from the warehouse with the permission of the Jurisdictional Assistant I Deputy Commissioner on condition that the clearance shall be effected on invoices prepared under Rule 8 on payment of duty, interest and other charges in cash.

M/s Haldia Petrochemicals Ltd. in Haldia Commissionerate transferred Motor spirit, Benzene, Pygas, etc., to its warehouse. During November 2007, these goods were diverted from the warehouses for home consumption on payment of appropriate duty through CENVAT account instead of payment through cash which contravened Board's clarification cited above. Moreover, the assessee did not obtain permission of the competent jurisdictional authority for such diversion of goods. This resulted in irregular utilisation of CENVAT credit of ₹ 45.76 lakh which was recoverable with applicable interest. (Union 8 of 2014)

## SERVICE TAX

Readers are expected to be familiar with the contents of Chapter 12 – Service Tax in the text book titled Public Expenditure, Revenue and Resource Management.

The purpose of the compliance auditing Service Tax revenue is to derive an assurance that tax department has identified potential tax payers; correctly assessed, levied and collected the tax due while by correctly allowing exemption, set-off etc.

Service Tax is levied at the prescribed rate on a service provided or agreed to be provided by a person to another in the taxable territory (unless it is specified in the negative list and thus exempt). Each of the word like person, territory, agreed to and service etc., are clearly defined in the Service Tax Rules. Similarly the place of provisioning service, point of taxation, consideration, valuation of service under different circumstances, occasions where tax would be paid by the service provider or receiver or both etc., are also explained.

Administration of Service Tax involves identification of taxpayers and potential tax payers, their registration, facilitating voluntary compliance through self-assessment, creating facilities for filing Service Tax returns and payment of tax, scrutiny of tax returns, provisional assessment/best judgement assessment, monitoring rebates, issue of show cause cum demand notice to raise differential tax, adjudication of disputes etc.

The entire process of registration, filing returns, claiming refunds, intimation, permission, etc., is carried out electronically through ACES. Administration of Service Tax and thus audit is similar to that of central excise, the main difference being one deal with goods and the other with services, though sometimes they are indistinguishable.

Compliance audit involves examining to what the tax officials have enforced the provisions of the Acts, Rules, judicial pronouncements, notifications instructions and circulars of Central Board of Excise and Customs etc., to safeguard the revenue due to the government. The Act and Rules are:

Finance Act, 1994
Service Tax Rules, 1994
Point of Taxation Rules, 2011
Place of Provision of Services Rules, 2012.
Service Tax (Determination of Value) Rules, 2006
Service Tax (Settlement of Cases) Rules, 2012
Service Tax (Compounding of Offences) Rules, 2012
Service Tax Voluntary Compliance Encouragement Scheme, 2013
CENVAT Credit Rules, 2004
Relevant Provisions of Central Excise Act, 1944
Notifications (Reverse Charge, Abatement, Exempted List, Negative List)

Compliance Audit examines the application of Acts, Rules etc., relating to taxability of the service with reference to point of taxation, computation of the assessable value, exemptions, availing and utilisation of CENVAT credit, rebate/refund, non/short levy of interest on belated payment of tax/ duty, duty/ tax collected but not deposited, refunds, penalty etc. Documents, records and information examined in audit those maintained in the tax offices and some called from the assessee include:

ST-1 (application for registration) & ST-2 (Registration Certificate granted by Department) & details of Centralized registration (more than one unit), if any
ST-3 Returns of all services
Revenue Register (335-C)
Files relating to Show cause cum Demand notices
Confirmed/unconfirmed Demand Register
Adjudication/offence Register
Refund & Rebate Register
Correspondence File & Personal Hearing (PH) Register
CEVAT Credit Documents along with credit register, payment particulars thereof.
Taxpaying documents (GAR-7 challans/e-Payment receipts)
Annual Reports, general ledgers, sundry debtors, creditors, trial balance
Invoices, vouchers relating to the service
Contracts/Agreements/work orders
Files relating to details of options exercised & details of exemptions/abatements availed on various services along with contract, invoice.
Debit note/credit note if any issued/received
Bank statement, Tax Audit report of the unit, TDS certificates received & issued

**Preliminary scrutiny**

Audit seeks to have an assurance that the preliminary scrutiny carried out by the tax officers (using ACES) ensured the completeness of information furnished by the assesse in their returns, arithmetic correctness of amount computed as tax, timely payment, and timely submission of returns and identification of stop-files. Returns with errors marked for review and correction were processed by the Range Officers/Superintendents. If assessee is unable to determine the actual value of any taxable he is permitted to submit provision assessment subject to certain conditions and pending final assessment.

**Detailed scrutiny**

A sample of returns are selected by the department for detailed scrutiny/assessment using risk parameters, risk tools and creating risk score files. Commissioner monitors them through a return scrutiny cell. Detailed scrutiny of returns is conducted by the Range Officer/ Superintendent assisted by a complement of Inspectors. Divisional DC/AC is responsible for the overall supervision.

Assessing Officer validates the information furnished in the self-assessed ST-3 return with the information in the Income Tax Returns, any third party information etc. For this purpose, assessing officer may ask further information/ detailed records (agreements, contracts, invoices, bills) from the assessee. Audit seeks to have an assurance that validity of information furnished in the ST-3 Return has been established with supporting documents/ information that is sufficient and complete.

Audit seeks to have an assurance that the detailed (manual) scrutiny carried out by the tax officials ensured the correctness of the assessment. Assessing officer is expected to ensure correctness of classification of service adopted, appropriateness of the rate of tax availed and admissibility of exemption notifications, if any; determining the correct value of services in terms of provisions made in the existing rules; ensuring correctly availing of CENVAT credit on inputs, input services & capital goods in terms of the existing rules; ensuring correctness of the exemptions or concessions availed and taking effective follow-up action on discrepancies.

Audit verifies all the transactions made by the assessee in respect of the services provided by the assessee from the ledger, trial balance & final accounts maintained by the assessee. Audit identifies the services which are taxable on the basis of the interpretation of the existing Act (Sec 65 of the Finance Act 1994) and the notifications issued by the Government from time to time. If assessee is availing exemption or abatement under any notification issued by the Audit examines whether there has been proper interpretation of the notification or whether the notification has been misconstrued in any manner. Test check of invoices is carried out for corroborating the fact that the assessee has made transactions in respect of any particular taxable service. Audit verifies the ST-3 returns of the assessee to have assurance on whether the assessee has paid the appropriate tax on all the taxable services through a test check of some challans.

Under Sec 66A of the Finance Act 1994, every assessee receiving taxable services from outside India is also liable to pay Service Tax on the transaction value of the service i.e. the amount paid by the assessee to the service provider outside India. Service Tax should be paid on the full amount including TDS. Any short fall in this regard is checked in audit. Utilisation of CENVAT credit by the assessee is examined by comparing the credit account (separate records of inputs/ input services) maintained by the Assessee and actual entitlement and applicable rules and notifications.

Issues examined in audit broadly fall under revenue reconciliation, taxability/ classification, CENVAT credit, valuation and others.

**A. Revenue reconciliation**

Output tax reconciliation: information in the Return ST-3 is compared with the information in the Income Tax Return, PLA entry 'duties, taxes and cess received or receivable in respect of goods and services sold or supplied' and entries 'total Service Tax paid

or payable', 'rates and taxes paid or payable to the government or any local body (excluding taxes on income) for service tax.

CENVAT credit realisation: information in the Return ST-3 is compared with information in the information of under PLA entries 'Duties and taxes paid or payable in respect of goods and services purchased' and 'total Service Tax paid or payable on services purchased'.

**B. Issues of taxability /classification**

Verification to examine whether services claimed as non-taxable are in fact non-taxable: Compared with the information under PLA entry 'credits to the Profit and Loss Account; agreements are called for and examined and a sample of invoices are tested

Issues relating to appropriate rate of tax: information in the Income Tax Return is examined to compare with declaration given in Service Tax Return. The section under which the deduction (TDS) is made would indicate the taxable Service Tax category. For example 194C explains taxable services for payments made to contractors, 194D explains for insurance payments, 194J for fee for professional and technical services. It is also examined whether all Services provided as indicated in the TDS certificate issued by the Income Tax Department to the Service provider have been exhaustively declared.

Verification of service claimed to be specifically exempt in the ST-3 return: Agreements, sample of invoices are verified with reference to the conditions in the applicable notifications.

Verification of services claimed to be exported by the assesse: to get the benefit of exports, in addition to getting the consideration in convertible foreign currency, the Place of Provision of Service should be outside India. The correctness of the claim is verified with respect to the Place of Provision Rules, 2012 read with Rule 6A of the Service Tax Rules, 1994. The determination of actual exports is made with respect to the declarations in the export documents and export details given.

Eligibility of abatement from the value for the purpose of applying the appropriate rate of tax: correctness is verified with reference to the conditions specified in the abatement notification especially whether the condition regarding non-availment of CENVAT credit is satisfied.

If assessee is claiming any deduction from the gross value of charges, the supporting documents like invoices/bills are verified.

**C. Issues relating to valuation**

Issues relating to non-inclusion of cost and expenditure in the taxable value on the grounds that these are reimbursable and incurred by pure agents: agreement/ invoices/debit notes are called for and examined to verify the correctness of the claim of benefit to pure agent. It is examined whether the reimbursements billed in the invoice or

whether any debit/credit note have been issued for this purpose. The bills/invoices raised by the third party against the assessee are called for. In case the claim of the assessee is correct, then the assessee should not take credit against those invoices raised by the third party.

Non-inclusion of any cost/expenditure in the taxable value while providing taxable service: some sample debit notes and corresponding invoices are verified to see whether such cost/expenditure have been included in the taxable value.

**Whether:**

Service Taxis payable on the gross amount charged by service provider; thus advances received are also taxable; gross amount charged includes value of taxable services along with Service Tax payable

Gross amount charged includes any amount received towards taxable service before, during or after provision of such services

In case of associated enterprises the gross amount charged includes any amount credited or debited, as the case may be, to any account, whether called 'suspense account' or by any other name, in the books of account of a person liable to pay service tax'

All the expenditure or costs incurred by the service provider in course of providing any taxable services are included in the 'value' for the purpose of charging of service tax

All the expenditure incurred by service provider not included in value satisfies all conditions as mentioned in rule 5(2) of Service Tax Valuation Rules

In case of import of service, gross value of any taxable service shall be such amount as is equal to the actual consideration charged for the services provider or to be provided, thus TDS amount should also form part of gross value

**D. Issues relating to CENVAT credit**

Eligibility of the assessee to avail CENVAT credit on inputs/input services/capital goods: eligibility requires determination as to whether the input services have been used 'in or in relation to the manufacture of the final product and clearance of final products up to the place of removal' (for input services used by a manufacturer); eligibility of inputs/input services to CENVAT credit to be determined with respect to the provisions in the CENVAT Credit Rules, 2004.

Use of common input for both taxable and exempted services: the assessee is expected to give a statement at the end of the year indicating the amount of credit attributable to exempted goods or exempted services and payment thereof; correctness of the ratio for of reversal of CENVAT credit is verified.

Availing of CENVAT credit used in exclusively exempted services: if it is determined that input services are used in exempted output services then CENVAT credit has to be reversed.

CENVAT credit Inputs- Whether

Input received is eligible for credit, are in the category of exempted goods

Quantity in the input invoices tallies with quantity in Goods Received Note

Credit taken of assessable value,

Credit is taken of duty paid on all goods except light diesel oil, high speed diesel oil, or motor spirit, commonly known as petrol

Materials directly supplied to job worker, if so whether credit taken only after receipt from job worker, whether entire quantity received back in factory within 180 days

In case of short receipt whether proportional credit reversed, credit taken of amount reversed in respect of exempted goods (such credit are not admissible)

Duty paid details given in invoice, total duty credit taken tallies with entries in profit/loss Account/ST3 Returns

CENVAT Input services – Whether

The assessee has availed CENVAT on services eligible for credit

Credit pertaining to one unit is not distributed to other units

Credit pertaining to Head office allocated in the ratio of turnover, where there are more than one premises from which services are provided and Service Tax paid thereon or more than one manufacturing units

Credit reversed if payment of value along with Service Tax to service provider is not made within 3 months

Reversed if separate records for CENVAT not maintained in respect of dutiable and exempted goods manufactured or services provided

Inputs Dealers invoice - Whether

Duty passed on is calculated correctly with reference to manufacturer's invoices

Details of manufacturer supplier details mode of transport, etc., correctly written

In case of second stage dealer whether invoices is authenticated by department

Whether the original manufacturer is a 100 per cent EOU/Importer

In case of importer, whether CVD passed on is correctly worked out

Inputs Bill of Entry -whether

In case of EDI Bill of Entry, whether TR 6 challan attached, B.E. assessed provisionally

Bills of Entry endorsed in favour of the assessee by the supplier importer

Credit taken only in respect of CVD, calculated correctly, paid in cash or debit trough DEPB scheme

CENVAT capital goods – whether

Capital goods are eligible for credit, used exclusively for the provision of exempted services

Credit taken only to the extent of per cent during the first financial year,

Credit taken only in respect of specified duty

**E. Miscellaneous issues**

Adjustment of credit under Rule 6(4A) Adjustment of credit under Rule 6(3), 6(4A): credit notes issued by assessee to the client are called for to verify this claim, calculation s of excess payments made earlier are called for to verify the claim

Payment of tax on advances: Service Taxis payable on advance received for the services agreed to be provided; such advances received shall appear as liability in the Balance Sheet and is declared at sources of funds in ITR.

Reverse charge on import of services: some of the expenses incurred by the services receiver are available in the ITR at Debits to Profit Loss Account.

Reverse charge other than imports: other important services on which reverse charge is applicable are: Manpower supply, Security services, Sponsorships, Legal etc., subject to fulfilment of conditions mentioned in the said notification.

Excise Officer under certain circumstances has the power to make an assessment of the value of taxable services provided by the assessee to the best of his judgement and determine the tax payable by assessee or refundable to the assessee on the basis of such assessment if assessee failed to submit information called for to satisfactorily complete the scrutiny.

## *Examples*

Unregistered service providers

Every person liable to pay Service Tax shall make an application for registration (Section 69 of the Finance Act, 1994, read with rule 4 of the Service Tax Rules, 1994) to the concerned central excise officer in form ST-1, within 30 days from the date on which the Service Tax under section 66 of the Act above is levied or from the date of commencement of business of providing taxable service if such business is commenced after introduction of the levy under the Finance Act.

Under section 65 (30a) of the Finance Act, 2005, 'Construction of Complex (Residential) Service' means construction of a new residential complex or a part thereof, completion and finishing services in relation to residential complex or restoration of or similar services in relation to residential complex.

Eighty seven contractors in Indore (16) and Bhopal (71) Commissionerates rendered the service of "Construction of Complex (Residential) Service" and received payment of ₹ 93.55 crore during the period from Oct 2006 to Oct 2009. Cross examination of the said information with the Service Tax records of the Service Tax ranges disclosed that these contractors were not registered with the department under the said service and did not discharge the liability of service tax. This resulted in non-payment of Service Tax of ₹ 11.51 crore including cess. (Para 2.3.1 Union 29 of 2010-11).

Registered service providers

Under section 65(33) of the Finance Act, 1994, 'courier agency' means any person engaged in the door-to-door transportation of documents, good or articles utilizing the services of a person, either directly or indirectly, to carry or accompany such document, goods or articles. M/s Expressit Courier Services Private Ltd. in Service Tax, Mumbai-I Commissionerate, engaged

in providing 'Courier Services' filed (May 2010) belatedly, the Service Tax returns for the half yearly periods ending Mar 2009, Sep 2009 and Mar 2010 in May 2010. Audit found that the assessee had not paid the Service Tax shown in the returns for the period from November 2008 to March 2010, which amounted to ₹ 1.42 crore. (4.1 Union 29 of 2011-12)

Section 65(19) of the Finance Act as amended in May 2006 defines 'business auxiliary services (BAS) to mean any taxable service provided or to be provided to a client by any person for promotion or marketing or sale of goods, promotion or marketing of services or any customer care or recovery of cheques etc., and includes services as a commission agent'.

M/s Ashok Chaturvedi, in Delhi Service Tax Commissionerate, had received payment aggregating to ₹ 2.50 crore from an individual for refraining from participating in various bids during the period 2005-06. By abstaining/refraining from bids on the request of an individual for a consideration, the assessee had indirectly promoted the business of that individual. As such the service rendered by the assessee was classifiable under the head 'business auxiliary service' but the assessee had not discharged his Service Taxliability on the same. Service Tax of ₹ 25.50 lakh is recoverable. Further interest of ₹ 15.19 lakh and penalty are also leviable. (4.3.1 Union 29 of 2011-12)

Recipient of services

Rule 2 (l) (d) (iv) of the Service Tax Rules, 1994, stipulates that in respect of taxable service provided by a person, who is a non-resident or is from outside India and does not have an office in India, the person receiving the taxable service in India is liable to pay service tax.

Intellectual property right services involves transfer of right to intangible property viz., trademarks, designs, patents or any other similar intangible property under any law for the time being in force, and were brought under the levy of Service Tax net from 10 September 2004. The term 'intangible property' for this purpose includes the right to use technical know-how belonging to another person.

M/s Air Liquide Engineering India Pvt. Ltd., in Hyderabad III Commissionerate, availed of technology provided by M/s Air Liquide, France for manufacture of air and gas separation plants on a turnkey basis. The assessee made payments to the foreign company towards royalty for having acquired the requisite technology. The payments were worked out with reference to sales turnover of air and gas separation plants manufactured by them. The assessee made payments aggregating ₹ 5.52 crore towards rights acquired by them for use of technology during the period from 2004-05 to 2006-07 but did not pay the applicable Service Tax of ₹ 58.85 lakh. (2.2.1 Union 13 of 2009-10)

Valuation of taxable services

Section 67 of the Finance Act, 1994, envisages that the value of taxable service in relation to commissioning or installation services is the amount charged by the service provider for rendering such services. Further, notifications dated 21 August 2003 and 1 March 2006 provide that, in the cases of contracts involving provision of services along with supply of materials, the service provider may pay the Service Tax on 33 per cent of the gross contract amount.

M/s CMC Ltd., in Kolkata Service Tax Commissionerate, engaged in providing software and hardware solutions, executed jobs of installation and commissioning along with supply of equipment under composite price contracts without having any price breakup for supply, installation and commissioning works. The assessee paid Service Tax at two per cent instead of 33 per cent of the gross contract value which was applicable for installation and commissioning work. Incorrect adoption of value resulted in short payment of Service Tax of ₹ 5.62 crore during the period from 2004-05 to 2007-08. (Para 4.1 Union 13 of 2009-10)

M/s Bharti Airtel Ltd., Ambala Cantt, in Panchkula Commissionerate, engaged in providing Business Auxiliary Services, received ₹ 257.69 crore in advance towards services provided as per their trial balance for the years 2003-04 to 2005-06. The assessee had not shown the advance receipt of ₹ 257.69 crore in the half-yearly returns submitted during the period 2003-04 to 2005-06 except a sum of ₹ 65.39 crore in the second half-yearly return for the period October 2005 to March 2006. Thus, the assessee had suppressed the assessable value of ₹ 192.30 crore on which Service Tax of ₹ 18.52 crore was evaded.Besides interest of ₹ 6.74 crore and penalty of ₹ 18.52 crore were also leviable. (Para 2.2.3 Union 13 of 2009-10)

Exemptions

Service Tax on maintenance or repair of computers or computer system or computer software was leviable from 9 July 2004.

M/s Microsoft Corporation (India) Private Ltd., Gurgaon, in Delhi Commissionerate of service tax, provided services under the category of business auxiliary services, manpower recruitment agency and maintenance and repair services. The assessee paid Service Tax on income on account of "service fees - product support services in relation to software" covered under maintenance or repair of software services from 7 October 2005. However Service Tax was not paid on similar charges of ₹ 12.55 crore obtained during the period from 9 July 2004 to 6 October 2005 treating the service as exempt under the aforesaid notification. Since the notification providing exemption was rescinded from 9 July 2004, Service Tax of ₹ 1.28 crore was recoverable with interest and penalty.

CENVAT

Under the CENVAT Credit Rules, 2004, the credit availed on Service Tax paid on input services and central excise duty paid on inputs and capital goods can be utilised for payment of central excise duty on finished goods or Service Tax payable on output services subject to fulfilment of certain conditions.

Provider of output services opting not to maintain separate accounts shall have an option either to pay an amount equal to eight per cent of the value of exempted service or pay an amount equivalent to the CENVAT credit attributable to inputs and input services used in or in relation to the manufacture of exempted goods etc. M/s Tata Consulting Engineers Ltd., in Mumbai-I Service Tax Commissionerate, provided taxable as well as exempted services during the 2008-09 and 2009-10 but had not maintained separate accounts of CENVAT credit availed on inputs/input services. The assessee had neither exercised the option to pay an amount equal to 8 per cent (five per cent with effect from July 2009) of the value of exempted services nor did the assessee pay an amount equivalent to the CENVAT credit attributable to inputs and input services used in or in relation to the provision of exempted services. The total exempted services provided during the period Apr 2008 to Sep 2009 was ₹ 14.96 crore. Therefore the assessee was liable to pay ₹ 1.15 crore being 8 per cent of the value of the exempted services during Apr 2008 to Jun 2009 and 5 per cent during Jul 2009 to Sep 2009. (5.3 Union 29 of 2011-12)

CENVAT credit of tax paid on input services shall be allowed, on or after the day on which payment is made for the input service and service tax. Where the CENVAT credit has been taken or utilised wrongly, the same along with interest shall be recovered from the manufacturer or the provider of output service. M/s Gwalior Chemical Industries Ltd., Nagada, in Indore Commissionerate, availed CENVAT credit of Service Tax paid on various input services on 31 August 2009. The payment of value of these input services including Service Tax was made in the subsequent month i.e. from 2 September 2009 to 21 September 2009. As the CENVAT credit was availed before the payment of value of service charges, therefore, the CENVAT credit of ₹ 16.24 lakh was wrongly availed, which was recoverable along with interest and penalty. (5.4 Union 29 of 2011-12)

When capital goods, on which CENVAT credit has been taken, are removed as such from the premises of the provider of output service, the provider of output service shall pay an amount equal to the credit availed in respect of such capital goods. M/s Vodafone Essar South Limited in Kolkata Service Tax Commissionerate, engaged in providing telecommunication, business auxiliary services, intellectual property services etc., sold capital goods valued at ₹ 1282.99 lakh during period 2009-10 to M/s Vodafone Essar South Limited, Mumbai. The assessee had earlier taken CENVAT credit on the same.

However, the assessee did not pay the amount equal to the CENVAT credit of ₹ 167.26 lakh (including Cess) in respect of the sold goods though required as per the statutory provision cited supra. Non-reversed CENVAT credit of ₹ 167.26 lakh (including Cess) was recoverable along with interest. (3.7.7 Union 6 of 2014)

Input service means any service (i) used by a provider of taxable service for providing an output service, or (ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products up to the place of removal and includes services used in relation to setting up, modernisation, renovation or repairs of a factory, premise of provider of output service or an office relating to such factory or premises, inward transportation of inputs or capital goods and outward transportation up to the place of removal. M/s Vedanta Aluminium Ltd., Langigarh a manufacturer of Calcined Alumina in Bhubaneswar I Commissionerate, had availed CENVAT credit of ₹ 1.30 crore towards Service Tax paid during the period between April 2008 and March 2010 on certain services like construction service viz., construction of barrack and hostel at civil township and outdoor catering services. The availing of Service Tax credit on these services was incorrect as these fell outside the scope of input service and had no nexus with process of manufacture of final products. (5.2.1 Union of 29 2011-12)

## CUSTOMS DUTIES AND EXPORT INCENTIVES

Readers are expected to be familiar with the contents of Chapter 11, Customs Duties in the Public Expenditure, Revenue and Resource Management.

Compliance audit concentrates on consistency in application of customs laws and rules to safeguard Government revenue from any possible revenue loss. Duties are mostly on imports. Import duties are of different types. Basic Customs Duty (BCD) at specific rat or ad-valorem rate, Countervailing Duty (CVD), Additional Customs Duty (ACD), Anti Dumping Duty (ADD), other protective safeguard duties, etc. These duties, particularly CVD (which corresponds to Central Excise) and ACD (which corresponds to VAT) are selectively applied or exempted, depending on the rules in force at a particular point of time. Export duties are levied only on a few commodities with the purpose to restrict their exports. If fact, exports are incentivised through a number of export promotion schemes.

Compliance audit of customs seeks to have an assurance on to what extent the tax officials are able to make importers and exporters of goods comply with Acts, Rules and notifications. Audit examines the extent of application of rules and instructions relating to valuation, classification, levy of prescribed duties, charges, interest, penalty, duty rates, effective date, computation, time period for compliance, exemptions, export credits etc. Approach in compliance audit is consignment oriented. It involves test check of a sample of transactions and examination of all the documents related to such transactions.

Some of important Acts and Rules are Customs Act, 1962, Customs Tariff Act, 1975, Central Excise Act, 1944, Central Excise Tariff Act, 1985, Customs (Import Of Goods At Concessional Rate Of Duty For Manufacture Of Excisable Goods) Rules, 1996, Customs Valuation (Determination Of Price Of Imported Goods) Rules, 1988, Baggage Rules, 1998, The Customs, Central Excise Duties and Service Tax Drawback (Amendment) Rules, 2006, Re-Export Of Imported Goods (Drawback Of Customs Duties) Rules, 1995, Customs Tariff (Identification And Assessment Of Safeguard Duty) Rules, 1997 etc.

The business process is highly automated. ICEGATE [Indian Customs Electronic Commerce/Electronic Data interchange (EC/EDI) Gateway] portal provides e-filing services to the trade and cargo carriers and other clients for about 24000 registered users and about 6.72 lacs importer/exporter. Bill of Entry (BE-import goods declaration), Shipping Bills (SB-export goods declaration), Import General Manifests, (IGMs) and Export General Manifest (EGMs) manifests filed electronically are processed by ICES (India Customs EDI System) at the customs locations. ICES (Indian Customs EDI System) through ICEGATE interact with banks, licencing and regulatory agencies such as DGFT, DGCI&S, Ministry of Steel, RBI etc. RMS (Risk Management System) facilitates the compliant trade segregating the transactions requiring deeper scrutiny and compliance enforcement by customs officers.

The practice of routine assessment, concurrent internal audit of almost all bills of entry was dispensed. The focus is on post clearance audit of bills selected by the system and a quality assessment. Accordingly audit is adapting to examination of electronic data available in the form of dump files and in residing in the system through an audit module.

**Imports**

In the case of imports, tax officials have to ensure that all import cargo of a vessel has been duly accounted for; all obligations of the master or agent of a vessel under the Act have been fulfilled; and import manifest documentation is complete in all respects.

Audit has to satisfy itself that (a) dutiable goods have not been imported without payment of duty (b) all goods are correctly described in documents as regards quantity, weight, value etc., (c) the procedure for the control, discharge and clearance of goods has been correctly followed and (d) that all documents relating to ships files are forthcoming and are complete.

The following checks are applied on ship files. Audit of aircraft export files is done in the same way as ships files.

The duplicate copies of bills of entry agree with the original bills in all respect with regard to the particulars required to be entered by importer and Customs Officers;

No goods in excess of the quantity covered by the bills of entry have been delivered;

All duties, penalties and fees recoverable have been duly levied and credited to Government

In the case of Into-bond bills of entry, the goods covered by them have actually been deposited in the warehouse;

The bills of entry have been correctly noted against the respective items in the manifest;

The particulars given in the manifest in respect of marks, numbers and the bill of entry number and duty have been correctly posted in the manifest;

In the cases of goods for transshipment, the transshipment passes have been issued and required fees recovered; the goods actually transhipped to be treated as accounted and for the balance necessary entries are made in the manifest;

The confiscated goods which have not been redeemed under Section 125 of Customs Act, 1962 have actually been sold in auction;

All wanting documents shown in the scrutiny reports are traced and verified.

Import duties assessed, levied and collected by the Customs Officials are audited by examining a sample of bills of entry which could be for (a) Non bonded goods (Dutiable home consumption, duty free or home consumption or for Government stores and (b) Bonded Goods (Into bond bills of entry, out of bond-Ex bond) and supporting documents.

*Audit checks on dutiable bills of entry are:*

The description given in the bill of entry is complete and gives clear idea of the goods imported e.g. in the case of component parts of the machinery, the machine of which they are component parts is also stated;

The Correct tariff heading is shown;

The correct rate of exchange has been applied;

When the goods are passed on tariff value or where the goods are subject to a specific rate of duty, the unit of quantity or weight, as the case may be, is recorded;

The value is arrived at as per provisions of section 14 of the Customs Act, 1962 and Customs Valuation (Determination of Price of Imported Goods) Rules, 2007;

The value, weight or quantity assessable to duty is correctly calculated;

The rate of duty levied is in accordance with the Customs Tariff Act 1975 as amended and Central Excise Tariff Act, 1985 and that the duty payable has been correctly calculated; rate of Anti Dumping Duty is the same with respect to the country specified in the country of origin certificate

If there is more than one item in the B.E., the summation of total value, weight or quantity of, the several items is correct;

In the case of duty not paid in time, the provision of section 47(2) is applied by the department.

In the case of goods assessed to duty at the preferential or protective rate of duty, the appraiser has attached a copy of the certificate of origin in the proper form duly attested;

Whether bill of entry is accompanies by documents like country of origin certificate, invoice, purchase order, freight certificate etc.

Exemptions claimed are the same as in accordance with the notifications

In high sea sales whether a legally enforceable contract with required conditions, declarations, undertakings, bond are available

In provisional assessment additional audit checks exercised are include whether (a) the proposed valuation was based on the recorded examination and Appraiser has recorded in details the basis of provisional assessment and (b) The goods are cleared by taking a Bond with appropriate security.

Project contracts are made in a number of consignments over a period of time, the duty is initially collected on each consignment provisionally. Within three months from the date of clearance of last consignment the importer should submit a reconciliation statement showing indicated items in the import license and those actually imported. The department checks the accuracy of the statement assesses the duty and collects the differential duty from the importer. It should therefore be seen in audit that the reconciliation statement was submitted in time by the assessee and the customs department assessed the duty correctly.

Whether proper Bond was executed in respect of Into-Bond bills of entry

*Audit checks for ex-bond bills of entry include:*

The description of goods, nature, number and other relevant particulars mentioned in Into Bond bills of entry match with the corresponding information in the Ex-Bond bills Verification of correctness of classification, tariff value (if any) and rate of duty

In the case of part clearance of goods assessed on weight ascertained by percentage weighment, quantity entered in the bill of entry, is proportionately correct according to the particulars on the reverse of the bill of entry.

The duplicate ex-bond bills of entry are compared with the original, when there are changes in tariff or exchange rates. Tariff value and the rate of duty applied is that in force on the date on which a B.E. for home consumption of such goods is presented.

If a tariff value has come into force for goods which are assessed ad valorem at the time of their entry into-bond the goods should be assessed on such tariff value.

If goods were assessed on tariff value at the time of their entry into-bond, but no tariff value is in force at the time of their clearance from Bond for home consumption, they should be reassessed ad valorem.

**Exports**

In the case of exports, the purpose is to see that the obligations of the owner of the goods under the Act and Rules have been fully complied; the manifest and other documents are complete; and every package in the Export General Manifest has been shipped under proper authority**.**

*In auditing an export ships file, it is seen that:*

All packages entered for export are fully accounted for by shipping bills, transshipment permits etc.

Dutiable cargo has not been exported free of duty;

All goods are correctly described in documents as regards quantity, value, weight;

The prescribed procedure for shipment of goods is followed;

Where necessary, prescribed percentages of check weighment of dutiable goods has been carried out and proper action have been taken for settling differences in excess of the prescribed limits;

Short shipment notices have been filed within the time limit laid down;

Fees have been properly levied for the amendment of the manifest;

Corrections in the manifests and connected documents have been dealt with according to the prescribed procedure;

In respect of goods shipped under claim of drawbacks, advices have been sent to other ports of call of the vessel;

Audit of aircraft export files is done in the same way as ships files.

Most of the exports from India are highly incentivised through several schemes under Foreign Trade Policy (FTP) administered by Director General Foreign Trade (DGFT). Export incentives that are facilitated by DGFT, assessed and allowed by the Customs Officials are audited by examining a sample of shipping bills (for free goods, for dutiable one, goods to be shipped under claim for drawback of customs or central excise or both, for export promotion schemes) and supporting documents such as invoices, orders, contracts, price list etc., with reference to Rules and notifications.

Dutiable shipping bills are audited to examine whether the rates are charged correctly in accordance with the Tariff Schedule read with exemption notification, if any; the value adopted is correct, export trade control regulations were observed etc.

## *Audit of incentives for export promotion*

### *Duty Drawback Scheme*

Under duty drawback scheme exporter of specified goods are entitled for refund of customs and excise duty paid on the inputs used in the manufacture of the export products.

*Audit examines to see whether:*

Whether such duty is more than 1% of FOB value of exports and drawback is limited to 98% of duty on import

The claims are presented in proper form and declarations furnished within the prescribed time period

That the goods were actually exported

Identification of goods re-exported and determination of imported goods

If goods are put into use in India after import (and prior) to its export whether the duty drawback is granted on a sliding scale basis depending on the extent of use of goods

The notified rate (A.I.R rate) of drawback was correctly applied as per descriptions on the shipping bill and examination of re-exports;

Whether the rate of drawback prevalent on the date of let export was allowed?

In the case of Brand Rate, the amount of drawback paid is correctly worked out on the basis of the rate adopted and the quantity exported;

*Reward and Incentive Schemes*

SFIS- Served from India Scheme, VKGUY-Vishesh Krishi and Gram Udyog Yojana, FMS-Focus Market Scheme MLFPS-Market Linked Focus Product Scheme and Status Holder Incentive Scrip are referred to as Reward and Incentive Schemes. *Audit checks on include:*

Actual exportation – to be verified from the Shipping Bill

F.O.B. value of export in free foreign currency is correct

Specified items are actually exported

All the conditions for grant of the scrips are fulfilled

The scrip is used for the purpose it is granted

Free foreign currency has been realized in time and in the case of delay in realization interest is levied

In the case of delay in submission of application, late cut is imposed

*Duty Exemption/Remission Schemes*

Duty Exemption Schemes (Advance Authorization and Duty Free Import Authorization -DFIA) enable duty free import of inputs required for export production. Duty Remission Schemes (Entitlement Passbook Scheme-DEPB and Duty Drawback-DBK Scheme) enables post export replenishment / remission of duty on inputs used in export product.

*Audit checks include:*

Whether DFIA/DEPB/Advanced Authorisation issued as per SION (Standard Input Output Norms notified by DGFT)

Export obligation was fulfilled (within specified time)

Free foreign currency has been realised (within specified time)

In the case of non-fulfillment of export obligation proper action has been taken
Authorisation and goods imported under the authorization are not transferred (AA)
In the case of Pre-export DFIA, prescribed value addition has been achieved;
In the case of transferred Authorisation (DFIA) additional customs duty is paid at the time of import;
In the case of delay in submission of application for DEPB, late cut is imposed; credit is given as per specified rate and all the conditions for grant of the scrips are fulfilled;

*Gems and Jewellery Scheme*

Replenishment Authorisations are granted with respect to exports actually made and taking into consideration of value addition;
Diamonds imported for grading are exported;
F.O.B. value of export in F.E. is correct;
Benefit of the scheme is given only for the export of specified items;
Prescribed value addition is achieved; free foreign currency realised;
In the case of imports before exportation, export obligations are fulfilled within specified time;
In the case of non-fulfillment of E.O. proper action has been taken

*Export Promotion Capital Goods (EPCG)*

Authorisation issued for import of Capital goods was as per provision of FTP
Duty on the imported Capital goods was correctly worked out;
Export Orders were worked out properly in respect of different schemes;
Export Orders was fulfilled in time;
In the case of non-fulfillment of E.O., proper action was taken by the R.A.

*Export Oriented Units (EOU)* -They include Electronic Hardware Technology Parks, STP-Software Technology Parks BTP-Bio-Technology Park).

The goods so imported or procured from DTA are actually used for the production of export products;
The DTA sales are within the prescribed limit and duty, if any, payable is actually paid;
There is positive NFE earning;
By products are sold in DTA on payment of duty;
Proper accounts of the utilization of the imported goods are maintained by the unit;
The performance of the units is monitored.
Special Economic Zone (SEZ) Scheme, Free Trade and Warehousing Zones (FTWZ)
The goods so imported or procured locally are actually used for export product;
For DTA sale, applicable customs duty has been paid;
There is positive NFE earning;
Proper account of the utilization of the imported goods is maintained; and
The performance of the unit is monitored annually

## *Examples*

Compliance audit findings usually relate to classification of goods (Freight and insurance not included in Assessable Value; Non-consideration of High Sea Sale price; Non-revision of Tariff Values; RSP is less than transaction value; Exchange rate on date of presentation of bill of entry is higher); duty rate and computation (Effective rate at that point of time; Date of withdrawal or introduction; Date of increase or decrease in rate); prescribed duties/charges (Non-levy of Antidumping duty, safeguard duty; Non-levy of Additional Duty of Customs (ACD); Non-levy of export duty, cess); duty exemptions and export credits (Incorrect grant of exemptions due to misclassifications; Incorrect grant of exemptions-non-fulfilment of end-use conditions; Incorrect issue of duty credits).

Classification of goods

'Insecticides, rodenticides, fungicides and herbicides' are classified under Customs tariff heading (CTH) 3808 and leviable to basic customs duty (BCD) at the rate of 10 per cent. M/s J.U. Pesticides and Chemicals Pvt. Ltd. and M/s Tropical Agro System (India) Ltd. imported (January to July 2009) 44 consignments of 'Imidacloprid 95 per cent technical', 'Pretilachlor 95 per cent technical' and other chemicals used as insecticides, herbicides and fungicides for a value of ₹ 30.10 crore through Chennai (Sea), Commissionerate. The imported goods were classified under CTH 29420090/29201100 as 'other organic compound' /'esters of other inorganic acids' and assessed to concessional BCD at the rate of 7.5 per cent under notification no.21/2002-cus dated 1 March 2002 (serial no.553) instead of applicable rate of 10 per cent. As these goods were 'technical grade chemicals meant for pesticides/ insecticides' they merit classification under the CTH 3808 in terms of the Board's circular dated 29 July 2003 and 17 September 2007. The misclassification had resulted in short levy of duty of ₹ 87.47 lakh. (5.1 Union 24 of 2010-11)

Perfumery products In terms of note 1(a) to chapter 44 of the Customs Tariff Act (CTA), 1975, wood in chips, shavings, crushed, ground or powdered form, of a kind used primarily in perfumery, inter-alia, is excluded from the purview of chapter 44 of the CTA, 1975 and is classifiable under the tariff heading of the said Tariff Act. M/s Jaya Perfumery Works, Kolkata and 28 others imported 146 consignments of 'Joss powder' (bark of litsea tree in powdered form) between Feb 2007 and Mar 2008 through Kolkata (Port) and Chennai (Sea) Commissionerate. The department classified these goods as 'agarbatti (perfumery product) and other odoriferous preparation,' sawdust, wood waste and scrap under CTH 3307/4401. However, the imported goods being raw material for making 'agarbatti' were correctly classifiable under CTH 1211, as

per the aforesaid chapter note. The incorrect classification resulted in short levy of duty of ₹ 51.39 lakh. (5.5 Union 14 of 2009-10)

Valuation of goods

Adoption of incorrect assessable value As per section 14 of the CA,1962 read with rule 10 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, value of imported goods for assessment of customs duty shall be the value of such goods for delivery at the time and place of import and shall include (a) the cost of transport of the imported goods to the place of import (b) loading, unloading and handling charges incurred on delivery of the imported goods at the place of import and (c) the cost of insurance. Where the cost of freight and insurance is not ascertainable, such cost shall be 20 per cent and 1.125 per cent respectively of the free on board (FOB) value of the goods.

M/s Tata Steel Ltd. imported a second hand aircraft through Kolkata (Airport) Commissionerate in August 2008. The assessable value of the aircraft computed was the invoice price of US $ 35,00,000 plus one per cent thereof as loading and unloading charges. However, the invoice price was not inclusive of the cost of freight and insurance and, therefore, it was to be added as per valuation rules to arrive at the correct assessable value. The correct value worked out to US$ 42,81,769. The incorrect computation of assessable value resulted in short levy of duty amounting to ₹ 72.80 lakh. (3.4 Union 14 of 2009-10)

Duty exemption

Disposable spinal needles As per Customs notification no. 21/2002-cus (serial no. 370) dated 1 March 2002, read with notification no. 6/2006-CE dated 1 March 2006, import of specified goods including 'spinal instruments' (serial no. E-9) intended for use as 'assistive devices, rehabilitation aids and other goods for disabled' are exempt from duty. M/s Kanji Shavji Parekh (Calcutta) Pvt. Ltd. and M/s Surgiplus, Pondicherry imported (between May and November 2007), eight consignments of 'Disposable Spinal Needle' through the Kolkata (Port) Commissionerate. The department allowed clearance of the goods at 'nil' rate of duty by extending the benefit under the aforesaid notifications. Audit observed that the goods were in the nature of general surgical instruments for enabling smooth penetration for spinal anaesthesia and cerebrospinal fluid collection and not spinal instruments meant exclusively for use as 'assistive devices/ rehabilitation aids' by the disabled/handicapped; hence the exemption was irregular. Thus, incorrect grant of exemption resulted in non-levy of duty of 40.89 lakh. (4.1 Union 14 of 2009-10)

Goods not re-exported In terms of notification no. 158/95-cus dated 14 November 1995, goods which are manufactured in India and re-imported for reprocessing or refining or remaking etc., are exempt from payment of duty, subject to the condition that the goods are re-exported within six months from the date of re-import or such extended period not exceeding a further period of six months. In the event of failure to comply with the prescribed condition, the importer is liable to pay the duty exempted along with interest. Twelve consignments of iron and steel and articles thereof were imported by M/s Metalink and nine others between November 2006 and August 2007 through the Kolkata (Port) Commissionerate, availing of the benefit of duty exemption under the above notification. The importers neither submitted any proof of re-export of the goods nor sought any extension of time. The department did not initiate any action to recover the duty leviable but for exemption. The omission resulted in non-recovery of duty of ₹ 26.08 lakh. (4.1.3 Union 14 of 2009-10)

According to SION, for the manufacture and export of one MT 'Polyester (PET) Chips (high pressure moulding grade/Bottle grade)', import of 0.3350 MT of 'Ethylene Glycol/Monoethylene Glycol (MEG)' is permitted.

M/s South Asian Petrochem Ltd. an EOU under the Kolkata (Airport) Commissionerate was issued a letter of permission by the Ministry of Industry in January 1998 for manufacture of 'Polyester chips'. The unit during the period July 2007 to March 2008 had consumed 36,239.99 MT of duty free 'MEG' against the permissible quantity of 35,823.34 MT of 'MEG' as per SION, for production of 'bottle grade polyester chip'. This resulted in excess consumption of 416.65 MT of 'MEG' on which customs duty amounting to ₹ 52.50 lakh was recoverable along with interest. (2.1.14 Union 14 of 2009-10)

Duty drawback

As per Customs, Central Excise Duties and Service Tax, Drawback Rules, 1995, Rule 3 (as amended), no drawback shall be allowed on any of the goods falling within Chapter 72 or headings 1006 or 2523 of the first Schedule to the Customs Tariff Act, 1975. Since introduction of the said debarring provisions, several other headings were added or existing ones were deleted by subsequent CBEC notifications, but the heading 1006 continues to exist till date.

M/s Jai Gurudev Industries & warehousing and 113 others exported "Rice in various forms" falling under CTH 1006 through the Commissioner of Customs (Port) Kolkata & Commissioner of customs (Preventive) West Bengal between

October 2011 and February 2013 against 789 shipping bills. Scrutiny of Customs ICES data on exports revealed that the department allowed drawback on export of these goods in contravention of the aforementioned provisions of the Drawback Rules, 1995. This has resulted in inadmissible payment of drawback of ₹ 2.27 crore which is recoverable along with interest of ₹ 49.66 lakh from the exporter. (4.1 Union 8 of 2015)

Export benefits

As per paragraph 6.5 of the FTP read with paragraph 6.10.1 of the HBP Vol.-I, EOU shall be positive Net Foreign exchange (NFE) earner and it shall be calculated cumulatively in blocks of five years, starting from the commencement of production. As per paragraph (3) (d) (ii) of notification No. 52/2003-Cus dated 31 March 2003, in case of failure to achieve the said positive NFE, the duty forgone proportionate to the ratio of unachieved portion of NFE to the positive NFE is to be recovered along with interest. In addition, the unit is liable to pay penalty under section 11 (2) of the Foreign Trade (Development and Regulation) Act, 1992.

M/s Vibgyor Paints Pvt. Ltd. Thane, an EOU under the DC, SEEPZ, Mumbai was issued a LOP in July 2001 for manufacture of industrial paints, decorative paints and resin. The unit imported raw materials worth ₹ 12.11 crore during 2001-02 to 2005-06, while the FOB value of exports during 2002-03 to 2005-06 was 13.92 crore. However, scrutiny of the annual performance report for the year 2005-06 revealed that export proceeds amounting to ₹ 4.69 crore were outstanding for realisation. This resulted in non-achievement of positive NFE, the shortfall amounted to ₹ 2.88 crore. As per provisions of the aforesaid notification, the duty foregone proportionate to the shortfall in positive NFE was ₹ 1.13 crore. (2.1.7 Union 14 of 2009-10)

Export promotion capital goods (EPCG) scheme Non-fulfilment of export obligation

According to paragraphs 6.11 and 6.12 read with paragraph 6.19 of the HBP Vol.-I, 1997-02, an EPCG (Export promotion capital goods) licencee is permitted to import capital goods at concessional rate of customs duty and required to achieve the prescribed block wise proportionate export obligation over the specified period. For monitoring of its export obligation, the licencee should submit to the licensing authority block wise report, periodically, on the progress made in fulfillment of the export obligation. In the event of failure to discharge a minimum of 25 per cent of the export obligation prescribed for any particular block of two years for two consecutive blocks, the licencee will be liable to pay forthwith the whole duties of customs along with applicable interest.

M/s Sun Fibre optics, an erstwhile EOU unit, on conversion was issued (February 2001) an EPCG licence by the RLA, Bangalore to import capital goods worth ₹ 1.05 crore with an EO of ₹ 5.23 crore to be fulfilled within a period of eight years. The licencee imported (Feb/Apr 2000) capital goods worth ₹ 1.04 crore under the EOU scheme and saved duty amounting to ₹ 52.62 lakh on coming over to the EPCG scheme. Audit scrutiny revealed that the licencee did not furnish all the prescribed block wise reports for fulfillment of export obligation, even after two months of the expiry of the validity (April 2009) of the licence. Accordingly, the licencee was liable to pay the customs duty foregone amounting to ₹ 52.62 lakh and interest (up to May 2009) of ₹ 65.12 lakh. (2.3 Union 14 of 2009-10)

As per paragraph 6.11 (c) of the FTP 2004-09, EOUs are entitled to full reimbursement of 'Central Sales Tax (CST)' on purchases made from DTA for production of goods. In terms of clause 2 (a) of Appendix 14-I-I of the Hand Book of Procedures (HBP) Volume-1, admissibility of the reimbursement is subject to the condition that the supplies from DTA must be utilised by the EOU for production of goods meant for export and/or utilised for export products. 2.1.5

M/s South Asian Petrochem Ltd. and two other EOUs functioning under the jurisdiction of the DC, FSEZ, Kolkata (Airport) Commissionerate were granted reimbursement of CST amounting to ₹ 10.46 crore on raw materials/consumables procured and utilised by these assessees in production of PET resin/hawai chappal sheet, coil and dust of aluminium between 2005- 06 and 2007-08. However, this amount also included reimbursement of ₹ 3.67 crore on sale of finished products back in DTA. All the deemed export benefits were to be extended on the principle that the goods were used in the manufacture of finished products which were subsequently exported. In the case of subsequent sale of finished goods back into DTA, the Rules provide for refund of the deemed export benefits already availed of against goods procured from indigenous sources. This resulted in excess reimbursement of CST amounting to ₹ 3.67 crore. (2.1.15 Union 14 of 2009-10)

Special Economic Zones (SEZ)/Export Oriented Units (EOUs)

As per Section 30 of SEZ Act, 2005, read with Rule 47 (1) of SEZ Rules, 2006, any goods removed from an SEZ to the DTA are chargeable to duties of customs as leviable on such goods when imported subject to submission of import license, under the provisions of the Foreign Trade Policy (FTP). Further, for a Duty Free Import Authorization (DFIA), the validity period for imports is 24 months and the export

obligation period (EOP), which was 24 months earlier, is now 36 months from the date of issue. The licensing authority (RA) may grant one revalidation for imports for 6 months from expiry date, on the request of the original authorization holder.

M/s Exotica International, Kolkata, a DTA unit, cleared (between Aug 2010 and Mar 2011) 10 consignments of 'Silk fabrics' valuing ₹ 3.17 crore, from two Falta SEZ units, namely, M/s Roto India and M/s S.R. Enterprises. The Deputy Commissioner of Customs, Falta SEZ allowed full duty exemption amounting to ₹ 72.70 lakh against a DFIA license issued in March 2008 by the Joint Director General of Foreign Trade, Kolkata (RLA). However, validity of the DFIA license for imports being 24 months from the date of issue had expired in March 2010 before clearances made in August 2010/March 2011 and its validity was not extended. The license was amended (July 2010) by RLA only for extending the EO period from 24 to 36 months, in pursuance of the aforementioned policy circular. But the customs authority apparently mistook the extension of EO period of 36 months as extension of validity for imports which remained at 24 months (i.e. up to March 2010) only. Thus duty exemption availed against the expired DFIA license amounting to ₹ 72.70 lakh was irregular and recoverable from the DTA unit along with interest. (Union 14 of 2014)

Served From India Scheme (SFIS)

The Supreme Court, in the case of Tata Consultancy Services Vs the State of Andhra Pradesh (STC Vol.137 of 2004) and in the case of BSNL Vs the Union of India and others (STC Vol. 145 of 2006) judicially held that Copyright or right to use the title are termed as 'goods' under the Sale of Goods Act. Accordingly, remittance from Copyright or right to use the title is not to be considered for duty credit under 'Served from India Scheme' (SFIS).

Regional licensing authority (RLA), Chennai granted (May 2010) duty credit of ₹ 4.70 crore and ₹ 0.35 crore to M/s Sun TV Network Ltd., and M/s Kalaignar TV Pvt. Ltd., respectively under SFIS at 10 percent of the free foreign exchange of ₹ 46.98 crore and ₹ 3.55 crore earned by them during the year 2009-10. The duty credit was granted for the license fee earned by them from various television channels abroad. The earnings could not be reckoned for duty credit under SFIS because they were on account of transfer of right to use the title or copy right and not on account of rendering of any service. This had resulted in irregular grant of duty credit of ₹ 5.05 crore which was recoverable with interest. (Union 14 of 2014)

# CHAPTER -17

# Compliance Auditing of Tax Revenue-States

## SALES TAX- VALUE ADDED TAX

Sales Tax or tax on sale of goods is the largest contributor to the State Tax Revenue. It is a tax on the turnover of the sale. It is multi point sales tax (Value Added Tax-VAT) which provides set-off of tax paid on purchases. VAT is administered by Commercial/ Sales Taxes Department (CTD). VAT is governed by VAT/Sales Tax Act of the State and Central Sales Tax Act (CST), VAT/Sales Tax State Rules, CST Rules, clarifications issued by the Commissioners/Committees and Appellate Tribunal/ Court judgments.

The CTD is usually headed by the Commissioner of Commercial Taxes (CCT) who is assisted by Additional Commissioners, Joint/ Deputy/Assistant Commissioners, Commercial Tax Officers (CTO), Deputy Commercial Tax Officers (DCTO) and Assistant Commercial Tax Officers (ACTO). States are usually divided into Divisions and Circles. The main functions of CTD include registration of dealers, levy and collection of taxes and monitoring the activities of dealers through assessment of returns and their audit.

Registration is compulsory for dealers exceeding the threshold limit of value of annual sales. Irrespective of such value dealers who are purchasing goods from other states or selling goods to other states, exporting or importing goods and paying at special rates need to register. Registration related issues examined in Audit include:

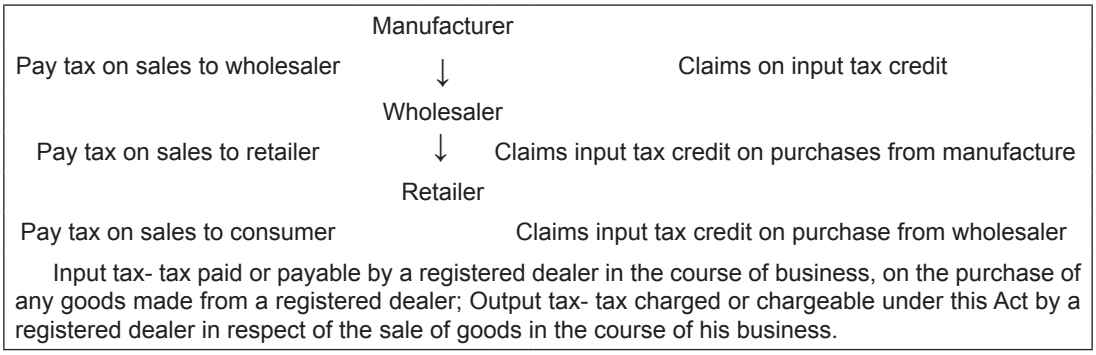
How is the Department ensuring that the dealers are getting registered? Is there a system of information interchange on dealers with other Departments? Are methods like street survey used?

Is there a system for ensuring that if the turnover of such a dealer crosses the threshold turnover, he is compulsorily registered as a VAT dealer?

Whether the registration certificates of dealers were cancelled in a timely manner, based on street survey reports of stopped businesses? Whether reversal of ITC was initiated on purchases from dealers whose registration was cancelled?

Every registered dealer should assess his tax liability (self-assessment) and furnish return for such period, in the prescribed form to the assessing authority at prescribed periodicity. 'Return' is a document reflecting the gross turnover, taxable turnover, statement

of purchases against VAT invoices in the prescribed VAT Form, statement of sales in the prescribed VAT Form, output tax, tax credit and net tax payable/refund due by a dealer during a return period (tax period) and bank challan as proof of payment of tax. Filing of true and correct return within the stipulated time is mandatory and legal obligation of the registered dealer. Otherwise it invites penal consequences.




*Preliminary scrutiny*

In most of the States, the entire process of registration, filing returns, preliminary scrutiny of returns and selection of a sample for detailed scrutiny is automated. Audit seeks to have an assurance that the preliminary scrutiny of the returns by their IT Systems ensures that:

Stop-filers are identified and action initiated

Delay in filing of returns is identified and interest was levied

The returns were accompanied by prescribed documents and proof of tax payment

Inconsistencies within the information provided by dealer with respect to turnover, valuation, classification, concession, exemption, input/output tax adjustments were identified and the differential tax due or refund is worked

Information provided by the dealer is compared with the information already available with and collected by the tax department from other sources to identified gaps in the taxable turnover

Purchases and sales of a dealer could be within the State, to/from other States, international import/export, intra-state or inter-state branch transfer/consignment sales, exempt goods or/and works contract. VAT is levied with reference to the financial transactions of the business, books of account and records. Dealers are mandated to maintain them in the prescribed form and preserve for a prescribed period.

The tax invoice establishes the VAT liability of the seller of taxable goods and is also the authority for a buyer to claim a credit for the tax paid on inputs.

*Detailed scrutiny/assessment*

Department selects a sample of returns on certain risk criteria and subjects them to detailed scrutiny/assessment by the assessing authority. The rest of the returns are deemed to have been assessed if it is not otherwise assessed with a defined time period (four or five years).

Issues having impact on the tax leviable/payable are volume of good sold, value of goods sold, nature of sale (within state, interstate, export, stock/branch/depot transfer), nature of goods sold (classification), any tax exempt goods, purchases made, input tax credit claimed (and thus arriving at the taxable turnover) and levy of tax rate applicable on that good.

It would involve understanding the assessee main business activities, other business activities, principal input and outputs, principle suppliers and main customers. It would involve having an assurance through examining that all purchases and sales are genuine and all sales and purchases correctly declared on the VAT returns. For conducting detailed scrutiny/assessment tax officials may call for accounts, registers, documents maintained by the assesse. Tax authorities have to access to premises, seizure of records and investigate in cases of suspected concealment/evasion.

The basic documents examined are Registration Certificate, Sales Register, (local, inter-State, export), Purchase Register (local, inter-State, import), Sales Invoices and Purchase Invoices (including lorry receipts, delivery challans/ goods received note) Credit/ Debit Note register, Consignment Notes / Branch Transfers Memos (stock transfer invoices), Monthly Returns-Original/ Revised, Stock Valuation Statement, audited Financial Statements, correspondence with the departments, Statutory Forms Register, Classification Schedule (Rate of Tax), Stock inward/Stock Outward Register, Input VAT / Output, VAT Register and Place of business within and outside State.

In the case of a manufacturer, stock registers for raw materials, component parts and inputs, consumables, receipt of goods, finished goods, opening stock, goods manufactured, goods used, sold or consumed or otherwise disposed off and closing stock of goods are specifically examined. For trading units, the stock register would reflect opening stock, purchases, sales, and closing stock.

The following steps are followed in Audit:

Preliminary study of the nature of the business of the dealer,
Examining the taxability of traded goods or other goods,
Examining the VAT rate applicable to such goods,
Study of any specific notifications applicable,
Verification of monthly returns and revised returns,
Reconciliation of books of accounts with the returns filed, study and reporting of the difference, if any,

Verification of the books of accounts as maintained by the dealer, analysis of the accounting ratios for taxable and non taxable goods, extracting and verifying the details

Examining the Input tax allowed as per law and claimed by the dealer,

Confirm the reversal of input tax added to the cost of purchase,

Applicability of the partial rebate or special rebating formula,

Verification of the contents of the total and taxable turnover,

Verification of eligible input tax credit and non-eligible input tax credit,

Examining the declarations of the issue of statutory forms and utilisation of the statutory forms,

Examining the CST sales and export sales in compliance to CST law,

Verification of sample of invoices to see that output tax has been properly accounted for by the seller in relation to the input tax

Cross verification i.e., checking of one VAT dealers input tax claim to the selling VAT dealer's output tax

Audit seeks to have an assurance that assessing officer had ensured the following.

The books of account and other related records and registers maintained by the dealer are sufficient for the verification of the correctness and completeness of the returns filed for the year;

The total turnover of sales declared in the returns includes all the sales affected during the year;

The total turnover of purchases declared in the returns includes all the purchases made during the year;

The adjustment to turnover of sales and purchases is based on the entries made in the books of account maintained for the year;

The deductions from the total turnover including deduction on account of sales returns claimed in the returns are in conformity with the provisions of the law;

The classification of goods sold, rate of tax applicable and computation of output tax and net tax payable as shown in the return is correct;

The computation of classification of goods purchased, the amount of input tax paid and deductions of input tax credit claimed in the return is correct and in conformity with the provisions of law;

Assessment is also done under certain sections when assessee files revised return, on best judgement basis when does not file returns, in case of avoidance or evasion of tax, rectification of mistake, or ex-parte.

### *Examples*

Concealed turnover/sales

Every dealer registered under the Act shall file return, which shall, among other things, include details of purchases including imports. In Tamil Nadu Audit scrutiny of the details obtained from the Customs Department indicated that 66 dealers pertaining to 23 assessment circles imported goods valued at ₹ 904 crore during the period from 2008-09 to 2011-12. Cross verification with the CTD database revealed that these dealers did not file monthly returns. The tax leviable on the turnover not disclosed by the dealers worked out to ₹ 48.91 crore. Penalty leviable at 150 per cent worked out to ₹ 73.37 crore. (2.1.3.3 TN 2 of 2014)

Audit noticed that seven dealers of five assessment circles imported goods valued at ₹ 50.35 crore during the period from 2008-09 to 2011-12. The import purchases disclosed by the dealers in the monthly returns filed by them with the CTD was ₹ 8.38 crore only resulting in suppression of purchase turnover of goods of ₹ 41.97 crore. The tax and penalty leviable on the turnover suppressed by the dealers works out to ₹ 2.90 crore and ₹ 4.35 crore respectively. (2.1.3.3 TN 2 of 2014)

VAT dealers had to report non-creditable/exempt purchases that include interstate purchases, local purchase of exempt goods; and taxable purchase from non-VAT dealers. In Andhra Pradesh State cross verification of turnovers reported by VAT dealers with that of GIS data available at check posts at several locations revealed alarming differences. A total of 715 dealers of sensitive commodities in their monthly returns (Nov 2012 to May 2013) had reported turnover for year 2011-12 as ₹ 6,626 crore, whereas, in GIS data of check posts, the turnover was ₹ 9,354 crore. Purchase turnover was thus short reported in VAT returns by ₹ 12,728 crore. (2.9.2 AP 4 of 2014)

Under Section 28 of Uttar Pradesh VAT Act, the AAs have to finalise the assessment after examining records kept by the dealer in relation to his business and other relevant records. During scrutiny (between Sept 2012 and Nov 2013) of records of trading and profit/loss account, annual balance sheet, current and previous year's assessment orders etc., of seven CTOs, Audit found that in the case of seven dealers for the period 2007-08 (1.1.2008 to 31.3.2008) to 2009-10, turnover of sale of ₹ 5.11 crore was disclosed by the dealers in the records submitted to the AAs. The details of turnover, which escaped assessment, were clear from details available in the respective assessment files of the dealers. These details were required to be examined by AAs at the time of assessment. But AAs did not detect the same while finalising the assessments between Jan 2012 and Mar 2013. This resulted in short-levy of tax of ₹ 38.18 lakh. (2.5.1.2 UP 1 of 2015)

As per Section 4(8) of AP VAT Act, 2005, every VAT dealer who transfers the right to use goods taxable for any purpose whatsoever, whether or not for a specified period, to any lessee or licensee for cash, deferred payment or other valuable consideration in the course of his business shall, on the total amount realized or realizable by him, pay a tax for such goods at the rates specified in the Schedules.

Audit noticed (December 2013) during the test check of records of CTO, Dabagarden circle that in one case, the AA while finalising the assessments for the years from 2007-08 to 2010-11 did not levy tax on a turnover of ₹ 41.85 lakh pertaining to lease rentals of Audio systems. This resulted in non-levy of VAT of ₹ 5.40 lakh. (2.21 AP 1 of 2015)

Misclassification/incorrect rate

During the test check (Nov-Dec2008) of the assessment and other related records of a dealer engaged in the manufacture of gases in Maharastra, Audit noticed in the assessment for the period (finalized in Dec 2007), that on sale of gases like Argon, Nitrogen and Oxygen valued at ₹ 2.51 crore, tax was levied at the rate of 5.4 per cent against the applicable rate of 15.3 per cent. Also sales of medical oxygen valued at ₹ 24.22 lakh tax was levied at the rate of 9 per cent instead of 15.3 per cent. Further, no resale tax was levied on the resale of these gases valued at ₹ 2.90 crore. This resulted in short levy of tax of ₹ 39.55 lakh, including interest. (2.4.5 MH 1 of 2014)

Government of Haryana in Sep 2007 clarified that Ultra High Temperature (UHT) sweetened flavoured milk is different from Ultra High Temperatured Milk which is covered under entry 81 of Schedule 'C' of HVAT Act. Hence, UHT sweetened flavoured milk products are taxable at general rate of tax 12.5 *per cent* and CST rate is same rate as VAT rate applicable in the State of selling dealers without 'C' forms. During test check of the records of the office in Sonepat in July 2012, Audit noticed that a dealer sold fermented milk drink worth ₹ 2.18 croreduring the year 2008-09 and claimed as tax free sale. The AA, while finalising the assessment in February 2012, also did not levy tax at the general rate of 12.5 *per cent* and allowed the 'consignment sale' (without 'F' form) and 'Inter State Sale' valuing ₹ 2.18 crore as tax free. This had resulted in non levy of tax ₹ 27.24 lakh. (2.4.2 HR 3 of 2014)

Non/Short levy of tax under the Central Sales Tax Act

Under Section 8 of the CST Act, every dealer, who in the course of inter-state trade or commerce, sells to a registered dealer, goods of the classes specified in the registration certificate of the purchasing dealer shall be liable to pay tax at the concessional rate of four per cent (three per cent with effect from 1 April, 2007 and two per cent with effect from 1 June, 2008) of such turnover provided such sales are supported by declarations in form C. Otherwise he is liable to pay tax in respect of inter-State sale of declared goods at twice the specified rate and in respect of other goods at the rate of ten per cent

or at the specified rate, whichever is higher up to 31 March, 2007 and at schedule rate from 1 April, 2007.

Audit on test check of the records such as assessment orders, audited accounts, purchase list etc., between Mar and Nov, 2012 in three regional offices, three circle offices in Madhya Pradesh found that in 10 cases of eight dealers assessed between January and December, 2011 for the period 2006-07 to 2009-10, C form in respect of interstate sale of ₹ 3.15 core were not furnished. However, the Assessing Authorities while finalising the assessment either levied tax at concessional rate or did not levy tax at all. This resulted in non/short levy of tax of ₹ 36.42 lakh, including interest of ₹ 6.95 lakh. (2.14 MP 1 of 2014)

Irregular allowance of deduction as branch transfer

Under Section 6(A) of the CST Act, consignment sale (branch transfer) shall be exempt from payment of tax on production of statutory Form-F. In the absence of the statutory forms and supporting documents, the tax on these goods is leviable at the rates prescribed in the Act. Audit in Gujarat observed that in 55 self assessment cases the dealers had claimed the branch transfer of goods valued at ₹ 364.02 crore without submitting Form-F in support of such branch transfer. In the absence of scrutiny of the returns, the omission escaped the notice of the Department resulting in non-levy of tax of ₹ 21.75 crore. In 49 cases involving sales of ₹ 34.94 crore to SEZ units, the dealers had not submitted the details in the prescribed form supporting such sales though they had availed exemption from payment of tax of ₹ 1.75 crore. (2.4.12.3 GJ 7 of 2014)

Set-off

During test check of assessment and other related records in June 2009 in Maharashtra, Audit noticed in respect of a dealer, engaged in manufacture of iron castings etc., that set-off was allowed @12.5 per cent on purchases of electrical installations valued at ₹ 14.48 lakh which were capitalised during 2005-06. However, these items are enumerated in the list of goods on which no set-off is admissible. This resulted in excess allowance of set-off of ₹ 5.11 lakh including interest and penalty (2.4.2 MH 1 of 2014)

Works contracts

As per Section 10 of Kerala VAT Act 2003, every awarder shall deduct from each payment made by him to any works contractor, the tax payable by the contractor in respect of works contract awarded. Where an awarder deducts tax from the payment due to the contractor, he shall issue a certificate to such contractor in Form 20F and the contractor can adjust the amount deducted by the awarder against his tax dues. If an assessee adjusts the TDS against his tax dues he shall furnish the copies of Form 20F certificate issued by the awarder.

Audit scrutinised 62 assessment files of works contractors and observed that four assessees in two assessment circles adjusted from their tax dues certain amount as TDS without furnishing the certificate in Form 20F required in support of their claim. In the absence of Form 20F, the correctness of TDS claimed by the contractors is not verifiable. The assessing authority should have taken note and disallowed the claim. However, the claim was allowed without required certificate. This resulted in short levy of tax of ₹ 35.87 crore including interest and penalty. (2.11.12.4 KL 1 of 2014)

Works contract – tax deduction at source

Scrutiny of records such as Cash Books and Running Account Bills in Roads and Building Divisions in Odisha revealed that from 407 RA Bills involving payment of ₹ 52.66 crore, 22 Tax Deducting Authorities deducted ₹ 1.22 crore towards TDS against recoverable amount of ₹ 2.11 crore. The short fall was due to application of lower rate and reasons thereof could not be furnished to audit. This led to short deduction of TDS of ₹ 88.18 lakh. Besides, penalty of ₹ 1.76 crore was also imposable against the TDAs under Section 54 (6) of the Act. (2.2.4.1 OD 4 of 2014)

Input Tax Credit

Input Tax Credit (ITC) is allowed on purchase of raw materials, which are directly used in manufacturing of goods for sale. In Odisha, during test check of self-assessed returns of M/s NALCO Ltd, Damanjodi, a Large Taxpayer Unit (LTU) engaged in manufacture of Alumina, for the tax periods from February 2007 to January 2008, Audit noticed (November-December 2008) that the dealer claimed and availed ITC of ₹ 2.27 crore on purchase of coal from a registered dealer of the State. This was not admissible as coal is not directly used as an input for manufacture of 'Alumina'. However, the dealer availed such inadmissible ITC of ₹ 8.05 crore for the tax periods from April 2005 to March 2009 including the above mentioned ₹ 2.27 crore. (2.4.3 OD 1 of 2013)

Under Section 13 of Uttar Pradesh VAT Act, 2008 read with Rule 24 of UPVAT Rules, 2008 tax paid on purchase of goods from registered dealers against tax invoice or deposited cash on purchase of goods from the unregistered dealers, Input Tax Credit (ITC) is allowed to the extent of the tax paid or payable by the dealer on such sale or purchase. If any dealer has wrongly claimed ITC in respect of any goods, in contraventions of provisions in the rules, benefit of ITC to the extent it is not admissible, shall stand reversed. If the Assessing Authority is satisfied that any dealer/person falsely or fraudulently claims an amount as ITC, he may direct that such dealer shall, in addition to the tax, if any, payable by him, pay by way of penalty, a sum equal to five times of amount of ITC. In the case reversal of ITC the dealer shall be liable to pay such amount of Reverse Input Tax Credit (RITC) along with simple interest at a rate of 15 per cent per annum for the period ending on the date on which amount has been deposited.

During scrutiny (between April 2012 and December 2013) of assessment orders and files related to the dealer of office of the 15 Commercial Tax Offices, Audit found that 15 dealers had falsely claimed ITC of ₹ 1.94 crore during the year 2008-09 to 2010-11. The AAs while finalising the assessment between Nov 2011 and Mar 2013 did not cross verify the ITC claims of the dealers and allowed claims ITC of ₹ 1.94 crore. The ITC was claimed on false/fraudulent grounds such as ITC claimed on rebate, incentive, discount, credit notes, damage goods, stock transfer, fraud purchase, wrong ITC brought forward from previous year, ITC claimed on right to use, ITC on capital goods and submitted false returns on which ITC was not admissible as these claims were in contravention of the provisions of the Act and Rules. These false claim attract reversal of ITC, non-imposition of penalty and non-charging of interest amounting to ₹ 12.41 crore (RITC: ₹ 194.00 lakh, Interest: ₹ 82.58 lakh, Penalty: ₹ 964.03 lakh).

During scrutiny (between May 2013 and December 2013) of assessment orders in the office of seven Commercial Tax Offices, Audit found that the seven dealers had wrongly claimed ITC of ₹ 48.03 lakh during the year 2008-09 and 2009-10 which was not admissible on stock transfer. The AAs while finalising the assessment between March 2012 and July 2012 were required to reverse this inadmissible ITC and direct the dealers to pay tax with interest. This resulted in short reversal of ITC and non-charging of interest of ₹ 74.35 lakh (Reversing ITC ₹ 48.03 lakh, interest ₹ 26.32 lakh and Penalty of ₹ 964.03 lakh(2.10.1 UP 1 of 2015)

Section 13 of the Uttar Pradesh VAT Act prescribes certain conditions to claim input tax credit by the dealers and its adjustment against the payable tax. Commissioner, Commercial Tax UP issued instructions on maintenance of a database of purchase list and sales list for verification of Input Tax Credit by AAs. All the Deputy Commissioners were required to ensure that hundred per cent verification of the Annexure-A (purchase list) with the Annexure-B (Sale list) was done for top 20 dealers who claimed the highest ITC and a database created by feeding the above details using either an outsourced agency or Departmental employees. Apart from this cent per cent checking and verification was also to be done of cases covered by a random statistical method.

During the test check (2012-13) for the period 2007-08 to 2010-11, Audit observed that for 122 dealers of 38 CTOs, AAs passed the assessment orders where ITC of ₹ 13.07 crore was adjusted with their payable tax without any attempt to verify the ITC claims. For 122 dealers pertaining to 39 CTOs, AAs passed the assessment orders where ITC of ₹ 23.33 crore was adjusted with their payable tax but the instructions given for verification were not followed. AAs passed the orders for the adjustment of ITC worth ₹ 36.40 crore without getting the same verified. (2.14 UP 1 of 2014)

Tax collection

In the State of Karnataka, tax collected is reduced from the total turnover for computing taxable turnover. Where total tax collected (VAT plus CST), is greater than tax liability of the dealer, the excess amount needs to be remitted into government account before their returns are accepted. An analysis of returns (VAT 100) revealed that an amount of INR 600 crore had been collected and retained by the dealers involving 57,407 returns out of 72,12,639 returns. (2.8.11 KA 1 of 2014)

Refunds

Every dealer is required to furnish separate returns in respect of the local sales under Maharashtra VAT Act and inter-State transactions under the CST Act. Further, a dealer whose turnover of sales or purchases exceeds ₹ 40 lakh in a year is required to submit an audit report in form 704 prepared by a chartered accountant. As per rule 55 of the MVAT Rules, if the dealer has claimed refund in the MVAT returns and dues in respect of inter-State transaction in the CST returns then the refund under MVAT can be adjusted against the dues under CST provided a refund adjustment order for the amount adjustable is issued in respect of that period

During test check of the business audit files in January 2012, Audit observed that for the periods 2005-06, 2006-07 and 2007-08, audit reports in the prescribed form prepared by chartered accountants indicated refunds aggregating ₹ 71.06 lakh in respect of 15 dealers under MVAT Act. In all these cases the dealers concerned had shown dues in the returns filed under the CST Act for the corresponding periods. While passing the assessment orders of the dealers under the CST Act, the Department had adjusted the refunds payable under MVAT Act aggregating ₹ 71.06 lakh against their corresponding dues under CST Act. However, in none of these cases the business audits had been completed or refund adjustment orders had been passed as prescribed in the rules. This resulted in incorrect adjustment of refunds aggregating ₹ 71.06 lakh under MVAT Act against the tax payable under the CST Act. (Para 2.4.4 MH 1 of 2014)

Delay in finalisation of assessment

Sub-section (l) of Section 34 of the Delhi VAT Act, 2004 provides that no assessment or re-assessment under Section 32 of this Act shall be made by the Commissioner after the expiry of four years from (a) the date on which the person furnished a return under Section 26 or Sub-section (1) of Section 28 of this Act, or (b) the date on which the Commissioner made an assessment of tax for the tax period, whichever is earlier. Provided also that where the Commissioner has reason to believe that tax was not paid by reason of concealment, omission or failure to disclose fully material particulars on the part of the person, the said period shall stand extended to six years.

Audit observed that Assessing Authority had finalised the default assessment of tax and interest under Section 32 and penalty under Section 33 of DVAT Act in respect of HDFC Bank Limited for the period April 2005 to November 2005 on different dates and issued a demand of 480.12 crore including tax, interest and penalty against the Bank. Assessing Authority passed the assessment orders within the prescribed time limit, but despatched the assessment orders after the expiry of the prescribed time limit of six years. The assessee filed objection u/s 74 of the DVAT Act, against the default assessment of tax and interest (u/s 32) and penalty thereon (u/s 33) of the DVAT Act. The Judiciary set aside these assessment orders. Delay by Assessing Authority resulted in loss of ₹ 480 crore (Para 2.3 Delhi 1 of 2014)

**STATE EXCISE DUTY**

The revenue from manufacture/sale of alcohol is the second largest source of revenue for most of the State Governments. Excise duty on alcoholic liquor for human consumption and on medicinal and toilet preparations containing alcohol or opium, Indian hemp and narcotics in a State is levied and collected under the State Excise Act, and Rules. Excise Department in the State headed by Commissioner assisted by Deputy Commissioner and their subordinates (Excise Inspector etc.) is responsible for administration of Act and Rules related to State Excise.

Excise policy of the State Government prescribes the procedure and fixation of reserve price and license fee for the grant of retail and wholesale vends, selling of country liquor (CL), Indian made foreign liquor (IMFL) etc. Indian Made Foreign Liquor includes all liquor manufactured in India (other than rectified spirit denatured spirit, and perfumed spirit imported into India, on which duty at a rate higher than that levied on country liquor is leviable. Country liquor means all liquor other than rectified spirit, denatured spirit and perfumed spirit not included in the definition of foreign liquor.

The Department grants Licences to Distilleries/Bottling Plants, bonded warehouses for the wholesale supply and those engaged in Retail trade for IMFL and beer and fix their prices including brand fee and brand registration fee. The Department invites tender on yearly basis for wholesale supply of country liquor from the distilleries/bottling plants and issues licence to successful tenderer. It also fixes the price and regulates it supply.

Receipts on account of Excise revenue may be broadly divided into Duties, License Fee and miscellaneous receipts such as sale proceeds and fines etc. Duties are imposed usually as per cent of manufacturing cost. They range from 150% to 300% per litre. They differ for IMFL, beer, wine, country liquor etc., License fee can be fixed, assessed, fixed by auction.

## Molasses

Molasses is heavy dark coloured residual syrup drained away in the final stage of the manufacture of sugar (sugar factory) and is distilled (distillery) to produce alcohol. In a distillery the spirits are distilled, compounded, blended, processed, fortified and/or diluted to produce wines of Indian liquor other than arrack, beer, or toddy and includes an operation for bottling of such liquor.

The owner of occupier of a sugar factory should maintain correct account of production and sale of molasses and furnish to Department. Similarly every distillery should furnish a weekly return showing receipts and consumption of molasses. The price at which and the manner in which different grades of molasses may be sold are regulated by the Government. Audit checks on molasses include:

Whether the distillery has submitted a statement in the prescribed format to the prescribed authority specifying its estimated requirement of molasses for the purposes of distillation during the next following molasses year should be seen.

The requirement of molasses of the distillery in prescribed form (indent) should be co-related with the allotment made by the authority and account of receipt of molasses in prescribed form with a view to seeing that the quantity allotted has been received in full by the distillery and that there is no pilferage.

It should be checked that no molasses supplied to an allottee have been used for a purpose other than that for which it was allotted or that no molasses were transferred to any other person without the prior permission of controller of Molasses.

The correctness of the records of all molasses received, utilized for distillation and the balance in the register should be checked.

The loss of molasses either during transit or during storage in a distillery should be examined; disposal of molasses or articles forfeited under the Excise Act or Rules should be checked to see if such disposal is in accordance with the Rules.

## Distilleries

Distillery should be licensed and would pay license fee and execute a bond. The licensee is required to enter in the prescribed register the exact quantity of gur, molasses or other substance used. When wash is to be prepared, the licensee is required to give notice to the officer-in-charge for the verification of the quantity. The entries for the preparation of bub are made in the prescribed form. Wash means a saccharine solution from which, after distillation, spirit is obtained. Bub is a composition itself in a state of fermentation prepared for addition to wash to promote fermentation.

As soon as wash is ready for gauging/proving it is entered in the Main Wash Register. The officer-in-charge on the receipt of intimation proceeds to verify the same and records the results in his diary. The accounts of distillery operations are kept in an Abstract of distillery operations. As soon as wash is fully attenurated and ready for distillation, the licensee again informs the officer-in-charge who by gauging and use gravity of the attenurated wash and records the particulars in his diary.

Several controls are exercised by the department over the production quantities from the distillery. State Excise receipts from distillery are (a) License fee and renewal fee (b) Still head duty on (i) Country liquor, (ii) Rectified spirit, (iii) Indian made foreign liquor; (c) Assessed fee on denatured spirit and (d) Manufacture and export duty on all issues of country liquor, rectified spirit, Indian made foreign liquor and denatured spirit when issued to any other State or Union Territory in India

Only a licensed vendor (his agent) can take the spirit from the distillery on payment of duty. It has to be checked in audit that duty/export fee or assessed fee on the issues are being levied and realised at the correct rates in force from time to time. It is usually a running (advance) deposit account. Audit checks include:

The terms and conditions of licence granted should be seen generally to find out whether they were adhered to by the distiller.

Advances are realised through deposit and credited to the accounts of distiller. As and when duty/export fee, etc., is levied, the amount is deducted from the standing advance and the balance is struck. The challans in token of having made the deposits have to be checked with reference to the records

It has to be seen whether the spirit outturn is commensurate with the raw materials used (vis wash sent in for distillation) as per provisions of Distillery. For this Licence General Register, Bub-Register, Wash register, Abstract or distillery operations and Inspector's Diary have to be scrutinized. It has also to be checked whether all the production has been taken to the register of receipt of bulk into the spirit store room and the issue of bulk and bottled spirit from the store room.

Sometimes spirits are received from other distilleries and these are entered in register of receipt and disposal of spirit received in bond from the distilleries). It has to be seen that receipts of spirit are also taken into stock in the above.

If it is found that the wastage in any distillery is excessive, the licensee shall pay duty as on issue, in respect of all losses attributed to wastage in excess of the scale fixed.

Allowance of waste in transit was as per norms

**Brewery**

Brewery means a building where beer is manufactured and includes every place therein where beer is stored or issued. Brewery Rules lay down the rules regarding establishment of breweries, manufacture and issue of beer. The licenses are granted subject to fulfilment of certain condition and payment of license fee. Its production and lifting the stock from brewery is controlled. Audit checks include:

The brewers hold valid licence in the prescribed form and paid the prescribed license fee.

The entries in the brewing book are promptly and correctly made by the brewer. These should be checked with the survey book maintained by the Inspector, as the duty on beer is charged on the total quantity actually brewed as entered in the brewing book of the survey book whichever is higher.

The produce of each brewing as shown in the brewing/survey book has been taken over in the registers of brewing operations and issues in the prescribed forms

In the case of export out of the State necessary bonds were executed and the certificates are furnished.

The rates of duty and export fee in the case of issues outside the State are correctly applied with reference to the orders for the time being in force.

In the case of breweries, excise duty is to be charged immediately the account of brewing has been taken after allowing an allowance for wastage, provided that the quantity of beer issued in bond during a quarter shall be deducted from the total quantity brewed and ten per cent allowance is to be calculated on the balance thus arrived at. It should be ensured that wastage allowance has been calculated in accordance with the provisions of Brewery Rules and orders

## Bonded warehouse

Bonded warehouse means a warehouse licensed for the receipt, storage under bond of liquor, both bottled and bulk of Indian manufacture, transported or imported into the State from any place within the Indian Union, as approved by the State Government, for its reduction, bottling, transport or export in bond, or on payment of duty within or outside the State. It is licensed operation and the operator had to pay the prescribed license fee and comply with the prescribed rules and procedures. He has to keep an account of all receipt into and issues of liquor from the warehouse in the prescribed registers. The stock would also be checked on the last working day of each month by the Excise Official in whose district the bonded warehouse is situated.

Bottling operations shall be carried out in separate rooms for country spirit and Indian made foreign liquor and likewise storage of the liquor shall be affected in separate rooms called the bottled spirit store room for country liquor and Indian made foreign liquor set apart

for the purpose, near the respective bottling rooms. The licensee shall set up such apparatus for filtering, bottling and processes connected therewith as may be needed. Bottling vats may be erected and liquor stored therein in the bottling rooms. While conducting the audit of bonded warehouses the following audit checks are exercised.

Licence fee and renewal fee have been correctly paid.

The quantity account of spirit received from the distillery has been correctly maintained in the prescribed form. The receipt entries should be checked with the passes issued by the Officer-in-charge of the distillery or bonded warehouse from which it has been imported

Whether the wastages claimed are within the permissible limits and in cases of excessive wastages, duty has been levied as on issues.

The issues should be checked with the applications of the licensee and treasury challans to ensure that correct duty has been realised on all issues. The payment of duty should also be verified with the records maintained in the treasury office.

In respect of bonded warehouses where rectified spirit is received in bulk and bottling operations are conducted in its premises the relevant provisions of the Distillery Rules, and audit checks prescribed in distilleries should be applied.

## Country Liquor

Auction system is used to select retail vends on country liquor. Under this system the amount of license fee is determined by competition among the bidders for right to sell. This is carried out under the State Liquor License Rules.

In a fixed fee system, a fixed fee is levied for the right of vend during the year or for a shorter period. Fixed fees for the various types of licences are notified by the government through gazette notifications, generally before the commencement of the financial year. Audit checks in auction of country liquor shops include verifying whether:

Wide publicity was given to the auction sufficiently ahead of the date of auction

All vends required in the auctioned have been put to auction

Receipts from auction money are generally on the increase; if there is a general tendency towards fall in auction in any year, the reasons, therefore, if any, are examined

The cases where highest bids were not accepted should be checked to see inter alia if the reasons thereon have been recorded by the Presiding Officer

The cases where the Collector had demanded an immediate deposit of one twelfth of bid money at the time of auction, should be scrutinized to ensure inter alia that sum, due were recovered on spot and promptly deposit into Government treasury

In case of re-auction of vends it should be seen if loss suffered by the Government has been recovered from the original licensee

The amount of the bids was correctly noted in the Demand and Collection Register for realisation

The prescribed amount of security deposit and monthly installments of license fee was recovered by the due dates. The entries for the realisation of auction money have been attested in the prescribed Register.

Defaulters of excise dues have not been allowed to take part in auction and the solvency of bidders stands verified.

The entries for the realization of licence money verified with the challans

No licensee is allowed quota of country liquor in excess of that sanctioned for the shop without payment of additional license fee.

## *Examples*

In Odisha, as per Bihar and Odisha Excise (B&OE) Act, 1915, no intoxicant (includes molasses) shall be sold except under the authority and subject to the terms and conditions of a licence granted by the Collector of the District. As per the Annual Excise Plan 2010-11 (AEP), licence fee for trading of molasses was fixed at ₹ 1 lakh. In the AEPs for the years 2011-12 and 2012-13, licence fee and application fee were fixed at ₹ 3 lakh and ₹ 20,000 respectively. Excise Deputy Commissioner (EDC) shall inspect the sugar factories at least once in a year. In case of unlawful import, export, transport, manufacture and sale of intoxicant, penalty of ₹ 20,000 to ₹ 50,000 per case is leviable against the offenders.

During test check of records of four SEs, Audit noticed (November and December 2013) that four sugar factories sold molasses during the years 2010-11 to 2012-13 without obtaining licences for trading from the SEs of concerned districts. The SEs failed to detect such irregular sale of molasses without licences. This resulted in non-realisation of licence fee of ₹ 13 lakh and application fee of ₹ 80,000. Besides, minimum penalty of ₹ 1 lakh was also leviable. (3.5.8 OD 1 of 2015)

License fee

According to rule 3(6-A) of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968, a licence in the Form CL-6A shall be issued by the Deputy Commissioner of Excise to Star Hotels for possession and sale of liquor whereas license in respect of Hotels and Boarding houses is issued in CL-7. The license fee and additional license fee leviable annually in respect of CL-6A was ₹ 9.20 lakh whereas for CL-7 it was ₹ 4.95 lakh.

Audit obtained information from Ministry of Tourism, Government of India regarding grant of star status to M/s Hotel Malligi, J.N. Road, Hospet and M/s Krishna Palace, Station Road, Hospet and found that these hotels were classified as Three Star Hotels

with effect from 27 January 2009 and 17 November 2009 respectively. This information was cross verified with the records relating to licences in the office of the Excise, Bellary during August 2012. Audit found that the Department issued licence in Form CL-7 applicable to Hotels and Boarding houses instead of Form CL 6-A applicable for star hotels. The total short levy for the period from 2009-10 to 2011-12 works out to ₹ 25.50 lakh. (5.6.1 KA 1 of 2014)

Permit fee

In Kerala under Section 10 read with Section 11 of the Abkari Act 1 of 1077, liquor or intoxicating drug exceeding such quantity as prescribed by Government from time to time, either generally for the whole State or for a local area shall be transported under a permit. Under Sections 6 and 7 of the Act, liquor or intoxicating drugs can be imported or exported by the various licensees for which No Objection Certificates (NOC) are issued under the specific Rules under which licences were issued. Government by Notification issued in March 1995 fixed a fee of ₹ 500 with effect from April 1995 on each permit to be issued for the import, export and transportation.

Scrutiny (September 2012) of permit issue registers of 21 FL9 (Bonded warehouses of Kerala State Beverages Corporation) Warehouses under the offices of the three Joint Excise Commissioners revealed that 71,074 transport permits within the state were issued (between 1 April 2011 and 8 February 2012). Permit fee of ₹ 3.55 crore was not realised while issuing the above transport permits. (6.7 KL 1 of 2014)

Licence fee

The condition for sale of liquor in Madhya Pradesh through shops for the year 2011-12 issued by the Excise Commissioner (EC) under notification dated 05 February 2011 provides that annual value of a liquor shop shall be the sum of Basic Licence Fee (BLF) and Annual Licence Fee (ALF). The BLF shall be fixed between 50 and 60 per cent of the annual value of the shop according to its location and the remaining amount shall be recovered as ALF. Both the BLF and ALF shall be recoverable in 24 fortnightly installments. The amount of duty deposited by the licensee to purchase the liquor shall be adjustable against the fortnightly demand of ALF of shop, issue of liquor will not be admissible on the amount paid by the licensee as BLF. Further, if licensee purchases liquor in excess of the amount of ALF prescribed for any fortnight, the same shall be adjustable against the ALF of the subsequent fortnightly period.

Audit observed (May 2012) from returns submitted by DECs in the EC office that ALF for 1668 country liquor and 600 foreign liquor shops in 26 districts for the year 2011-12 was ₹ 973.88 crore. The licensees had purchased the liquor by depositing duty

of ₹ 994.71 crore, which was in excess of ALF fixed for the shops by ₹ 20.83 crore. Instead of adjusting the excess deposit towards payment of both BLF and ALF, the entire amount was allowed towards payment of duty for purchase of liquor. Reckoning the amount adjusted towards payment of duty against purchase of liquor, the amount of BLF recoverable from the shop owners worked out to ₹ 20.83 crore treating the minimum prescribed BLF of 50 per cent. Some licensees remitted a portion of BLF amounting to ₹ 40.81 lakh. Thus, the short collection of BLF from the licensees worked out to ₹ 20.42 crore. (3.8 MP 1 of 2014)

State Excise Duty

In Odisha, the Bihar and Odisha Excise (B&OE) Act, 1915 and Rules made there under by the Government of Government of Odisha as well as by the Board of Revenue (BOR) read with the Excise Manual, AEPs and notifications of Government provide for levy and collection of State Excise Duty (SED), fees like Utilisation Fee (UF), Import Fee (IF), Bottling Fee (BF), Transportation Fee (TF) and charges like establishment cost and extra hour operation charges etc., at the prescribed rates. Odisha State Beverage Corporation Ltd. (OSBC) has the exclusive right and privilege of importing, exporting and carrying on the wholesale trade of foreign liquor in the State and sale of liquor to the retailer at the issue price inclusive of SED. In the AEP 2012-13, SED was increased by ₹ 20 to ₹ 30 per Bulk Litre (BL) of Beer/ London Proof Litre (LPL) of India Made Foreign Liquor (IMFL) based on the brands.

During test check of pass issue (FL 16) records and stock taking reports in office of the Superintendent of Excise (SE), Khurda, Audit noticed (November 2013) that from 1 April 2012, OSBC Odisha State Beverage Corporation Ltd,) issued IMFL/ Beer to retailers at the revised rates as per Annual Excise Plan of 2012-13 and collected enhanced SED (State Excise Duty) on the closing stock of 2011-12. But, OSBC did not deposit the differential SED of ₹ 4.04 crore so collected during 2012-13 on closing stock of 2011-12 of IMFL/ Beer. The SE, Khurda also did not raise demand for realisation of the amount. This resulted in non-realisation of SED of ₹ 4.04 crore. (3.5 OD 1 of 2015)

Licence fee

Foreign liquor as defined in UP Excise settlement of licences for retail sale of foreign liquor (Excluding beer and wines) (Third Amendment) Rules 2002 includes Malt sprit, Whisky, Rum, Brandy, Gin, Vodka and Liquor. Beer is not included in the definition. As per Rules 647 and 648 of the United Provinces Excise Act, 1910 and Rules made there under the UP Excise (Wholesale and retail vend of Foreign Liquor) (Thirteenth Amendment) Rules 2002 state that beer bar licence in form FL 7B is required for retail sale of beer on premises of hotels, dak bunglows or restaurants. Rule 10 provides for issue of licence of FL 6A composite for retail sale of foreign liquor by four and five star hotels and issue of FL 6 licence for hotel other than the above. FL 7 licence is required

for retail sale of foreign liquor by Restaurants. FL 6A composite and FL 7 will also cover sale of draught beer only and not bottled beer.

Audit examined (April 2013 to March 2014) the records of bar licences, consumption statement and revenue collection register that six DEOs of Agra, Basti, Ghaziabad, Jalaun, Jhansi and Sonebhadra. Audit observed that several hotels/restaurant bars were not issued the FL 7B licence required for retail sale of beer. As a result of non-issue of FL 7B licence, the Government was deprived of licence fee of ₹ 1.31 crore. (3.5 UP 1 of 2015)

Licence fee

As per Section 28 of the Andhra Pradesh (AP) Excise Act, 1968, read with Rule 10 of AP Excise (Grant of licence of selling by bar and conditions of licence) Rules, 2005, any additional enclosure for consumption of liquor, which is not contiguous, shall attract ALF at 10 per cent of the annual licence fee.

In terms of explanation given below the Rule 10, the word 'enclosure' means an area of consumption of liquor which is contiguous in utility for consumption. If one consumption enclosure is separated from another enclosure by non- contiguity and interposition of areas of different utilities other than consumption of liquor, it attracts ALF. The Commissioner clarified that parking area between two consumption halls also amounts to non-contiguity.

During test check of the records of six offices of Prohibition & Excise Superintendent (P&ES), and physical verification conducted by audit and excise authorities jointly, of premises of bars and restaurants, it was noticed (between July 2013 and February 2014) that these P&ESs did not levy ALF amounting to ₹ 55.00 lakh for the years 2011-12 and 2012-13 in respect of non-contiguous consumption enclosures of eight bars and restaurants. (3.4 AP 1 of 2015)

Vend fee

As per sub rule 6 of rule 69 of the Rajasthan Excise (RE) Rules, 1956, the special vend fee (SVF) is leviable for sale of foreign liquor to retail on, retail off and composite retail off licencees of Indian Made Foreign liquor (IMFL) and Beer at the rate of ₹ 10 and ₹ 5 per bulk litre (BL) respectively.

During test check of permits issued by District Excise Officers (DEO) Jaipur City and Bikaner, it was noticed (Sept 2013 to Jan 2014) that wholesale depots of Canteen Store Department (CSD) at Jaipur and Bikaner had sold 34.83 lakh BL IMFL and 4.23 lakh BL Beer to its retail off licencees (unit run canteens) in the State during the period from Apr 2012 to 4 Nov 2012. However, SVF of ₹ 3.48 crore on IMFL and 21.17 lakh on Beer were neither deposited by the CSD nor demanded by the Department. This resulted in non-recovery of SVF amounting to ₹ 3.69 crore. (6.5 RJ 1 of 2015)

Production norm

As per U.P Government order dated 5 April 1991, the national standard and prescribed norm for recovery of alcohol from per quintal of molasses is 22.5 A.L. (94% v/v). The cost of country liquor is calculated on the basis of the above norms by the EC at the time of fixation of its MRP. Formula adapted for calculation of manufacturing cost of 94% v/v alcohol

| | | |
|---|---|---|
| cost of reserved molasses (in quintals) / 22.5 | = | cost of one litre alcohol of 94% v/v |

Conversion costs, labour costs, wastage etc., are added to this cost to arrive at the cost of alcohol of the required strength i.e. 25%, 36% or 42.8%. To this bottling, labelling, capsuling, packing costs, hologram costs are added. Then the Excise Duty (ED) is added. Further components like freight, godown expenditure, wastage (0.5%), incidence of licence fee at whole seller's profit of wholesales, incidence of retailers licence fee, retailers profit and expenses etc., are added to calculate the final fixed MRP of Country Liquor (CL).

The EC as Controller of molasses allots the reserved molasses to distillers who manufacture the CL. A certain percentage of molasses for year to year produced by Sugar Mill are reserved for production of country liquor and the price of this reserve molasses is fixed by the Excise Commissioner/Molasses Controller. No molasses supplied to an allottee shall be used for a purpose other than that for which it has been allotted, except with the prior permission of Controller. The norms of recovery of 22.5 AL (94% v/v) per quintal of molasses forms the basis of fixation of MRP of CL as well as that of the excise duty levied.

Audit examined (August 2012 to May 2013) records like continuous out turn (COT) registers of 19 Distilleries and observed that these Distilleries did not maintain the minimum recovery of alcohol from molasses as per norms. During April 2007 to March 2013, 5071.49 lakh AL of alcohol should have been produced from 239.79 lakh quintal of molasses consumed by these distilleries against which actual production of alcohol was 4781.07 lakh AL. This resulted in short production of 290.42 lakh AL alcohol. After bifurcating this in the same ratio as that of the total production of potable and industrial alcohol by these distilleries, we found 174.85 lakh AL of potable alcohol involving excise revenue of ₹ 736.49 crore was short produced. Distilleries did not maintain separate inventory of alcohol produced from reserved molasses. (3.8.10 UP 1 of 2014)

Wastage norms

Rule 7 (5) of the Kerala Foreign Liquor (Compounding, Blending & Bottling) Rules, 1975 read with Rule 55 of the Kerala Distillery and Warehouse Rules, 1968, specifies allowance for wastage in the case of spirits allowed to be imported. In the case of spirits obtained by the distilleries/blending units in the State, the licensee shall pay duty at the rate of 20 per proof litre (PL- Spirit having same alcohol content as one litre of 'proof spirit', i.e. a mixture of alcohol and water with alcohol 57.06 per cent by volume at 60° F.) for excess wastage where such losses could not be accounted for the satisfaction of the Deputy Commissioner of Excise. As per Rule 47 A (4) (b) of the Kerala Distillery and Warehouse Rules 1968, all consignments of extra neutral alcohol (ENA) obtained shall be verified by volume and strength jointly by officer-in-Charge of the distillery and licensee and the net quantity received shall be taken into account. As per Rule 11 of the Kerala Rectified Spirit Rules, 1972 a fine at the rates of duty applicable to rectified spirit shall be levied on quantity of spirit wasted in excess of such limits.

Scrutiny of the consignment registers on ENA for the year 2012-13 maintained in five distilleries (United Distilleries Ltd., Amruth Distilleries Ltd., United Spirits Ltd., Empee Distilleries Ltd., Kerala Alcoholics Products Ltd.) revealed that the volume and strength of each consignment of spirit received in distillery was less than the volume and strength recorded at the exporting unit. The Department computed the wastage only on the basis of volume in bulk litres without considering the volume in proof litres based on the strength of the spirit. The incorrect computation of the wastage resulted in allowing excess wastage of 1.12 lakh PL and non-levy of duty of 22.46 lakh. (6.5 KL 8 of 2014)

In Madhya Pradesh, the Excise Act and Rules made there under provide that the maximum wastage allowance for all exports of bottled foreign liquor/beer shall be 0.25 per cent irrespective of the distance. For all transports, it shall be 0.1 per cent if the selling and purchasing licensees belong to the same district and 0.25 per cent if they belong to different districts. In case of transport of bottled country liquor it shall be 0.5 per cent irrespective of the distance. Further according to the amendment made by the State Government dated 12 January 2012 it shall be 0.1 per cent in case of transport in pet bottle and 0.25 per cent in glass bottle with effect from 1 April 2011. In case of RS/ENA, the Rules allow wastage of 0.1 to 0.2 per cent on account of leakage or evaporation of spirit/ENA transported or exported in tankers from a distillery/ warehouse to another distillery/warehouse according to their distance. In case of wastage beyond the permissible limit the licensee shall be liable to pay penalty at a rate prescribed by the Government from time to time.

Audit observed that minimum penalty was leviable in 3,451 cases on wastages of 54,487.14 PL bottled country liquor. Wastage during transport from eight bottling units to 52 country liquor warehouses during the period April 2011 to December 2012 was beyond permissible limits. It resulted in non-levy/realisation of penalty of ₹ 1.24 crore.

Audit also observed from the Excise Verification Certificates (EVC) of foreign liquor warehouse, Bhopal and Jabalpur, wastages of 57433.005 PL foreign liquor (Spirit) and 36840.12 PL beer was found in excess of the admissible limit during export/ transport between October 2011 and May 2013 in 4747 cases on which the penalty of ₹ 1.03 crore was leviable. (3.7 MP 1 of 2014)

Transport permit

In Madhya Pradesh, according to MPFL Rules, the exported/transport of foreign liquor/beer is permissible on payment of duty or on furnishing a bank guarantee or on executing a bond in form FL-23 with adequate solvent sureties for the amount of duty involved. Besides, the licensee shall obtain an Excise verification certificate (EVC) from the Officer-in-Charge (OIC) of the destination unit and furnish it to the authority, who issues the transport /export permit, within 40 days of the expiry of the permit. In case of default of licensee, the duty involved shall be recovered from the deposit made, bank guarantee furnished or the security bond executed by the licensee.

Audit observed from the export/ transport permits register and EVC received register in three bottling units of foreign liquor (FL-9) two breweries (B-3) and two central godowns of outside manufacture (FL-10A) of four districts between October 2012 and February 2013 that the licensees exported/ transported 50163 boxes of bottled foreign liquor (Spirit) and 55000 boxes of beer on 178 permits involving duty of 4.58 crore. It was noticed that in violation of the provision, the Department issued the export/ transport permits without recovering the prescribed duty or obtaining the bank guarantee or bond with adequate solvent sureties for the amount of duty involved. It was further noticed that though the verification certificate of receipt of quantity of liquor exported/ transported were not submitted by the licensee even after a lapse of two to 399 days after the permissible period, the Department did not initiate any action for adjustment of duty against the bank guarantee or bond. This resulted in non-realisation of revenue of ₹ 4.58 crore. (3.9 MP 1 of 2014)

Transport

Rule 41 of the Rajasthan Brewery Rules, 1972 provides that no beer shall be removed from a brewery until the duty imposed under Section 28 of the Rajasthan Excise Act, 1950 has been aid or until a bond under Section 18 of the Act has been executed by the brewer for export of beer outside the State. Bond conditions prescribed that if the quantity of beer mentioned in the bond has not been delivered at the destination, the

brewer is liable to pay for any loss of duty which the Government may suffer by reason of such non-delivery or short delivery and will have to pay on demand the duty at the rate in force. During scrutiny of records of five breweries for the period 2010-11 and 2011-12 under DEOs Alwar and Behror, it was noticed that during export of beer outside the State under bond, 1.32 lakh BL (16,233 cartons) beer involving excise duty of ₹ 55.27 lakh were not delivered at the destination. Neither was the duty paid by the brewers nor was it demanded by the Department. This resulted in non-levy of state excise duty of ₹ 55.27 lakh. (6.10 RJ 4 of 2014)

Minimum Guaranteed Quota (MGQ) of Country Liquor

In Uttar Pradesh, as per the Excise Commissioner's circular dated 9 March 2009, under the UP Excise (Settlement of licences for retail sale of country liquor) Rules 2002, the licensee has to lift at least 80 per cent of the Minimum Guaranteed Quota (MGQ) in the month of March. If a licensee fails to do this, the licence fee will be adjusted from the security deposit of the licensee.

Audit observed from the records of 15 DEOs between Aug 2012 and Mar 2013, that during the year 2007-08, 2008-09 and 2009-10, 902 licensees lifted 1140947.58 BL country liquor against the quota of 1724353.05 BL fixed for the month of March 2008, March 2009 and March 2010. The differential amount of licence fee amounting to ₹ 5.51 crore due to this short lifting had not been adjusted by the Department from the security deposit of the licensees. (1 of 2014 UP 3.8.8.3)

## MOTOR VEHICLE TAXES

In a State, its Transport Department is responsible for implementing the Union and State laws on Motor Vehicles. The Department grants and issues permits for plying vehicles, licences for driving and collects taxes. Transport Commissioner (TC) heads the Department. TC is assisted by Additional/ Joint Transport/Deputy Transport Commissioners who in turn are assisted by Regional Transport Officers and District Transport Officers (DTOs). They in turn are assisted by the Motor Vehicles Inspectors (MVIs). The legal provisions governing the use and regulation of motor vehicles include the Central Motor Vehicles Act, 1988 (CMV Act), the Central Motor Vehicles Rules, 1989 (CMVR), and State Act and State Rules. Taxation is mainly dealt under the Rules framed by the State Governments.

Two major types of taxes are levied on motor vehicles: (a) taxes on ownership of vehicles and (b) taxes on operation of vehicles.

*Taxes on ownership of vehicles* include registration fee, fees for transfer of ownership and motor vehicle tax. They are applicable during the period of ownership; it is recurring charge usually in the form of annual tax. Vehicle registration is compulsory to drive a motor

vehicle. It could be temporary registration, registration of new vehicle, and registration of vehicle arriving from out of State or assignment of a new registration mark etc. The rates vary across the States. Vehicles also need to obtain fitness certificate that is valid for certain number of years. There are different bases for computation for motor vehicle tax across the States and also different rates. On non-transport two wheelers (motor cycles), some states levy a life-time motor vehicle tax on the basis of engine capacity, some on the unladen weight and some on cost of vehicle etc. The bases used for levying on car for personnel use are cost of vehicle, unladen weight, and seating capacity, on the basis of horse, power, cubic capacity, ownership and floor area etc., it is usually a life-time tax. In the case of passenger transport vehicles (e.g. stage or contract carriages) the seating capacity, the distance covered and sometimes the type of route on which the vehicle is plying forms the basis for levying tax. The tax rates vary from State to State. Motor vehicles Act, 1988 differentiates goods vehicles into heavy and light-commercial essentially on the basis of weight. Taxes are levied at the rates prescribed on the type of vehicle classified on the basis of unladen weight (ULW) or gross vehicle weight, also called registered laden weight (GVW or RLW) or the difference between two (payload) etc.

*Taxes levied on the operation* of vehicles are Passengers and Goods Tax, fee for driving licences and travel permits. The Passengers and Goods Tax is levied on passengers and goods carried by road or by inland waterways. States usually levy both the taxes (ownership and operation) separately. Some States, like Odisha have merged both and levy a single tax. The states that levy Passengers and Goods Tax fall into two categories. First category levies tax on the actual collection of fare and freight. The second category of the States levies a composite tax; the tax is a compounded levy based on the criteria of seating capacity, occupancy ratio etc. In some states it is a per cent of the purchase price of the vehicle. Fee rates for licenses vary from State to State on each type of vehicle.

Various permits for a variety of uses are issued for plying vehicles in different parts of the country. Permit for Passengers Vehicles (stage carriage permit is granted to a passenger vehicle (mini or full body bus) for operation on hire or reward for a particular route on stage to stage basis. Contract carriage permit is granted to a motor vehicle which carries a passenger or passengers for hire or reward and is engaged under a contract; issued to three wheeler auto-rickshaws, taxis and maxi-cab vehicles having maximum seating capacity of 9 passengers. Private Service vehicle permit is granted to a firm/company for carrying their staff in connection with his trade or business, to educational institutional buses. Local Goods Permits for goods vehicles are granted to the vehicles operating within States. Permits granted to a particular vehicle for carrying load has to be applied for that particular area only. Inter-State Goods Permits are granted to the vehicle to carry goods from one State to another subject to meeting the respective tax liabilities with the concerned State and any other norms. Countersignature

Permits for Goods are the permits which are initially issued by one State and later on endorsed in another State by the concerned State Transport Authority. There is provision under the Act for a National Permit for those vehicles that need to travel across the country.

During audit of motor vehicle tax revenue, the following registers/records are examined:

Permit registers for State Carriages, Public Carriages, Private Carriers, and Contract Carriages

Registers of application fee, of permit fee, of transfer/cancellation of permits, of detection cases

Tax ledgers, daily collection register, cash book, receipt books etc.

Audit of assessment and levy of motor vehicle tax involves examining whether the classification (categorisation) of the vehicle was as correct and the applied tax rate was correct. Similarly assessment and levy of passenger and goods tax is audited with reference to the classification (categorisation) and rate of tax.

## *Examples*

Short/Non-levy of motor vehicle tax

Stage Carriage Buses: As per the Section 3 of Punjab MVT Act, there shall be levied and paid to Government, Motor Vehicle Tax (MVT) on stage carriages at the rate per kilometre/per day as may be specified by Government from time to time by the end of every month on the entire distance permitted to be covered. Failure to pay tax within the prescribed period attracts simple interest at the rate of one and half per cent per month following the due date, till the default continues and also penalty not exceeding ₹ 5,000 but not less than ₹ 1,000 per default. Audit pointed that MVT of ₹ 25.34 crore was collected against ₹ 65.98 crore worked out on the basis of permitted kilometers operated by the Pepsu Road Transport Corporation (PRTC), six depots of Punjab Roadways and 27 private transport companies during the period 2008-09 to 2012-13. There was non/short realisation of MVT of ₹ 40.64 crore besides interest of ₹ 23.66 crore and minimum penalty of ₹ 6.31 lakh was also leviable.

Mini Bus Operators: Under the provisions of the PMVT Act, for mini buses plying on hire and used for transporting passengers, MVT is leviable on lump sum basis per annum and payable quarterly or annually in advance. In eight District Transport Offices (DTOs), Audit noticed that 301 mini bus operators did not pay or short paid MVT of ₹ 1.67 crore for the period 2008-09 to 2012-13. This resulted in non/short realisation of MVT of ₹ 1.67 crore, besides minimum penalty of ₹ 21.56 lakh was also leviable.

Educational Institutions: As per PMVT Act, MVT is leviable on school, college/ other educational institute buses running up to 50 Kms from the place of registration, at the rates prescribed by Government from time to time. MVT is payable quarterly or annually in advance. In nine12 DTOs, audit noticed that 499 buses of educational institutes did not pay or short paid MVT amounting to 2.58 crore for the period 2008-09 to 2012-13. This resulted in non/short realisation of MVT of 2.58 crore, besides minimum penalty of 47.19 lakh was also leviable.

Goods Vehicles: Under Section 3 of PMVT Act, the Government specified MVT on gross vehicle weight (GVW) in respect of goods vehicles registered in the State of Punjab. MVT is payable quarterly or annually in advance. In eight DTOs, audit noticed that 788 goods vehicles did not pay MVT of ₹ 1.62 crore including penalty of ₹ 73.10 lakhs for the period 2008-09 to 2012-13.

Private Service Vehicles: MVT is leviable on lump sum basis per annum and payable quarterly or annually in advance on private service vehicle used for trade and business. Further, the State Government revised (August 2010) the rates of MVT on the basis of seating capacity. In State Transport Corporation (STO) office and four DTOs, audit noticed that MVT amounting to 47 lakh including minimum penalty of ₹ 0.91 lakh was not realized/short realized in respect of 38 vehicles used for trade and business during the period 2008-09 to 2012-13. (5.3.7 PB 4 of 2014)

Short/Non-Levy of Tax

During test check of the registration records, tax ledgers and general index registers of 19 RTOs and DTOs in Rajasthan for the period from 2009-10 to 2011-12, Audit noticed (between May 2012 and February 2013) that motor vehicle tax and special road tax (goods and passengers tax) in respect of 3,705 vehicles (all types of vehicles) for the period between April 2009 and March 2012 were either not paid or paid short by the owners of these vehicles. There was nothing on record to show that the vehicles were off the road or their liability was transferred to any other on/short realisation of tax and taxation officer. This resulted in non/short realisation of tax and surcharge amounting to ₹ 10.12 crore. (3.9 RJ 4 of 2014)

In Odisha examination of the database of the vehicles maintained by the Transport Department and cross check of records like General Registration Register (GRR), Permit Register (PR) and Off Road Register (ORR) of 26 Regional Transport Offices mentioned between May 2012 and March 2013, revealed that motor vehicle tax and additional tax from 37,023 vehicles, for different periods between April 2011 and March 2012, was not realised even though the vehicles were not covered by off road

declarations. This resulted in non-realisation of motor vehicle tax and additional tax of ₹ 27.60 crore and penalty of ₹ 55.21 crore. In Odisha Additional tax is leviable in respect of Public Service Vehicles in addition to motor vehicle tax whereas motor vehicle tax is leviable on two wheelers, personal vehicles, tractor trailers etc. (3.3.1 OD 4 of 2014)

In Madhya Pradesh According the Section 3(1) of the Adhiniyam, tax shall be levied on every motor vehicle used or kept for use in the State at the rates specified in the First Schedule. If the tax due has not been paid within the prescribed period, penalty is also leviable at the rate of four per cent.

Audit scrutinised (December 2012) the registration records in RTO, Jabalpur and found that the seating capacity of three deluxe/sleeper vehicles (RTO Jabalpur, ARTO, Seoni and OTO, Narsinghpur) were registered as 35 and 36 excluding driver. Cross checking with records (Panchnama) of inspection wing. The same vehicles seating capacity was found between 43 and 50. Irregular registration of seating capacity of these vehicles resulted in short realisation of revenue of ₹ 11.52 lakh. Besides, penalty of ₹ 12.73 lakh was also leviable. (4.1.4 MP 1 of 2014)

Life time tax

In Karnataka, Tax on cars and jeeps owned by Central Government employees, defence personnel, employees of PSUs owned by Government of India including Nationalised banks, were taxed (up to 28 December 2011) on quarterly basis. With effect from 29 Dec 2011, LTT was levied on motor cars and jeeps purchased by these persons in the State of Karnataka. Non-payment of tax invites payment of 1 per cent of the tax payable for each defaulting month, as penalty.

Test-check of records of six RTOs between June 2013 and November 2013 revealed that LTT of ₹ 29.80 lakh due in respect of 50 vehicles bought in the State by these employees was not paid. Instead quarterly tax is being paid on these vehicles. No action had been taken by the Department to raise demand. A sum of ₹ 3.92 lakh was required to be levied as penalty in these cases. (5.5 KA 7 of 2014)

Lifetime tax

In Andhra Pradesh, as per Section 4 (aa) of APMVT Act, tax levied under second proviso to sub-section (2) of Section 3 shall be for life time of motor vehicle and shall be paid in advance in lump sum by registered owner of motor vehicle or any other person having possession or contract thereof. As per amended provisions of Section 3(2) of APMVT Act, through an ordinance, construction equipment vehicles were brought

under purview of life tax. Rates, as specified in fourth schedule to AP MVT, Act are leviable on these vehicles which vary from four per cent to 7.5 per cent, depending upon cost of vehicle and age of vehicle at the time of registration.

During data analysis and test check of records audit noticed (July and August 2012) that in offices of DTC Medak and RTO Khammam, life tax of ₹ 1.41 crore was not levied in respect of 167 vehicles; in remaining two offices there was short levy of life tax of ₹ 52.22 lakh on 57 construction equipment vehicles. Thus there was a total non/short levy of life tax of ₹ 1.93 crore in respect of 224 construction equipment vehicles. (5.9 AP 4 of 2014)

Permit Fee

In West Bengal Section 66 of the Motor Vehicles (MV) Act, 1988 provides that the owner of a transport vehicle can use his vehicle in a public place only after obtaining a permit from the prescribed authority. Fee for application and grant/renewal of permit in respect of different kinds of vehicles are realisable as per rates specified in Schedule- 'A' of the WNMV Rules. Rules provide that in case of delay in applying for renewal beyond 90 days after the expiry of the permit, a late fee of ₹ 3,000 is realisable.

During the course of audit between Jan and May 2011 from the scrutiny of permit registers of nine Registering Authorities (RAs), Audit observed that 252 public transport vehicles were plying with permits expired during 2006-07 to 2009-10. Vehicle owners were paying fitness fees and road taxes, RAs did not realise permit fees from them. This resulted in non realisation of permit fees including late fee of 22.92 lakh. Audit also found that permit fees in case of 349 public transport vehicles were realised during 2006-07 to 2009-10 at the pre-revised rates. This resulted in short realisation of permit fees of 10.38 lakh. There was an overall non/short realisation of permit fees of ₹ 33.30 lakh. (4.11 WB 2 of 2013)

Permit Fee

Under the provisions of the Uttar Pradesh MVT Act, no Educational Institute shall use vehicles for transportation of students without proper permit. Further, Rule 125 of the UPMVT Rules, 1998 prescribes ₹ 3,750 for issue of new permit, its renewal and countersignature and ₹ 1,000 for application fees. During scrutiny (June 2013-March 2014) of the vehicles files, permit register and vehicles database, Audit found that, 762 school vehicles were plying in sub regions without permit during the period June 2012 to February 2014. This resulted in non-realisation of permit fees and application fees of ₹ 36 lakh. (4.4 UP 1 of 2015)

Permit Conditions

Section 72 of Motor Vehicle Act, 1988 provides different conditions for grant of stage carriage permit. Sub section 2(iii) ibid specify that the minimum and maximum number of daily trips to be provided in relation to any route or area generally or on specified days and occasions may be provided after issue of such permit. Subsequently as per Rule 17 of the Uttar Pradesh Motor Vehicles Taxation Rules, 1998 as amended from 28 April 1999 every operator of the stage carriage shall within seven days of coming into force of the Act or being possessed of the vehicle, as the case may be, furnish to the Taxation Officer a table regulating timing of arrival and departure of his stage carriage, as well as the number of single trips made in a quarter and such other particulars connected with this business, as the Taxation Officer may by order, from time to time require. Violation of permit condition attracts imposition of compounding fee ₹ 4,000 per case fixed vide notification dated 25 August 2010. Audit scrutiny of route file of stage carriage vehicles of five RTOs revealed that none of the 788 stage carriage vehicles were covered under stage carriage permit and plying during the period from April 2012 to January 2014 have submitted their time table for arrival and departure of vehicle. Compounding fees amounting to ₹ 71.52 lakh was to be levied. It was levied. (4.4.2 UP 1 of 2015)

Dealers' Tax

Section 3 (2) of the WBMVT Act prescribes that every dealer or manufacturer who keeps in his possession or control any motor vehicle shall pay dealer's tax on such motor vehicle at the time of its first registration at the prescribed rates. Further, section 11 (b) (iii) of the Act provides that in case of delay in payment of tax exceeding 60 days after the expiry of grace period of 15 days, penalty equal to the amount of tax payable is also realisable from a defaulter dealer. During analysis of data of six Registering Authorities (RAs) between January and February 2011 we found that dealer's tax and penalty in respect of 1,249 newly registered vehicles amounting to 18.26 lakh were not realised from the dealers during the period from April 2005 to March 2010. (4.13 WB 2 of 2013)

Trade Fee

Rule 34 of the Central Motor Vehicle Rules, 1989 provides that an application for the grant or renewal of a trade certificate shall be made by the dealer in Form 16 and shall be accompanied by the appropriate fee (₹ 50 for two wheeler and ₹ 200 for four wheeler) as specified in Rule 81. The fee is chargeable for each vehicle sold by the dealer. In three districts (Ludhiana, Patiala and Ropar), audit noticed from the information furnished by the DTOs and STC that 7,16,410 vehicles were registered

under different categories between April 2008 and March 2013. However, the dealers had not deposited the requisite trade fee or deposited less trade fee than that prescribed. The transport authorities did not ascertain the actual number of vehicles sold by each dealer against which trade certificates were issued and recover the correct amount of trade fee. This resulted in non-realisation of revenue of ₹ 6.05 crore. (5.3.12 PB 4 of 2014)

Registration numbers

The Haryana Government notification dated 27 November 2008 provides that anyone opts for out of turn allotment of special numbers would pay an additional fee of ₹ 10,000. Audit observed that in five RAs and RTAs for the year 2011-12, out of turn registration numbers were allotted in 242 cases but no additional fee were charged from these vehicles owners. This resulted in loss of revenue of 24.20 lakh. (5.2.16 HR 2014)

## STAMP DUTY AND REGISTRATION CHARGES

State Governments impose a variety of stamp duties and registration fees on different kinds of transactions and instruments. There are about 50 different kinds of such charges imposed by the States. These charges effectively amount to a tax on the value of a transaction, most commonly on the transfer of movable and immovable properties and of instruments used in commercial and business transactions.

There are two basic types of charges, stamp duties and registration fees.

Stamp duty is a tax on the value of instruments used in various business transactions. Within this broad definition of stamp duties, there are two sub-classifications: judicial stamp duties and .non- judicial stamp duties. Judicial stamp duties are fees collected from litigants in courts, referred to as court fees. Revenue from judicial stamp duties is relatively small in magnitude. Non-judicial stamp duties are typically a one-time charge on the transfer of immovable property. It is a one-time payment, a tax on transaction with value of the transaction as tax base. It can be seen as a tax on the transaction. These non-judicial stamp duties are usually referred to as stamp duties.

Registration fee is a payment made for a specific service provided by government in recording contracts and deeds, and so is more closely related to a user charge. The government maintains a registry of deeds in return for a fee. The sub-registrars who register them are usually not concerned with the legal validity of the document. They are concerned only with the correct payment of the fee because the payment of the registration fee does not entitle the payee to a guaranteed legal title.

Under Entry 91 List (I), the Central government sets the rates of stamp duties on bills of exchange, bills of lading, cheques, promissory notes, letters of credit, insurance policies, share transfers, debentures, proxies, and receipts-in-brief. The rates are uniform across all States. The collection of the duties is the responsibility of the State government in which the transaction occurs, and the State government retains all revenues collected by the State.

Under Entry 63 of the State List (II), State governments have the exclusive power to fix the stamp duties for other instruments listed on the State List. The specific items taxed vary by State. However, the instruments on which the stamp duties are imposed fall into five broad categories:

Instruments that relate to conveyance and property transfer
Instruments that are connected with loans and advances
Instruments that related to capital market transactions
Instruments that are used in daily business and commercial transactions
Instruments that are executed under other statutes for record-keeping purposes

Receipts from stamp duty and registration fee are regulated under the Indian Stamp Act 1899, (IS Act), Registration Act, 1908 (IR Act). Under this Central Act, each State has the authority to enact its own stamp duties. Specific features of the stamp duties are broadly similar across the States, also have State specific characteristics. In a State it is administered by Inspector General of Registration and Stamps (IG) assisted by Deputy Inspectors General (DIG), who in turn are assisted by District Registrars and Sub-Registrars (SR).

For most States, the bulk of stamp duty revenues come from the tax on a conveyance. (or a deed of sale).Duties collected on conveyances typically account for 70 to 90 percent of total (non-judicial stamp duty) revenues in the States. The stamp duties can be imposed an ad valorem rate, a specific rate, or a mix of ad valorem and specific rates. In all cases, it is the buyer who is legally liable for the stamp duties. The steps involved in the process of payment of stamp duties (and the registration of the sale deed) to complete the transaction are:

The seller purchases stamp paper of the required value from a licensed stamp vendor for his sale instrument, from Treasury if it is of high value

The seller gets the instrument written on the stamp paper by a licensed deed-writer, by an advocate, or by himself.

Instrument is executed by the seller (or his authorized attorney under a power of attorney), a copy of it is made and filed along with the original instrument.

The instrument and its copy presented to the Registering Officer (RO) for registration.

The RO verifies the adequacy of the stamp duty paid and also the admissibility of the instrument under the Registration Act.

RO verifies that the value of the property stated in the instrument is correct

If the stated value is the same or above the guideline market value, the instrument is accepted, after the RO verifies that all the conditions required for admission of the instrument have been met, the document is registered on payment of the prescribed fees.

If the stated value is below the guideline value, the seller must pay the difference between the payable stamp duty and the actual amount paid.

If there is disagreement, instrument is referred to the District Sub-Registrar for further review and further up if necessary

Audit seeks to examine whether the amount due is correctly worked and collected. Certain studies indicate that the values declared for stamp duty transactions are grossly understated, perhaps party due to very high duty rate. There can ways of avoiding by way of long term lease on long term payment, exchange of properties of much different values, the splitting of one property into smaller properties to avoid higher stamp duty rates etc.

### *Examples*

Valuation of land

Section 143 of the Uttar Pradesh *Zamindari* Abolition and Land Reforms Act, 1950 provides that where a *bhumidhar* with transferable rights used his holding or part thereof for a purpose not connected with agriculture, horticulture or animal husbandry, the Assistant Collector in charge of the sub- division may, *suo moto* or on an application after making such enquiry as may be prescribed, make a declaration to that effect. If the land is used fully or partially for residential purposes, the concerned SDM should *suo moto* declare the whole land as *abadi* under Section 143 of Uttar Pradesh *Zamindari* Abolition and Land Reforms Act (UPZA&LR Act). If the land was declared non-agriculture under Section 143 of the above Act, the same should be valued at residential rate for the purpose of levy of Stamp duty.

During scrutiny (March 2014) of Book 1 *Khand*, Sale Deed and Circle rate of SR-II Hapur, we found that four deeds of conveyance having 54,997.40 square meter of land were registered during January 2014 and March 2014 for a consideration of ₹ 3.56 crore at agricultural rates on which stamp duty of ₹ 24.70 lakh was paid. Audit noticed that *Arazi* numbers 338, 340, 342, 385, 644 were declared as non-agricultural on 28.1.2009 and 22.4.2013 by order under Section 143 of UPZA&LR Act, prior to the date of registration of four deeds. Hence the properties were required to be valued at ₹ 11.22 crore at residential rates and stamp duty of ₹ 78.34 lakh was leviable at residential rate. The concerned SR did not consider these aspects while registering the documents. This resulted in short levy of stamp duty of ₹ 53.64 lakh**.** (5.4 UP 1 of 2015)

As per Articles 23 and 31 of Schedule I to IS Act, in the case of conveyance and exchange of immovable property respectively, stamp duty shall be levied at the rate of eight *per cent* (upto March 2012) and at seven *per cent* thereafter, including surcharge, on the market value of the property which is the subject matter of conveyance. According to Section 27 of IS Act, the consideration, market value and all other facts and circumstances affecting the chargeability of the instrument with duty or the amount of duty with which it is chargeable shall be fully and truly set forth therein. If the RO has reason to believe that the market value of the property which is the subject matter of conveyance, has not been truly set forth in the instrument, he may after registering such instrument, refer the same to the Collector for determination of the market value of the property and the proper duty payable thereon. Guidelines are supplied to ROs to arrive at the market value of the land. The value as per the Guidelines Register or the value of the property set forth in the document, whichever is higher, is the basis for levy of stamp duty and registration fee.

Audit noticed during test check of records of nine Registering Offices (between Mar 2013 and Feb 2014), that through 26 instruments of sale and one instrument of exchange executed and registered between March 2012 and March 2013, vacant land/ house sites and building were conveyed and stamp duty and registration fee of ₹ 0.42 crore was collected on the set forth value of ₹ 5.19 crore. However, as per the Guidelines Register the value of the properties was ₹ 17.66 crore. The RO failed to adopt the guideline value for the purpose of levy of stamp duty. Thus, there was undervaluation of properties amounting to ₹ 12.47 crore, on which deficit stamp duty and registration fee of ₹ 100.10 lakh was required to be collected. (3.4.3 TN 2 of 2015)

Lease Deeds

Under the provisions of Article 33(a)(iii) of the Schedule appended to Rajasthan Stamp Act, 1998 where the lease purports to be for a term in excess of twenty years or in perpetuity or where the term is not mentioned, SD is chargeable as on a conveyance on the market value of the property. The term of a lease shall include not only the period stated in the document but shall be deemed to be the sum of such stated period along with all previous periods immediately preceding this without a break for which the lessee and lessor remained the same.

On scrutiny of records of two SRs (Jaipur-VII and Jhadol-Phalasia), it was noticed Oct 2012 and Jan 2013) that two lease deeds were registered for a period of more than 20 years. In another case, the house was given on lease from 26 Dec 2005 and new lease deed was executed for 15 years from 12 Aug 2011 after cancelling the previous lease

on 25 July 2011. The SR charged SD on the basis of the average rent for the period shown in lease deed instead of chargeable SD as on conveyance on the market value of the property. This resulted in short levy of SD and RF aggregating to ₹ 11.73 lakh. (5.12 RJ 4 of 2014)

Classification of conveyance deeds

Section 2 (10) of the Indian Stamp Act (Act), provides that conveyance. includes conveyance on sale and every instrument by which property, whether movable or immovable, is transferred *inter vivos* and which is not otherwise specifically provided for by Schedule 1-A of the Act. Further, Section 54 of the Transfer of Property Act, 1882 defines 'sale' as transfer of ownership in exchange for a price paid or promised or part paid and part promised. The classification of an instrument depends upon the nature of the transaction recorded therein.

Audit noticed (May 2013) from the records of the office of SR, Mohalli that a development agreement was registered (June 2012) in respect of land on which stamp duty of ₹ 0.02 lakh was levied as applicable in the case of an agreement not involving sale of land. Scrutiny of the agreement showed that the owner of the land authorized the developer to take possession of the land with the right to construct, develop and deal with the land in accordance with the terms and conditions of the agreement. In exchange of the land, the owner of the land was entitled to take a part of the developed land. The developer was entitled to dispose of his share of developed land in such a manner as may deemed fit without requiring any consent from the owner. Developers were to pay Stamp Duty (as applicable to conveyance deed). Total value of land transferred to the developer worked out to ₹ 7.04 crore on which Stamp Duty of ₹ 56.34 lakh was leviable. (4.8 PB 4 of 2014)

Lease

As per Section 27 of IS Act, 1899 (Odisha Amendment), the consideration, if any, and the market value of property and all other facts and circumstances affecting chargeability of any instrument with duty or the amount of the duty with which it is chargeable shall be fully and truly set forth therein. Where the lease is granted for a term exceeding 30 years but not exceeding 100 years for a premium, in addition to rent reserved, SD and RF are charged at the prescribed rates for a consideration equal to the amount of such premium along with four times the amount of average annual rent and cess of the property. Government of Odisha clarified (Feb 2006) the components which constitute the consideration amount for charging SD and RF, in case of transferring the private land acquired by IDCO to Industrial houses.

During test check of lease deeds in SR, Dhenkanal, Audit noticed (September 2013)that the RA registered a 90 years lease deed in respect of land measuring 184.392 acres in village Kharagaprasad, District- Dhenkanal, for a consideration of ₹ 9.23 crore as per recital in the document and realised ₹ 67.74 lakh towards SD and RF. Further scrutiny of document revealed that the value of land as per Bench Mark Value-BMV (approved market value) record was ₹ 14.61 crore on which SD and RF of ₹ 102.26 lakh was realisable. Thus, registration of document without verifying the BMV, resulted in short realisation of SD ₹ 24.66 lakh and RF of ₹ 9.86 lakh. (4.63 OD 1 of 2015)

Tenancy

In Maharashtra as per instruction 2.2 of Annual Schedule of Rates (ASR), benefit of tenanted property is available only if tenants gives at least two of the eight prescribed documents in support of tenancy for last five years and should from part of instrument. Further the area occupied by tenant is required to be stated in detail in the recital of the instrument.

During test check of records in April 2012, Audit noticed that an instrument of development agreement executed on 5 June 2008 for inbuilt area of 4,227 sq.m., situated in Tardeo division within Mumbai Municipal Corporation limits was adjudicated by Collector of Stamps, Mumbai in February 2011. Though the property was stated to be tenanted, the area occupied by tenants, rent recovered, proof of tenancy and area to be allotted to these tenants in new building were not mentioned in the body of the instrument. The Department had worked out the market value of property at ₹ 1.09 crore incorrectly by giving the benefit of tenancy and levied stamp duty of ₹ 5.44 lakh. Audit pointed out that the correct market value of property works out to ₹ 28.62 crore at the rate of 67,700 per sqm on which stamp duty of ₹ 1.43 crore and penalty of ₹ 1.59 crore for the period from June 2008 to March 2013 was leviable. (3.4.6 MH 1 of 2014)

Collaboration

In Haryana in test check of records, Audit noticed that 10 Collaboration Agreements relating to four districts were registered between Jan 2011 and Nov 2012 in respect of land on which Stamp Duty (SD) of ₹ 1,300 was levied as applicable in the case of agreement, not involving sale of land. Scrutiny of these agreements revealed that the owners of land authorised the developers to take possession of the land with the right to construct, built-up shop-cum-flats and residential houses in exchange for a share of the developed land and/or receive part payments. The developers were entitled to dispose of their shares of developed land in such a manner as they deemed fit without requiring any consent from the owners. Hence, the development right/collaboration agreements were conveyance deeds and were liable to pay SD on sale of property in respect of the

developer's share of land. As per rates fixed by the Collector, total value of agricultural land transferred to the developers worked out to ₹ 45.89 crore on which SD of ₹ 2.32 crore was leviable. However, the registering authorities misclassified these documents as agreement to sell charging SD of 1,300 instead of 2.32 crore, resulting in short levy of SD of 2.32 crore. (4.4 HR 3 of 2014)

Development Agreements

Section 2 of the Gujarat Stamp Act, 1958 (GS Act) defines the various terms/ instruments mentioned in the Act. However, the Development Agreement has not been defined in the Act. With effect from1 Sep 2001, as per Article 5(ga) of Schedule I of the GS Act, the development agreement in the form of agreement, memorandum of records, which gives authority or power to a promoter or a developer for construction on or development of, or sale or transfer of, any immovable property shall be chargeable with stamp duty at the rate of one *per cent* of the market value of the property. Simultaneously, similar provision was also inserted in the GS Act under Article 45(g), where the Power of Attorney (PoA) is given for development of immovable property. However, under Article 45(f), when a PoA is given for consideration and authorising the attorney to sell any immovable property, then stamp duty chargeable shall be as is chargeable on a conveyance deed, i.e., at the rate of 4.9 *per cent* (w.e.f. 01.04.2007) of the amount of consideration or the market value of the property which is the subject matter of such conveyance, whichever is greater.

Accordingly, a document is required to be classified on the basis of the recitals therein and not on the basis of its title. During Audit it was observed that the documents though styled as development agreements contained recitals so as to classify them as deemed conveyance. Stamp duty is levied either at the rate of one *per cent* of the market value of the property or ₹ 100 only instead of payment of 4.9 *per cent* stamp duty. The developers thus get undue benefit in the disguise of a development agreement.

Audit examined the system of levy of stamp duty and registration fees on the development agreements/PoAs for development/ documents having reference about development agreements between Apr 2013 and Mar 2014 in 52 out of 262 Sub Registrar offices. Audit verified 267 development agreements/Power of Attorney given for development of immovable properties and noticed irregularities in 97 documents. More than one third of these development agreements were entered into for the purpose of evasion of stamp duty and registration fees. In these test checked cases, there was evasion of stamp duty and registration fees of ₹ 23.17 crore. (5.3 GJ 7 of 2014).

PPP Agreements

In Andhra Pradesh out of the 111 PPP agreements entered into since late 1990s, 34 were executed as lease agreements, 18 agreements contained clauses which made them leases, but were not executed as leases. As all these 52 agreements were executed on or after 1 April 1999, they were all to be registered compulsorily. Audit observed that only one of them was registered. As the remaining agreements were not registered, stamp duty was not levied on any of them. Even in the one agreement which was registered, there was short levy of stamp duty.

Detailed audit observation of the 18 agreements contained clauses which made them leases, but were not executed as leases is given below.

According to Section 105 of the Transfer of Property Act, 1882, a lease of an immovable property is the transfer of right to enjoy such property, made for a certain time, express or implied, or for perpetuity in consideration of a price paid or promised, or of money, a share of crops, service or any other thing of value, to be rendered periodically on specified occasions to the transfer or by the transferee who accepts the transfer on such terms.

Under Article 31(d) of Schedule 1A to IS Act, where the lessee undertakes to effect improvements in the leased property and agrees to make the same to the lessor at the time of termination of lease, stamp duty is to be levied at five per cent on the value of the improvements contemplated to be made by the lessee as set forth in the deed in addition to the duty chargeable under other clauses of Article 31.

Audit noticed that 18 PPP agreements as noted above were executed between Apr 1999 and Aug 2013 on ₹ 100 non-judicial stamp papers. A scrutiny of recitals of these agreements revealed that those agreements fulfilled all conditions as provided in the definition of lease in terms of Section 105 of the Transfer of Property Act. Hence, these agreements were to be classified as leases and were to be registered compulsorily under Section 17 of the Registration Act 1908. Registration fee under Section 78 (Article 1C) of Registration Act 1908 and stamp duty under Article 31 of Schedule 1A to IS Act were leviable.

In these 18 agreements, the concessionaires (private parties) had to make certain improvements in the land/space provided to them by the Departments/ Corporations and at the end of the period of agreement, transfer the property along with the improvements to the respective Department/Corporation. These agreements, therefore, attracted stamp duty under Article 31(d) of the IS Act on improvements made. The misclassification of these 18 documents as agreements or memoranda of agreements instead of treating them as leases resulted in non-registration and consequent non-levy of stamp duty of ₹ 665.38 crore.

It was noticed that of 34 PPP agreements under Build Operate Transfer (BOT) schemes executed as leases during the period from April 1999 to August 2013, 33 had not been registered although they were required to be registered compulsorily under Section 17 of Registration Act. In addition to the registration fee, stamp duty as per Article 31(c) of the IS Act, was also leviable by taking into account the fine or premium or money advanced in addition to the rent reserved. Since, in all these cases, the concessionaire had to pay Annual Ground Licence Fee (AGLF), Additional Development Premium (ADP) or one- time Upfront Development Fee (UDF)/premium, these payments were to be taken into consideration for levy of stamp duty. Total stamp duty and registration fee leviable on these 33 documents was ₹ 43.77 crore. (4.4 AP 1 of 2015)

# CAG Compliance Auditing Guidelines -February 2016

**Introduction**

1.1 These guidelines contain the framework for the process of compliance auditing within the Indian Audit and Accounts Department headed by the Comptroller and Auditor General (CAG) of India hereinafter referred as IA &AD. The officers and the staff of IA &AD must follow these guidelines in planning, implementation, reporting, observing follow-up processes and obtaining quality assurance in compliance audits. They outline principles, objectives, approach, methodology, techniques and procedures for conducting compliance audits. These guidelines are based on the existing guidelines and instructions applicable within IA &AD and have adapted the ISSAIs (International Standards of Supreme Audit Institutions) for compliance auditing.

**Applicability**

1.2 These guidelines have been formulated to suit the requirements of IA &AD. These provide detailed instructions on preparation of audit plan for compliance risk profiling and reporting for compliance audits. However, the detailed audit checks to be performed while conducting compliance audits prescribed in the MSO (Audit) and the existing area specific checklists, instructions and guidance notes dealing with audit of contracts, fraud and corruption, quality and timelines etc., would continue to remain applicable.

**Scope for individual initiative and professional judgement**

1.3 While these guidelines are prescriptive in nature, they are not intended to supersede the professional judgement of the Accountant General, relevant to specific situations. The Accountant General is expected to make situation or subject specific adjustments to the provisions set out in these guidelines. However, Accountants General will be expected to document the rationale of all significant departures from the guidelines. The term Accountant General includes all heads of field audit offices of the rank of SAG and above within the IA&AD

**Audit Mandate**

1.4 The audit mandate of IA&AD is derived from the Articles 149 & 151 of the Constitution of India. Article 149 of the Constitution of India envisages that CAG shall perform such duties and exercise such powers in relation to the accounts of the Union, of the States and of any authority or body as may be prescribed by or under any law made by Parliament. Article 151 of the Constitution of India provides that the reports of the CAG of India relating to the accounts of the Union or a State government shall be submitted to the President or the Governor of the State respectively, who shall cause them to be laid before each House of Parliament/ Legislature of the States. The statutory position is established under the CAG's (Duties, Powers and Conditions of Service), Act 1971. In addition to above, Audit mandate is governed by other provisions in the Constitution and other acts of Parliament which provide for audit of specific entities by the CAG. The audit mandate of CAG, therefore, extends to bodies or authorities such as statutory authorities, statutory corporations, government companies, autonomous bodies legally organised as societies, trusts or not-for-profit companies, urban and rural local bodies (the third tier of government below the Union and State Governments) and also to any other body or authority whose audit may be entrusted to

the CAG under law. All these entities follow different systems, procedures and norms for their financial and operational management which may or may not conform to those applicable to government departments. The Accountants' General are therefore required to keep this broad consideration in mind while applying these guidelines for compliance audit of these auditable entities. CAG's Regulations on Audit and Accounts, 2007 provides appropriate guidance on the various audits undertaken by IA &AD and Chapter 6 of the CAG's Regulations on Audit and Accounts, 2007 contains specific guidance on compliance audit.

**Compliance Auditing: Definition and Objective**

1.5 The concept of compliance audit is embedded in the description of the purpose of public sector audit in the Lima Declaration of Guidelines on Auditing Precepts:

*'……*Audit is not an end in itself, but an indispensable part of a regulatory system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent or at least render more difficult, such breaches'

1.6 ISSAI 4100 defines compliance audit as follows:

Compliance audit deals with the degree to which the audited entity follows rules, laws and regulations, policies, established codes, or agreed upon terms and conditions, etc. Compliance auditing may cover a wide range of subject matters.

1.7 The CAG's Regulations on Audit and Accounts, 2007 define compliance audit as

'an assessment as to whether the provisions of the Constitution of India, applicable laws, rules and regulations made there under and various orders and instructions issued by the competent authority are being complied with'.

1.8 The CAG's Regulations on Audit and Accounts, 2007 envisage that compliance audit includes an examination of the rules, regulations, orders and instructions for their legality, adequacy, transparency, propriety and prudence and effectiveness that is whether these are:

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

The CAG's Regulations on Audit and Accounts, 2007 further provide that the compliance audit also examines the rules, regulations, orders and instructions for their consistency with each other.

1.9 Seen from the perspective of public sector audit[1], compliance with rules, regulations and applicable authorities[2] is the primary and most important requirement for ensuring

1 Public sector refers to the sector that is controlled by Central, State and Local Governments. Public sector entities include all Central and State Government Ministries, Departments, Directorates /Commissionerate, and all other entities/bodies owned/controlled by the Central and/or State Governments

2 Authorities include the Constitution of India, laws, regulations etc.. Detailed definition - para 1.14

accountability of the public executive, which primarily relate to safeguard and use of resources – financial, natural, human and other material resources. Compliance audit also performs the function of deterrence, especially in situations where internal controls are not as effective. The objective of public-sector compliance auditing, therefore, is to enable the CAG to assess whether the activities of public-sector entities are in accordance with the authorities governing those entities. Compliance audits are carried out by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities, which govern the auditable entity. It is concerned with *regularity and propriety audit.*

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

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

As such compliance audit not only includes examination of rules, regulations, orders, instructions but also every matter which, in the judgment of the auditor, appears to involve significant unnecessary, excessive, extravagant or wasteful expenditure of public money and resources despite compliance with the rules, regulations and orders.

It also includes audit of sanctions to expenditure, which is guided by the principles of legality, propriety, competence of the sanctioning authority, adherence to the criteria for sanction, availability of funds, determination of physical targets, objects of expenditure and the accounting procedure. Thus, besides verifying compliance by the auditable entities to the applicable regulatory framework, compliance audit is also expected to examine the regulatory framework for consistency and raise questions on grounds of propriety also.

**Elements of compliance audit**

1.10 Compliance audit in Public Sector audits have certain basic elements (i) Three parties in the audit i.e. the auditor, the responsible party, intended user, (ii) Subject matter and (iii) Authorities and criteria to assess the subject matter.

**The three parties**

1.11 The three parties involved in compliance audit are briefly described below:

**The auditor:** represents the Indian Audit & Accounts Department and the persons delegated with the task of conducting audits. However, clear cut demarcation of roles and responsibilities of officers and staff for various audit functions is done through a hierarchical structure. Auditors in compliance audits typically work as a team with different and complementing skills. The auditor is responsible for planning and implementation of audit and issuing a compliance audit report.

**The responsible party**: represents the executive branch of government and/or its underlying hierarchy of public officials and entities responsible for the management of public funds

and the exercise of authority under the control of the legislature. The responsible party in compliance auditing is responsible for the subject matter of the audit.

**The intended users**: represent the individuals, organizations or classes thereof for whom the auditor prepares the audit report. In compliance auditing the users generally comprise the executive which includes auditable entity and those charged with Governance, the legislature and the citizens who are the ultimate users of compliance audit reports.

**Subject matter**

1.12 Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria while conducting an audit. Compliance auditing may cover a wide range of subject matters depending upon the audit scope. Subject matter may be general or specific in nature. Some of these may be easily measureable (for example – compliance with a specific requirement like adherence to environment laws) while others may be more subjective in nature (for example- financial prudence or ethical behaviour).

**Authorities and criteria**

1.13 **Authorities** are the most fundamental element of compliance auditing, since the structure and content of authorities furnish the audit criteria and therefore form the basis of how the audit is to proceed under a specific constitutional arrangement. Authorities include the Constitution, Acts, Laws, rules and regulations, budgetary resolutions, policy, contracts, agreements, PPP contracts, established codes, sanctions, supply orders, agreed terms or the general principles governing sound public-sector financial management and the conduct of public officials. Most authorities originate in the basic premises and decisions of the legislature, but they may be issued at a lower level in the organisational structure of the public sector.

1.14 Because of the variety of possible authorities, they may have mutually conflicting provisions and be subject to differing interpretations. In addition, subordinate authorities may not be consistent with the requirements or limits of the enabling legislation and there may be legislative gaps. As a result, to assess compliance with authorities in the public sector it is necessary to have sufficient knowledge of the structure and content of the authorities themselves. Authorities are, typically the source of the criteria.

1.15 **Criteria** are the benchmarks used to evaluate or measure the subject matter consistently and reasonably. The auditor identifies criteria on the basis of the relevant authorities. To be suitable, compliance audit criteria must be relevant, reliable, complete, objective, understandable, comparable, acceptable and available. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Where formal criteria are absent audits may also examine compliance with the general principles governing sound financial management. Suitable criteria are needed both in audits focusing on regularity and in audits focusing on propriety.

**General outlay of Compliance Auditing Guidelines**

1.16 These guidelines are being presented sequentially to typically represent the process flow of compliance audit

| | | | | |
|---|---|---|---|---|
| | | | | |
| **Documentation, Communication, Quality Control** | | **General principles and Annual Compliance Audit Plan** (Chapter 2,3) | | Consider principles with ethical significance<br>Consider principles directly relating to compliance audit process<br>Determine Auditable entities, audit units and implementing units<br>Develop annual plan for compliance audits |
| | | | | |
| | | **Planning Compliance Audits** (Chapter 4) | | Determine compliance audit objective and scope<br>Develop audit strategy and plan<br>Identify subject matter and criteria<br>Understand the entity and its environment<br>Understand internal control<br>Establish materiality for planning purpose<br>Assess risk; Plan audit procedures |
| | | | | |
| **Documentation, Communication, Quality Control** | | **Performing the Audit and Gathering Evidence** (Chapter 5) | | Gather evidence through various means<br>Continually update planning and risk assessment<br>Consider non-compliance that may indicate suspected unlawful acts |
| | | | | |
| | | **Evaluating Evidence and Forming Conclusions** (Chapter 5) | | Evaluate whether sufficient & appropriate evidence is obtained<br>Consider materiality for reporting purposes<br>Form conclusions<br>Ongoing documentation, communication and quality control |
| | | | | |
| | | **Reporting** (Chapter 6) | | Prepare the report; Include responses from entity as appropriate<br>Follow-up previous reports as necessary |

**Chapter 2- General Principles for Compliance Audits**

2.1 The General principles that apply during the conduct of compliance auditing and are relevant throughout the audit process are enumerated below.

Auditors should plan and conduct the audit with 'professional scepticism' and exercise 'professional judgement' throughout the audit process.

2.2 **Professional scepticism** refers to the attitude of the auditor, which must include a questioning mind. The auditor should plan and conduct the audit with an attitude of professional scepticism, recognising that certain circumstances may cause the subject matter to diverge from the criteria. An attitude of professional scepticism means that the auditor makes a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit. The concept of professional scepticism is fundamental to all audits.

**Professional judgement** refers to application of relevant training, knowledge, skills and experience, within the context provided by auditing standards, so that informed decisions can be taken about the courses of action that are appropriate given the circumstances of

audit. The auditor must apply professional judgement at all stages of the audit process to assess the subject matter, suitable criteria, audit scope, risk, materiality, audit procedures to be used in response to the defined risks, in reporting and in determining the form, content and frequency of communication throughout the audit.

**Auditors should possess the necessary skills**

2.3 The audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being undertaken, familiarity with the applicable standards and authorities, an understanding of the auditable entity's operations and the ability and experience to exercise professional judgement. Auditors should be able to maintain their professional competence through ongoing professional development.

Audits may require specialised techniques, methods or skills from disciplines not available within IA&AD for which external experts may be deployed without involving them in actual conduct of audit. The confidentiality of the specific information/records made available by the auditable entity should be maintained in such interface with external experts. Auditors should evaluate and document whether experts have the necessary competence, capabilities and objectivity and determine whether their work is adequate for the purposes of the audit.

**Auditors should observe the code of ethics**

2.4 IA&AD has adopted a code of ethics which should be observed by auditors at all times. The auditor promotes trust, confidence and credibility by adopting and applying the ethical requirements of the concepts embodied in the key principles of the code - Integrity, Independence and Objectivity, Confidentiality and Competence. The conduct of auditors should be beyond reproach at all times and in all circumstances.

**Auditors should take responsibility for the overall quality of audit**

2.5 The auditor is responsible for the conduct of audit and should implement quality control procedures throughout the audit process. Such procedures should be aimed at ensuring that the audit complies with the applicable standards and providing assurance that the audit report, conclusion or opinion is appropriate under the given circumstances.

**Auditors should consider audit risk throughout the audit process.**

2.6 Audits should be conducted in such a way as to manage, or reduce the audit risk to an acceptable level. Audit risk is the risk that the audit report – or more specifically the auditor's conclusion - will be inappropriate in the circumstances of the audit. The auditor should consider three different dimensions of audit risk – inherent risk, control risk and detection risk – in relation to the subject matter and the reporting format, i.e. whether the subject matter is quantitative or qualitative. The relative significance of these dimensions of audit risk depends on the nature of the subject matter and the nature of assurance to be provided.

**Auditors should consider materiality throughout the audit process.**

2.7 Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. This judgement may relate to an individual item or to a group of items taken together. Materiality is often considered in terms

of monetary value, but it also has other quantitative as well as qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs. Materiality should be considered for the purposes of planning, evaluating the evidence obtained and reporting, though the materiality levels would differ for each of the processes. An essential part of determining materiality is to consider whether reported cases of compliance or non-compliance (potential or confirmed) could reasonably be expected to influence decisions by the intended users. Factors to be considered within this judgment are mandated requirements, public interest or expectations, specific areas of legislative focus, requests and significant funding and include other issues, which may have a low level of monetary value or incidence, such as fraud.

**Auditors should prepare sufficient audit documentation.**

2.8 Documentation should be sufficiently detailed to enable an experienced auditor, with no prior knowledge of the audit, to understand the following: the relationship between the subject matter, the criteria, the audit scope, the risk assessment, the audit strategy and audit plan and the nature, timing, extent and results of the procedures performed; the evidence obtained in support of the auditor's conclusion or opinion; the reasoning behind all significant matters that required the exercise of professional judgement; and the related conclusions. Documentation should be prepared within a reasonable period before the issue of audit report and as far as possible audit processes may be documented simultaneously. The documentation should be retained for an appropriate period of time.

**Auditors should maintain effective communication throughout the audit process.**

2.9 Communication takes place at all audit stages - before the audit starts, during initial planning, during the audit process, and at the reporting phase. Any significant difficulties encountered during the audit, as well as instances of material non- compliance, should be communicated to the appropriate level of management or those charged with governance.

**Auditors should determine the audit scope.**

2.10 The audit scope is a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The scoping of an audit is influenced by materiality, risk and legal requirements, and it determines which authorities and parts thereof will be covered.

**Auditors should identify the subject matter, authorities and suitable criteria.**

2.11 Determination of the subject matter, authorities and criteria are one of the first steps in a compliance audit. As stated in Chapter 1 subject matter could be either general or specific. The subject matter should be identifiable, and it should be possible to assess it against suitable criteria. It should be of such a nature that it enables sufficient and appropriate audit evidence to be gathered in support of the audit conclusion. The auditor should identify authorities and suitable criteria to provide a basis for evaluating the audit evidence and developing audit findings and conclusions. The authorities and criteria should be made available to the intended users and others as appropriate.

**Auditors should understand the auditable entity**

2.12 Compliance auditing may cover all levels of the executive and can include various administrative levels, types of entities and combinations of entities. The auditor should therefore be familiar with the structure and operations of the auditable entity and its procedures for achieving compliance. The auditor will use this knowledge to determine materiality and assess the risk of non-compliance.

**Auditors should understand the control environment**

2.13 An understanding of the auditable entity and/or the subject matter relevant to the audit scope depends on the auditor's knowledge of the control environment and the system of internal controls. The control environment - encompassing the attitude and measures adopted by the management in the form of policies and procedures to instil a culture of honesty and ethical behaviour- forms the basis for the system of internal controls. In compliance auditing, a control environment that focuses on achieving compliance is of particular importance.

The particular type of controls which the auditor focuses on will depend on the nature of subject matter, nature and scope of the audit. In evaluating internal controls, the auditor should assess the risk that they may not prevent or detect material instances of non-compliance. The auditor should consider whether the internal controls are in harmony with the control environment so as to ensure compliance with the authorities and criteria in all material respects.

**Auditors should perform a risk assessment**

2.14 In the light of the audit criteria, audit scope and characteristics of the auditable entity, auditor should perform a risk assessment to determine the nature, timing and extent of the audit procedures to be performed. The identification of risks of non- compliance and their potential impact on the audit procedures should be considered throughout the audit process. As part of risk assessment, the auditor should evaluate any known instances of non-compliance in order to determine their materiality.

**Auditors should consider the risk of fraud**

2.15 Fraud in compliance auditing relates mainly to the abuse of public authority and to fraudulent reporting on compliance issues. Instances of non-compliance with authorities may constitute deliberate misuse of public authority for improper benefit. The execution of public authority includes decision making and avoidance of decision making, preparatory work, advice, information handling and other acts in the public service. Improper benefits are advantages of a non-economic or economic nature gained by an intentional act by one or more individuals among management, those charged with governance, employees or third parties.

While detecting fraud is not the main objective of compliance audit, auditors should include fraud risk factors in their risk assessments and remain alert to indications of fraud when carrying out their work. If the auditor comes across instances of non- compliance which may be indicative of fraud, the auditor should exercise due professional care and caution so as not to interfere with any future legal proceedings or investigations. When such suspected fraud has been identified, auditors should take action to ensure that they respond appropriately based on existing Headquarters instructions in this regard.

**Auditors should develop an audit strategy and an audit plan**

2.16 Audit planning should involve discussion among members of the audit team with a view to developing an overall audit strategy and an audit plan. The purpose of the audit strategy is to devise an effective response to the risk of non-compliance. It should include consideration of the planned audit responses to specific risks through the development of an audit plan. Both the audit strategy and the audit plan should be documented. Planning is not a distinct phase of the audit, but a continuous and iterative process.

**Auditors should gather sufficient and appropriate audit evidence**

2.17 The auditor should gather sufficient and appropriate audit evidence to provide the basis for the conclusion or opinion. **Sufficiency is** a measure of the quantity of evidence, while **appropriateness** relates to the quality of evidence – its relevance, validity and reliability. The quantity of evidence required depends on the audit risk (the greater the risk, more the evidence that may be required) and on the quality of such evidence (the higher the quality, lesser the evidence that may be required). Therefore, sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence does not compensate for its poor quality. The reliability of evidence is influenced by its source and nature, and is dependent on the specific circumstances in which it was obtained. The auditor should consider both the relevance and the reliability of the information to be used as audit evidence and must respect the confidentiality of all audit evidence and information received.

The audit procedures should be appropriate in the circumstances of the audit and suited to the purpose of obtaining sufficient and appropriate audit evidence. The nature and sources of the necessary audit evidence are determined by the criteria, subject matter and scope of the audit. The auditor will often be needed to combine and compare evidence from different sources in order to meet the requirements for sufficiency and appropriateness of evidence. If audit evidence obtained from one source is inconsistent with that obtained from another, or if there are any doubts about the reliability of the information to be used as evidence, the auditor should determine what modifications or additions to the audit procedures would resolve the matter and consider the implications, if any, for other aspects of audit.

**Auditors should evaluate audit evidence and form relevant conclusions**

2.18 After completing the audit, the auditor will review the audit evidence, which includes consideration of the responses provided by the auditable entities, in order to reach a conclusion. The auditor should evaluate whether the evidence obtained is sufficient and appropriate so as to reduce the audit risk to an acceptably low level. It also includes considerations of materiality. After evaluating the evidence, the auditor should consider how best to conclude in the light of the evidence. The auditor should also determine whether the risk assessment and initial determination of materiality were appropriate in the light of the evidence collected, or whether they need to be revised.

**Auditors should prepare a report based on the principles of completeness, objectivity, timeliness and a contradictory process**

2.19 The principle of completeness requires the auditor to consider all relevant audit evidence before issuing a report. The principle of objectivity requires the auditor to apply professional judgement and scepticism in order to ensure that all reports are factually correct and that

findings or conclusions are presented in a relevant and balanced manner. The principle of timeliness implies preparing the report in due time. The principle of a contradictory process implies checking the accuracy of facts with the auditable entity and incorporating responses from responsible officials as appropriate.

## Chapter 3- Compliance Audit Plan

3.1 Compliance with rules and regulations is the primary and the most important requirement for ensuring accountability of the public executive. Decision makers need to know whether relevant laws and regulations are being complied with, whether they have achieved the desired results, and whether the accepted standards of financial propriety are being adhered to; and if not, what corrective action is necessary. It is imperative that compliance audits are planned to achieve adequate coverage at an acceptably low level of audit risk, audit processes are carried out in an economic, efficient and effective manner and result in a high quality audit report. However, given the size of Government and its implementing arms and the limited audit resources it is impracticable to plan for audit coverage of all audit units in the audit universe-as defined at present. Proper planning and prioritisation of compliance audits based on an appropriate risk assessment, is therefore, paramount.

**Audit Universe and Annual Compliance Audit Plans**

3.2 Understanding the Audit Universe and prioritisation of compliance audits to be taken up is essential, which is in itself a complex task, given the various layers of Government and the Government implementing a significant number of programs /schemes with various implementing agencies, some of which could even be private sector entities. To implement the mandate entrusted to CAG by the Constitution of India, we are expected to cover, over a reasonable period of time, all the sectors/departments of the concerned State Governments/ Central Government wherever public funds are spent or revenues are generated or nation's wealth or resources are utilised. While the various departments/sectors are accountable for policy formulation and implementation, the organisational hierarchies within each Department /sector are typically organised as Directorates/Commissionerates, zones, divisions, circles, ranges etc., and further down to the last mile implementing agencies. All these units together implement the Government policy and expend public money or collect public revenues and can be called as the audit universe. This Audit universe is required to be broken down into audit units for the purpose of planning and scheduling audits.

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

**Defining the Apex Auditable Entities and Audit Units**

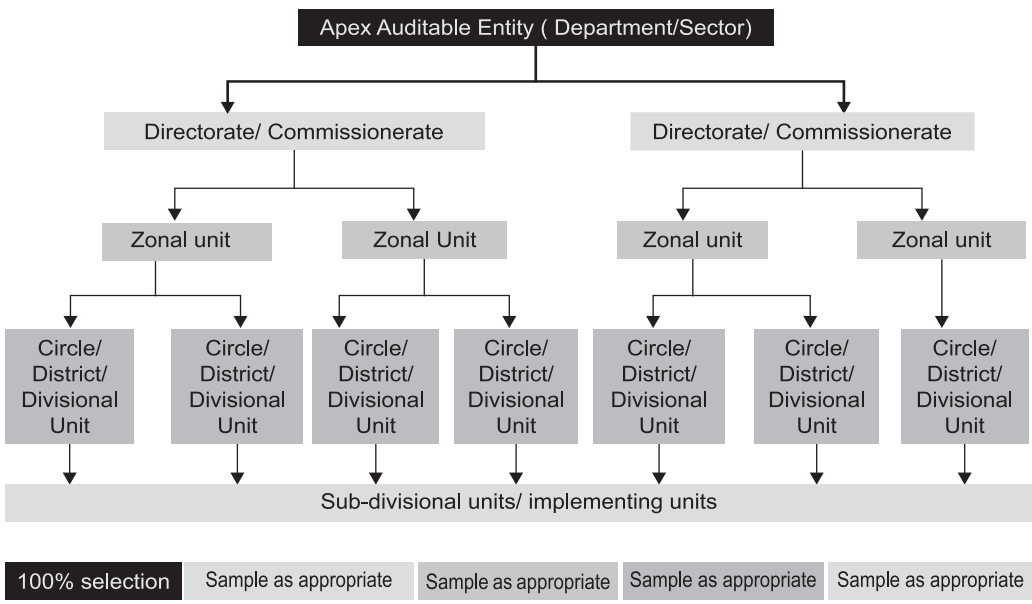
3.4 A top down and risk based approach to identification of audit units intends to place the Department/Sector as the centre piece of the audit focus and provide a scientific mechanism of defining audit units. The Department / Sector in the State Government or the Central

Government being the top layer would be defined as the Apex Auditable Entity[3]. Since policy formulation and oversight flow from the Departments/Sectors (Apex Auditable Entities) and responsibility for implementation of schemes/programs vests with the lower formations of the Government (Directorates /Commissionerates/zones, divisions, circles, ranges etc.) a significant portion of the risk is embedded in these layers, while the lowest layer is typically the implementing arm and accountability for its performance invariably rests with the higher organisational hierarchies. The top down approach for identification of audit units mentioned in these guidelines therefore envisages that audit units are identified beginning with higher organisational hierarchies of the Apex Auditable Entity and fanning out to operational units at the field level.

3.5 The audit units may be defined based on the quantitative measures of devolution of administrative and financial powers, the qualitative measures of functional autonomy and operational significance attributable to the unit for achievement of objectives of the Department. The devolution of powers would have to be substantial and not limited to the routine delegation of powers for managing the establishment and contingent expenses. This would ensure that the administrative authority for allocation of funds and delegation of powers are at the centre of compliance audit.

An Audit Unit is therefore defined as a unit, which has one or more of the following attributes:

- Substantial devolution of administrative and financial powers;
- Functional autonomy; and
- Operational significance with reference to achievement of objectives of the apex auditable entity.




3 The Regulation 2 of the CAG's Regulations of Audit and Accounts, 2007 defines Auditable entity as ''an office, authority, body, company, corporation or any other entity subject to audit by the CAG'. The highest authority or Head of Department under the audit jurisdiction of the Accountant General would be the Apex Auditable Entity

3.6 After determination of Audit Units based on the aforesaid parameters, the organisational hierarchies and implementing agencies below the Audit Units are to be categorised as Implementing Units. The Implementing Units are typically the last mile service providers and implementation arms of Government, with very limited delegation of financial and administrative powers - of contingent nature and for managing establishment. These Implementing Units would be audited, based on a sample selection, as a part of audit of their respective Audit Units. The process of sample selection is explained in the subsequent sections. The envisaged typical representation of Apex Auditable Entity, Audit Units and Implementing Units are shown in the diagram.

3.7 Preparation of audit universe by defining Apex Auditable Entity and Audit Units in terms of these guidelines would be carried out by the respective Accountants General in field offices. Each field office would be required to prepare an organisation chart of the Departments to identify the audit units based on the above parameters. The list of Audit Units and the Implementing Units would have to be maintained in the field offices, which would henceforth form the basis of planning compliance audits. While the above representation showcases organisational structure from the State Government's perspective, the central functions such as Central Revenue, Railways, Commercial, Posts and Telecommunications etc., and the Local Self Government – the Local Bodies shall also define their Apex Auditable Entities and Audit Units keeping in view the philosophy described in paras 3.4 to 3.6 above.

3.8 With the evolving governance structure, the nation's wealth/natural resources are being dealt with not only by the Union, State or its instrumentalities but also by the private parties, for delivery of public goods and services, it has become important that these implementing agencies or service providers are made accountable to the people and to the Parliament. These implementing agencies would also, therefore, be included in the aforementioned category of implementing units.

Records of these implementing agencies are required be accessed through the respective audit units. Detailed instructions of the procedure to be adopted for access and audit of records of such agencies are contained in the Guidance Note issued by Headquarters in this regard**.** However, the scope and extent of examination of records of such implementing agencies will depend upon the applicable regulatory framework including any contract/ agreement which the implementing agency may have entered into with the government, professional standard or practice used by the industry in which the entity operates and also judicial pronouncements.

**Risk Profiling**

3.9 The risk based approach to planning compliance audits is about focussing audit efforts on the perceived high risk areas/activities. Risk profiling of the Apex Auditable Entities and their Audit Units has to be done considering their structures, roles they are expected to perform and compliance requirements. As governments and other organisations transition into digital environment, they generate, process and store voluminous data. Also, useful and relevant data in disparate forms and continuously produced by various government and non-government agencies and entities. When collated, they provide the contextual framework and valuable insight into the functioning of an apex auditable entity. Capacity and infrastructure limitations

have so far restricted the reach of auditors in the big data environment. The advent of big data marks a paradigm shift, which by design integrates data from various sources and in various formats to transform data into actionable information. This aims to enhance the efficiency and effectiveness of audits. IA&AD has adopted a Big Data Management Policy to harness such opportunities. This policy is expected to facilitate greater and deeper insights into the Apex Auditable Entity's environment to clearly identify risk areas and prioritise the audit units.

3.10 Apex Auditable Entities while being responsible for delivery of public goods and services and expending public funds or collecting revenues may also be responsible for administering and / or enforcing various laws, rules or regulations. At the same time, these are also governed by various rules, laws and regulations. Similarly, officials entrusted with management or stewardship of public funds and public entities are expected to act with propriety in all matters concerning the discharge of their responsibilities**.** Keeping all the above factors in mind, the field audit offices are encouraged to apply the risk assessment methodology by evaluating high risk areas/activities of these entities relating to:

Administration and/ or enforcement of laws, rules and regulations etc.;
Compliance with applicable laws, rules and other authorities;
Responsibility for government receipts and expenditure;
Safeguarding of assets and liabilities;
Prevention of losses and wastage, frauds, leakage of revenue;
Promoting transparency, prudence and probity; and
Internal control environment

3.11 The risk assessment methodology should include a review of the following:

Latest socio-economic survey of the Centre/ State
Current Budget & Demands for Grant; Outcome budgets
Five year plans and Working Group reports/ Annual plans
Finance Commission Report
Annual/ Performance/ Activity Reports of Ministries/ Departments/ Companies and other information on Government websites
Major policy announcements/initiatives of Government
VLC data & Report on State Finances
Finance & Appropriation Accounts
Geographical location; Past audit coverage
PAC/COPU suggestions
Court orders
Audit Advisory Board suggestions
Reports of Legislative Committees
Changes in legislation
Replies to questions given to the Legislature
Past Audit findings/ Inspection Reports
Media reports and visibility of topics
Trend of expenditure and /or receipts

**Preparing Annual Compliance Audit Plans**

3.12 The exercise, as described above, would help in creating risk profile of the apex auditable entities as well as audit units under these entities. Based on their risk profile, the audit units should be prioritised for planning and conduct of compliance audits. The risk profile of the audit units should be considered vis-à-vis the audit capacity of the field office- in terms of

availability of resources, and an annual Audit plan of compliance audits to be taken up and completed during the year should be prepared by each field office.

The field offices under the IA&AD conduct financial audits, performance audits and compliance audits each year and the Annual Audit Plan of each office shall therefore be prepared by adopting a holistic approach of covering Apex Auditable Entities/Audit Units for each type of audit and leveraging common processes. The Annual Audit Plan of each office would therefore indicate the Apex Auditable entities/Audit Units for which compliance audits would be conducted. The outcome of analysis of sanctions and vouchers by the Financial Audit Wing, detailed processes of which are provided in the Financial Attest Auditing Guidelines for audit of State Government Accounts and other existing manuals and instructions, can be leveraged for planning compliance audits.

3.13 It must be the endeavour of the field offices to ensure coverage of all Apex Auditable Entities in a reasonable period of time, between three to five years. The risk profile of the audit units would have to be reviewed and updated periodically to assess continued maintenance or to consider revision in the risk profile assigned to the apex auditable entities and audit units based on new intervening developments, changes and increase/decrease in irregularities noticed by various stakeholders, etc.

3.14 The formulation of annual Compliance Audit Plan would therefore require:

Updating the Audit Universe such that it comprises all units that qualify as audit units. A separate inventory of implementing units under their respective Audit units may be maintained.

Applying risk assessment methodology to the Apex Auditable Entities for arriving at risk profile of the Apex Auditable Entities and Audit Units under these entities.

Preparing the annual Compliance Audit Plan by selecting audit units after considering available audit resources. This would include a risk based selection of Apex Auditable Entities and an appropriate sample of audit units at various hierarchies and implementing units within each Apex Auditable Entity. The selected sample of units shall be auditable both from the propriety and regularity perspective. Where evaluation of high risk areas/activities against regularity involves complexity and multifarious aspects, a specific subject matter may be selected within the high risk area/activity for evaluation of compliance against regularity.

3.15 Components of Annual Compliance Audit Plan

Selection of Apex Auditable Entities and Audit Units that would be taken up for compliance audits;

Selection of implementing units under the audit units as necessary;

Determination of specific subject matter, where considered necessary; and

Allocation of audit resources for the audits to be undertaken.

3.16 With the introduction of risk based approach to planning compliance audits, tempered by the audit capacity of each field office, as envisaged in these guidelines, the question of audit arrears would generally not arise.

## Chapter-4 Planning Compliance Audits

4.1 A compliance audit has to be planned in a manner which ensures that a high quality audit is carried out in an economic, efficient and effective way and in a timely manner. Adequate planning will ensure that appropriate attention is accorded to crucial areas of audit and that potential problems are identified in a timely manner. It is essential that Auditors plan the audit with an attitude of professional scepticism and exercise professional judgement. Further,

auditors should possess the knowledge, competence and skills to understand the compliance requirements that apply to the auditable entities.

4.2 After the preparation of the annual Compliance Audit Plan as discussed in Chapter 3, the process of planning for individual compliance audits commences. Individual compliance audit, hereafter means audit of the identified Apex Auditable Entity along with the selected Audit Units.

**Planning for individual compliance audits**

4.3 Planning for individual compliance audits includes preparing the audit strategy and an audit plan. Preparation of audit strategy for the identified audit entity would include:

An understanding of the auditable entity and its internal control environment, including the statutory, regulatory and legal framework applicable to the auditable entity and the applicable rules, regulations, policies, codes, significant contracts or agreements etc;

An understanding of relevant principles of sound public sector financial management and expectations regarding the conduct of public sector officials for propriety related issues;

Identification of the intended users, including responsible party and those charged with governance;

Consideration of materiality and risk assessment including suspected unlawful acts or fraud;

Determining the scope of audit with reference to the selected specific subject matter, if selected, as well as proprietary concerns;

Development of audit objectives for the specific subject matter, if selected;

Identification of audit criteria for specific subject matter;

Sampling considerations, specifically for implementing units below the selected audit units; and

Considerations related to direction, supervision and review of the audit team(s).

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

Description of selected audit units;

Sample selection of implementing units under the selected audit units;

Extent of audit in each selected unit;

Timing of audit;

Formation of audit team/s (in case more than one audit team is needed for the auditable entity);

Assignment plan detailing the duties of the audit team members;

Planned audit procedures; and

Potential audit evidence to be collected during the audit.

4.5 Both the overall audit strategy and the audit plan should be documented in the audit file. Planning for individual compliance audits is a continual and iterative process. The overall audit strategy and plan are therefore required to be updated as necessary throughout the audit.

**Scope of Audit**

4.6 The scope is the boundary of audit. It defines “what to audit”, “who to audit”, “where to audit” and “which period to audit”.

What to Audit - The propriety issues are to be seen in all units selected to be audited. However,

the selected specific subject matter for regularity audit would define the scope for "what to audit" and would also determine the criteria.

Who to Audit - The issue of "who to audit" is decided by the predetermined annual compliance audit plan as discussed in Chapter 3 that specifies the auditable entity and selected audit units below the auditable entity.

Where to audit - brings us to selection of units for audit within the auditable entity, and also to the selection of transactions, areas etc. Sampling decisions would be crucial for this stage.

Which period to Audit - the period of audit to be covered would have to be determined as per the risk assessment. In case of audit units, the period of audit should ordinarily cover period from the previous audit to the current period. However, specific circumstances may exist where current risk assessment reveal areas of concern that warrant coverage of period included in previous audit(s). In case of implementing units, the period of audit to be covered would correspond with the audit period of audit units.

**Compliance Audit Objectives**

4.7 The overall Compliance Audit Objectives can be summarized as below:

To assess whether the subject matter adheres to the formal criteria arising out of the laws, regulations and agreements applicable to the auditable entity;

To assess whether the general principles of sound public sector financial management and ethical conduct have been adhered to; and

Report the findings and conclusions to the responsible party, those charged with governance, legislature and/or other parties as appropriate.

4.8 The particular objectives of a compliance audit for the identified apex auditable entity are to be derived from the scope of audit. Illustrative and not comprehensive, instances of scope and detailed audit objectives of compliance audits are given below:

| Scope | Detailed audit objectives |
|---|---|
| Contracting and procurement | Verify whether procurement was carried out as per extant rules and in accordance with delegated financial powers.<br>Verify whether financial propriety was ensured during the stages of tendering, evaluation and award of contract |
| Tax receipts | Verify whether assessments were in accordance with the relevant tax laws and rules thereunder.<br>Verify whether the assessed demands were collected and properly accounted for. |
| Establishment audit | Verify whether payments in respect of salaries and other entitlements were in accordance with the relevant rules and instructions. |
| Availability of infrastructure in Heath Department | Verify whether health center has been set up in accordance with specified population norms.<br>Verify whether the necessary infrastructure facilities (medical equipment, operation theatre, UPS, water supply, stock of drugs, etc.) have been provided as per Indian Public Health Standards (IPHS).<br>Verify whether the complement of doctors and other staff are as per IPHS. |
| Plant efficiency | Verify whether the usage of power, fuel is as per approved norms.<br>Verify whether plant shutdowns are as per approved norms.<br>Verify whether the production is as per the prescribed scale.<br>Verify whether the installed capacity of the plant is designed as per regulatory approvals.<br>Verify whether the operation of plant complies with environmental norms. |

| | |
|---|---|
| Corporate social responsibility | Verify whether corporate social responsibility framework is as per regulatory approvals.<br>Verify whether activities of corporate social responsibility are as per corporate policy.<br>Verify whether the corporate policy is in consonance with relevant regulations and DPE guidelines. |
| Audit of sanctions | Verify whether the sanction is within the general or express powers delegated to the sanctioning authority.<br>Verify whether the criteria for sanction such as - availability of funds, determination of physical targets, objects of expenditure and accounting procedure- have been adhered to<br>Verify whether the sanction is not split to avoid obtaining sanction of a higher authority.<br>Verify whether sanction is conflicting with general principles of public sector financial management or other orders /instructions. |

**Criteria**

4.9 Criteria are the benchmarks used to evaluate or measure the subject matter consistently and reasonably. The criteria provide the basis for evaluating audit evidence, developing audit findings and conclusions. Criteria may be formal, such as a law or regulation, terms of a contract or agreement or less formal such as a code of conduct, principle of propriety or they may relate to expectations regarding behaviour. Generally, criteria for regularity audits would therefore emanate from specific authorities while criteria for propriety issues would emanate from the General Financial Rules of the Government of India and those codified in the corresponding State Financial Rules.

The criteria should have the following characteristics:

**Relevant**– relevant criteria provide meaningful contributions to the information and decision making needs of the intended users of the audit report.

**Reliable**– reliable criteria result in reasonably consistent conclusions when used by another auditor in the same circumstances.

**Complete**–complete criteria are those that are sufficient for the audit purpose and do not omit relevant factors. They are meaningful and make it possible to provide the intended users with a practical overview for their information and decision making needs.

**Objective** – objective criteria are neutral and free from any bias on the part of the auditor or on the part of the management of the auditable entity.

**Understandable** – understandable criteria are those that are clearly stated, contribute to clear conclusions and are comprehensible to the intended users.

**Comparable** – comparable criteria are consistent with those used in similar audits of other agencies or activities and with those used in previous audits of the entity.

**Acceptable** –acceptable criteria are those to which independent experts in the field, auditable entities, legislature, media and the general public are generally agreeable.

**Available** – criteria should be made available to intended users so that, they understand the nature of audit work performed and the basis for the audit report.

**Understanding internal controls**

4.10 Understanding internal controls is normally an integral part of understanding the entity and the relevant subject matter. The CAG's Regulations on Audit and Accounts, 2007 explain that the auditor should examine and evaluate the reliability of internal controls. In compliance audit, this includes understanding and evaluating controls that assist the executive in complying with laws and regulations applicable to the auditable entity. The type of controls that need to

be evaluated depends on the subject matter, nature and scope of the particular compliance audit. In evaluating internal controls, auditors assess the risk that the control structure may not prevent or detect material non-compliance. The internal control system in an entity may also include controls designed to correct identified instances of non- compliance, presence and effectiveness of institutionalised mechanisms such as Internal Financial Adviser system, Internal Audit system etc.

Auditors should obtain an understanding of the internal controls relevant to the audit objectives and test controls on which they expect to rely. The assurance derived from the assessment of internal controls will assist the auditors to determine the confidence level and hence, the extent of audit procedures to perform. This would also determine the sample size of implementing units to be selected as well as the sample selection of transactions etc.

**Materiality**

4.11 Materiality consists of both quantitative and qualitative factors. Materiality is often considered in terms of monetary value but the inherent nature or characteristics of an item or group of items may also render a matter material. As mentioned in Chapter 2, determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. A matter can be judged material if knowledge of it is likely to influence the decisions of the intended users. The CAG's Regulations on Audit and Accounts, 2007 state that in formulating audit opinion or report, the auditor should inter-alia give due regard to the materiality of the matter keeping in view the amount, nature and context. In performing compliance audits, materiality is determined for

Planning purposes;

Purposes of evaluating the evidence obtained and the effects of identified instances of non-compliance; and

Purposes of reporting the results of the audit work

4.12 During the planning process, information is gathered about the entity in order to assess risk and establish materiality levels for designing audit procedures. Issues that may be considered material even if the monetary value is not significant would include the following:

Fraud;

Intentional unlawful acts or non-compliance;

Incorrect or incomplete information to executive, the auditor or to the legislature (concealment);

Intentional disregard to the executive, authoritative bodies or auditors; and

Events and transactions made despite knowledge of the lack of legal basis to carry out the particular event or transaction.

**Risk assessment**

4.13 Risk assessment is an essential part of performing a compliance audit. Due to the inherent limitations of an audit, a compliance audit does not provide a guarantee or absolute assurance that all instances of non-compliance will be detected. Inherent limitations in a compliance audit may include factors such as:

Judgement may be applied by the executive in interpreting laws and regulations;

Human errors;

Systems may be improperly designed or function ineffectively;

Controls may be circumvented; and Evidence may be concealed or withheld

4.14 In performing compliance audits, auditors assess risks and perform audit procedures as necessary throughout the audit process. This is done in order to reduce audit risk to an acceptably low level in the particular circumstances, so as to obtain reasonable assurance to form the basis for the auditor's conclusions. The risks and the factors that may give rise to such risks will vary depending on the particular subject matter and circumstances of audit. Results of the risk assessment would again affect the sampling considerations.

**Risk assessment considerations with regard to fraud**

4.15 As a part of audit, auditors should identify and assess fraud risk and gather sufficient appropriate evidence related to the identified fraud risks by performing suitable audit procedures. As mentioned in Chapter 2, while detecting fraud is not the main objective of compliance audit, auditors should include fraud risk factors in their risk assessments and remain alert to indications of fraud when carrying out their work. If the auditor comes across instances of non-compliance which may be indicative of fraud, the auditor should exercise due professional care and caution so as not to interfere with any future legal proceedings or investigations.

**Planning audit procedures**

4.16 Planning audit procedures involves designing audit procedures to respond to the identified risks of non-compliance. The exact nature, timing and extent of audit procedures to be performed may vary widely from one audit to another. Nonetheless, compliance audit procedures in general involve establishing the relevant criteria and then measuring the relevant subject matter information against such criteria.

4.17 After determination of the scope of audit, development of audit objectives, identification of relevant criteria for measuring the selected subject matters, when specifically selected for an apex auditable entity or across auditable entities, both for regularity and propriety issues, auditors should prepare a **Compliance Audit Design Matrix** for the identified apex Auditable entity in the following format.

| **Compliance Audit Design Matrix** | | | | |
|---|---|---|---|---|
| Audit objective/ Sub objective | Audit questions on selected subject matters | Audit criteria | Data collection and analysis method | Audit evidence |
| | | | | |

4.18 The Compliance Audit Plan would detail out the selected Apex Auditable Entity, the selected Audit Units and the Implementing Units. However, the selection of sample of transactions within the audit units may be necessary for detailed scrutiny. When compliance audit is planned and conducted based on a top down and department centric approach, sampling for selection of transactions may have to be conducted at multiple levels. This multi stage sampling typically involves the following:

Selection of transactions from the selected Audit Units falling directly under the chain of command of the selected Apex Auditable Entity (either in whole or in part depending upon the selected specific subject matter) relevant to evaluation of the selected subject matters for regularity and propriety audits respectively; and

Selection of transactions from the Implementing Units, as considered necessary, relevant to evaluation of the selected subject matters for regularity and propriety audits respectively.

4.19 Statistical sampling may be adopted for selection of transactions, which would enhance the level of verifiable audit assurance. Accountants General may exercise professional judgement with regard to adoption of a suitable sampling methodology depending upon the selected subject matters, audit objectives being pursued and the envisaged scope of audit, as per extant instructions.

**Compliance auditing in digital environment**

4.20 In case of departments/ sectors where e-governance has taken roots and transactions are being conducted in virtualised environments, digital auditing can also be adopted by the audit teams. Digital auditing facilitates looking at whole of the population for outliers or unexpected variations. Such outliers can be taken up for detailed scrutiny. Data analytical tools can be of immense help here.

**Team composition**

4.21 Audit team(s) with an appropriate team composition should be constituted for each audit. As mentioned in Chapter 2, the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being undertaken, familiarity with the applicable standards and authorities, an understanding of the auditable entity's operations and the ability and experience to exercise professional judgement. The work allocation for each member of the audit team should be clearly delineated and it must be ensured that each member understands his/her role in the audit team. Appropriate arrangements should be ensured for providing direction, supervision and review of audit teams. In some cases, it may be possible to conduct the audit of the apex auditable entity and its selected audit units by one dedicated team. However, in case of large entities, it may become necessary to constitute multiple teams for audit of the apex auditable entity and its selected audit units. In such a scenario, a lead team may be constituted from amongst the audit teams, which should be entrusted with the responsibility of providing a cohesive and synergised approach to compliance audit. The lead team in such cases may also be required to provide guidance, liaison support to other teams throughout the audit process and also consolidate audit findings of all other audit teams to enable achieving a holistic analysis and a reasoned conclusion.

**Intimation to the auditable entity**

4.22 After the overall strategy and audit plan as discussed above have been drawn up intimation should be provided to the identified auditable entity (executive) and all other audit units down the line regarding the audit being taken up. The intimation to the executive should include the scope of audit, audit objectives being pursued, subject matters that have been selected, criteria that would be used to evaluate the subject matters, designed sampling of audit units / implementing units. The intimation should indicate the composition of audit team(s), duration and schedule of audit and should solicit the requirements from and co-operation of the executive for the smooth conduct of audit.

## Chapter -5: Conducting compliance audits

5.1 Conduct of audits start after the finalisation of audit strategy and audit plan. Conduct of audits is about gathering evidence, evaluating evidence, forming conclusions, documenting the audit process and communicating with the auditable entities.

**Audit evidence**

5.2 Audit evidence is the information used by the auditor for arriving at the audit conclusions. Auditors design and apply appropriate audit procedures to obtain sufficient and appropriate audit evidence in order to form a conclusion or opinion as to whether a subject matter complies, in all material respects, with established criteria.

The CAG's Regulations on Audit and Accounts, 2007 state that the auditor shall verify compliance with applicable laws, rules and regulations and highlight deviations, if any (Regulation 29(4)). Further, the auditor has to obtain competent, relevant and reasonable evidence to support his/her judgement as well as conclusions regarding the organisation, programme, activity or function under audit (Regulation 168).

5.3 In the planning phase, as mentioned in Chapter 4 (para 4.10) auditors review the internal controls and institutional arrangements established by the auditable entity to prevent, detect, and rectify instances of noncompliance. Based on this review auditors identify control risks and other risks and keep these in consideration while they start gathering audit evidence. The audit procedures to be applied would depend on the particular subject matter and criteria and auditors' professional judgment. When the risks of noncompliance are significant and auditors plan to rely on the controls in place, such controls are required to be tested. When controls are not considered reliable, auditors plan and perform substantive procedures to respond to the identified risks. Auditors perform additional substantive procedures when there are significant risks of non-compliance.

5.4 The compliance auditor will often need to combine and compare evidence from different sources in order to meet the requirements for sufficiency and appropriateness of audit evidence. Professional judgment needs to be exercised in considering the quantity and quality of available evidence when performing the engagement, in particular when determining the nature, timing and extent of procedures.

**Sufficiency and appropriateness of audit evidence:**

5.5 The sufficiency and appropriateness of evidence are interrelated**.** Sufficiency is the measure of the quantity of evidence. The quantity of evidence needed is affected by the risks of the subject matter information being non-compliant or prone to compliance deviation (i.e. the higher the risks, the more evidence is likely to be required) and also by the quality of such evidence (i.e. the higher the quality, the less may be required). Obtaining more evidence, however, may not compensate for its poor quality. In assessing the sufficiency of evidence, the auditor needs to determine whether enough evidence has been obtained to persuade the intended users that the findings are reasonable. The need for further evidence is weighed against the cost and time needed to collect it.

5.6 Appropriateness is the measure of the quality of evidence; that is its relevance, its validity and its reliability in providing support for the auditor's conclusion.

Relevance refers to the extent to which the evidence has a logical relationship with, and importance to, the issue being addressed;

Validity refers to the extent to which the evidence is a meaningful or reasonable basis for measuring what is being evaluated. In other words, validity refers to the extent to which the evidence represents what it is purported to represent; and

Reliability refers to the extent to which the evidence is consistent when measured or tested and includes the concepts of being verifiable or supported. The reliability of evidence is influenced by its source and by its nature. While recognising that exceptions may exist, the following generalisations about reliability of evidence are useful, when:

It is obtained from sources outside the responsible party;

It is obtained directly by the auditor e.g. by observation, inquiry and verification of the application of a control, by substantive checks;

It exists in documentary form whether paper, electronic or other media; and

It is obtained from different sources.

5.7 The auditor's professional judgment as to what constitutes sufficient and appropriate evidence is influenced by factors as the following:

Significance of a potential non-compliance or compliance deviation and the likelihood of its having a material effect, individually or when aggregated with other potential non-compliance, on the subject matter information;

Effectiveness of the responsible party's responses to address the known risk of noncompliance or compliance deviations;

Experience gained during previous audit with respect to similar potential non-compliance or compliance deviation; and

Results of procedures performed, including whether such procedures identified specific noncompliance or compliance deviation.

**Gathering and Evaluating Evidence**

5.8 The evidence gathering and evaluation is a simultaneous, systematic and an iterative process and involves:

Gathering evidence by performing appropriate audit procedures

Evaluating the evidence obtained as to its sufficiency (quantity) and appropriateness (quality)

Re-assessing risk and gathering further evidence as necessary

5.9 The evidence gathering and evaluation process should continue until the auditor is satisfied that sufficient and appropriate evidence exists to provide a basis for the auditors' conclusion.

**Gathering Evidence**

5.10 Audit evidence is gathered using a variety of techniques such as the following:

**Document scrutiny -** This is the predominant mode of obtaining audit evidence and involves scrutiny of a wide variety of documents – Cabinet Notes, Expenditure Finance Committee minutes and recommendations, agenda and minutes of Board of Directors files, cash books and accounting records, reports etc.

**Physical inspection/site visits-**This involves inspection of physical assets (eg a dam, road, bridge, stores and stock etc). Generally such inspection is conducted jointly with departmental personnel to ensure acceptability to the audit findings. Where the auditable entity does not co-operate with physical inspection, the fact of such non-cooperation may be appropriately documented and reported to the top management of the auditable entity, but the physical inspection may continue nevertheless by the audit team on its own. Photographs taken during physical inspection/site visits are an acceptable form of evidence, provided the location and date of photograph are amply clear.

**Observation-**Observation involves looking at the process or procedure being performed. In performing compliance audit, this may include looking at how transactions are processed in real time by staff of the auditable entity, including processing of information and transactions in an IT system.

**Questionnaires-** This involves seeking information from relevant persons within the auditable entity through issue of a formal questionnaire to elicit further information and gather relevant audit evidence.

**Surveys-** This involves interaction with persons outside the auditable entity to get the information from the affected parties or the beneficiaries of programmes/ schemes, as the case may be. This would involve careful selection of the survey sample, formulation of an appropriate survey questionnaire, collation and analysis of the survey responses. Evidence gathered from surveys would be corroborative in nature to support evidence gathered by conventional techniques.

**Confirmation -** Confirmation is a type of inquiry and involves obtaining, independently of the auditable entity, a reply from a third party with regard to some particular information – for example confirmation of balances from the banks.

**Re-performance -** Re performance involves independently carrying out the same procedures which have already been performed by the auditable entity. This can be carried out either manually or by computer assisted audit techniques. Where highly technical matters are involved experts may be involved for re- performance.

**Analytical procedures -** Analytical procedures involve comparing data, or investigating fluctuations or relationships that appear inconsistent. Data analytics tools, statistical techniques or other mathematical models could also be used in comparing actual with expected results.

**Evaluation of Evidence**

5.11 Audit evidence, collected through above mentioned audit procedures, is to be evaluated against the relevant, already identified criteria. This involves consideration of evidence collected vis-à-vis the subject matter information as well as the written responses obtained from responsible officers of the auditable entity against the applicable criteria. The evaluation process enables auditors to assess whether the subject matter information is, in all material aspects, compliant with the identified criteria.

What constitutes material non-compliance is a matter of professional judgement and includes consideration of the circumstances, quantitative and qualitative aspects of the transactions or the issues concerned. Auditors consider a number of factors in applying professional judgement to determine whether or not the non-compliance is material. Such factors may include the following:

Extent and importance of amounts involved, which include both monetary values and other quantitative measures;
Nature of the non-compliance;
Cause leading to the non-compliance;
Possible effects and consequences of the non-compliance;
Visibility and sensitivity of the program in question; and
Needs and expectations of the legislature, public and other users of audit reports

5.12 After evaluating the evidence and considering its materiality, the auditor should decide how

best to conclude in the light of the evidence collected, which would be the supporting key documents and arrive at audit conclusions. While evaluating evidence auditors can find that audit evidence is conflicting i.e. while some evidence supports the subject matter information other evidences seem to contradict it. In such situations, auditors need to weigh the extent and credibility of conflicting evidence in order to reach a conclusion or collect more evidence to resolve the conflict.

5.13 Audit conclusion should clearly bring out the nature and extent of non-compliance, cause of such non-compliance, its materiality and also the effect of non-compliance, if possible. The audit conclusions in case of regularity issues should also indicate whether non-compliance is a solitary one-off case, or wide spread systemic issue in the auditable entity.

5.14 Auditors are encouraged to prepare an Audit Findings matrix in the following format. The Audit Findings matrix is an extension of audit design matrix as discussed in para 4.17. The Audit Findings matrix is intended to provide a link between the audit objectives, criteria, evidence gathered and evaluated and the audit findings that emerged on evaluation of the selected subject matters, if specifically selected, both for regularity and propriety issues. This should include all findings - both positive and negative findings. The Audit Findings Matrix has to be prepared for each audit unit.

| Audit findings matrix | | | | |
|---|---|---|---|---|
| Audit objective/ sub-objective | Audit questions on selected subject matters | Criteria | Audit evidence | Conclusions |
| | | | | |

**Documentation**

5.15 Documentation of audit evidence supports audit conclusions and confirms that the audit was carried out in accordance with relevant standards. CAGs Auditing Standards on Audit evidence state that

Auditors should adequately document the audit evidence in working papers, including the basis and extent of planning, work performed and the findings of audit. Working papers should contain sufficient information to enable an experienced auditor, having no previous connection with the audit, to ascertain from them the evidence that supports the auditor's significant findings and conclusions.

5.16 The **Standards** further add that adequate documentation is important for several reasons. It will

confirm and support the auditor's opinion and report;
increase the efficiency and effectiveness of audit;
serve as a source of information for preparing reports or answering any; enquiries from the auditable entity or from any other party;
serve as evidence of the auditor's compliance with Auditing Standards;
facilitate planning ad supervision; and
provide evidence of work done for future reference

5.17 Documentation should take place throughout the entire audit process. The confidentiality of documentation should be maintained and they should be retained for a period sufficient to meet the professional, legislative and legal requirements as mentioned in para 2.8 of Chapter 2 of the guidelines.

5.18 Documentation in compliance audits should comprise

**Audit file and Working papers.**

The Audit file for each compliance audit may include documentation relating to the audit strategy, scope and methodology, sample selection, nature and timing of planned audit procedures, audit design matrix, supervision and monitoring the progress and quality of audit, audit findings matrix, conclusions reached and the significant professional judgements made in reaching those conclusions. Audit file may also include discussions of significant matters with management, those charged with governance and others.

Audit file, maintained in one or more folders or other storage media in physical or electronic form, therefore contains documents that summarises the specific compliance audit engagement. Audit file should be properly indexed, referenced with and supplemented by the set of working papers.

Working papers for each compliance audit comprise of all documents collected during the field audit process. They include the documents relating to the nature timing and extent of audit procedures that were performed by individual members of the audit team, details of contracts/ agreements that were examined etc., evidences that were gathered, evaluation of evidences, consideration of written responses from responsible officials of the auditable entities, supporting key documents and the process of arriving at the results of audit procedures – audit findings and conclusions. The working papers could also be in one or more folders and should be similarly indexed and referenced. Working papers serve as a link between the field work and the audit report and should therefore be complete and appropriately detailed to provide a clear trail of audit.

5.19 Some of the broad characteristics of working papers are set out below:

Completeness and accuracy: Provide support to audit conclusions.

Clarity and conciseness: Facilitates understanding the entire audit process without need for any supplementary examination.

Legibility and neatness: Applies particularly to photocopies.

Relevance: Working papers should be restricted to matters, which are important, pertinent and useful for the intended purpose.

Ease of reference: Working papers may be organised in volumes in a manner that facilitates easy reference. An omnibus, easy to follow, index may be created for all the volumes with a proper narration to broadly explain their contents. Each of the volumes may further be internally indexed.

Ease of review: Working papers should contain cross references to audit memoranda, discussion papers, audit observations, field audit report and the compliance audit report as the case may be to enable Accountants General and supervisory officers to link the working papers to audit findings and conclusions.

Complete audit trail of analysis: Working papers should provide a complete trail of the audit procedures performed, evidence that were gathered and evaluated, audit findings and conclusions that were drawn. This should contain evidence for positive findings as well.

Documentation of significant audit findings.

**Communication with the auditable entity**

5.20 Good communication with the auditable entity throughout the audit process will help make the process more effective and constructive. Communication takes place at various levels and at various stages – during initial planning, conduct of audit and reporting as mentioned in para 2.9 of Chapter 2 of this guidelines, which should be retained for future reference. During planning phase –the audit strategy, suitable audit criteria and other elements of planning should be discussed with the appropriate level of management and those charged with governance. Regular interaction needs to be maintained throughout the audit conduct phase – to make enquiries of relevant persons, communicate any significant difficulties being encountered in audit and significant instances of non-compliance to the appropriate level of management or to those charged with governance.

5.21 Audit teams should also hold entry meeting(s) with the heads of audit units before the commencement of audit. During these meetings, the audit team should explain the purpose, objectives of audit, timelines and cooperation expected from the head of the audit unit. Similarly at the close of audit, the audit team leader or the Group officer in charge should also hold an exit meeting with the officer in charge of the audit unit to discuss the audit findings and request responses. The minutes of the exit meeting should be prepared and shared with the audit unit and acknowledgement requested.

5.22 If auditors come across instances of non-compliance, which may be indicative of unlawful acts or fraud, due professional care and caution needs to be exercised so as not to interfere with the potential future legal proceedings or investigations and respond appropriately as mentioned in para 2.15 of Chapter 2 of the guidelines. Auditors may communicate their findings to the appropriate level of Management or to those charged with governance and then follow up to ascertain whether appropriate action has been taken.

## Chapter-6 Reporting compliance audits

CAG's Regulations on Audit and Accounts, 2007 (Regulation 205) state that the form, content and time of submission of audit reports shall be decided by the CAG.

6.1 Reporting is an essential part of any audit as through this process the results of audit are presented to the intended users on the responsible party's compliance with the stated criteria. Compliance audits involve reporting the deviations from the applicable criteria and violations of the applicable rules, regulations etc., so that corrective actions may be taken, and those responsible for such deviations or violations could be held accountable for their actions.

6.2 Auditors should consider materiality for reporting purposes and adhere to the principles of completeness, objectivity, timeliness and contradictory process while reporting.

The principle of completeness requires the auditor to consider all relevant audit evidence before issuing a report;

The principle of objectivity requires the auditor to apply professional judgement and scepticism in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and balanced manner;

The principle of timeliness implies preparing the report in due time; and

The principle of a contradictory process implies checking the accuracy of facts with the apex auditable entity and incorporating responses from responsible officials as appropriate.

**Forms and Content of Reports**

6.3 The top down, risk based approach to conducting compliance audit, as described in earlier chapters, is envisaged to provide a department centric view of the extent of compliance. As the compliance audit involves evaluation of both regularity and propriety aspects, as discussed in earlier chapters, Auditors are required to report results of audit on both these aspects. The audit findings on the selected specific subject matter are to be relied upon for providing the audit conclusion on the extent of compliance. Other audit findings noticed during the conduct of audit are to be reported separately.

As the compliance audit is conducted at various levels of the organisational hierarchy and needs to be reported to the responsible party, those charged with governance, and the legislature, the form of reports to present compliance audit findings and conclusion would have to address these perspectives. Therefore, Auditors shall present the results of compliance audit in the following reports.

Inspection Report
Departmental Appreciation Note (where considered necessary)
Compliance Audit Report

**Inspection Reports**[4]

6.4 On completion of audit, an Inspection Report presenting all the findings – both positive and negative – shall be issued within 30 days of completion of audit to each of the selected Audit Units with a copy to the corresponding next higher level in the organisational hierarchy and to the lead team if constituted. The findings pertaining to implementing units shall be included in the Inspection Report of the respective Audit Units. A period of four weeks may be allowed to the Audit Units to provide responses to the audit findings contained in the Inspection Report.

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

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

**Part II – Audit findings**–This part shall contain all findings – both positive and negative findings that pertain to the audit unit and may be arranged in two distinct parts - Part IIA and IIB - the first part comprising significant audit findings relating to evaluation of the regularity

4 Even though compliance audits conducted in accordance with these guidelines are not in the nature of an inspection, the existing terminology of Inspection Report is continued because of its historical import.

related subject matter(s)/ specific subject matter(s) and propriety related subject matters and the second part – IIB comprising other incidental findings relating to both regularity and propriety aspects. The audit findings should be organised in decreasing order of materiality and significance, if possible.

Presentation of audit findings shall conform to the Auditing Standards and other reporting principles enunciated in this chapter and clearly bring out the applied criteria, the results of evaluation of the subject matter against the criteria highlighting the cause and effect relationship. Audit findings may also appropriately indicate the extent of non-compliance and whether they involve systemic issues or represent isolated cases of non-compliance.

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

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

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

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

**Departmental Appreciation Note**

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

6.8 The Departmental Appreciation Note may comprise the following features:

**Title**: Departmental Appreciation Note on compliance audit of (name of the Apex Auditable entity)

**Introduction:** This part may commence with a broad overview of the Department, the organisational goals, governance structure, jurisdiction, and challenges of the Department, financial and operational performance, which may be followed by a broad description of the high risk areas and the related internal controls to enable the responsible party/intended users to appreciate the factors that were considered by auditors while selecting the area for compliance audit during the year.

**Objectives and scope:** A brief explanation of the objectives and scope of audit should

be provided.

**Audit findings:** This part shall contain all significant audit findings – both positive and negative findings aggregated from all audit units and may be arranged in two distinct sections – the first section comprising audit findings relating to evaluation of the selected subject matter(s), and the second section comprising audit findings on other subject matters and other incidental findings

These findings may be organised in decreasing order of materiality and significance. The audit findings included in the Departmental Appreciation Note, which could potentially feature in the next level of reporting through the Compliance Audit Report (discussed in para 6.10 to 6.12 below) should be clearly indicated to the responsible party.

**Conclusion:** Depending upon the extent and pervasiveness of compliance of the selected subject matter observed during audit, auditors may provide conclusion of compliance of the selected subject matter with the applied criteria. Further based on the veracity and pervasiveness of findings relating to adherence of sound financial management principles and ethical conduct and other findings, Auditors may conclude, as appropriate, on the efficiency and effectiveness of internal controls in the areas audited.

**Acknowledgement:** This part may contain acknowledgement of the extent of Department's cooperation in all matters including production of records.

6.9 The responsibility of drafting the Departmental Appreciation Note may vest with the Audit team and that of approval with the Accountant General in field offices. In cases where multiple teams were deployed for audit of an Apex Auditable Entity and a lead team has been identified for conduct of compliance audit, lead team may draft and finalise the Departmental Appreciation Note, for approval by the respective Accountant General.

**Compliance Audit Report**

6.10 The Compliance Audit Report represents the last phase of reporting the results of compliance audits and shall feature significant audit findings which require the attention of the legislature and other intended users including the public at large. Presently, the significant audit findings that could potentially feature in the Compliance Audit Report are communicated to the Apex Auditable Entity by issuing Draft Paragraphs and/or Statement of Facts. The significant audit findings would therefore emerge from the Inspection Reports, Draft paragraphs, Statement of Facts and from the Departmental Appreciation Notes containing conclusion if any on a specific subject matter, which shall be carried forward for reporting in the form of a Compliance Audit Report of the CAG of India.

To ensure objectivity of the audit findings and conclusions of the Compliance Audit Report, confirmation of facts and figures by the Apex Auditable Entity and incorporation of responses of the responsible party is very crucial. Auditors shall therefore ensure that facts and figures are accepted by the Apex Auditable entity and shall pursue responses from the Apex Auditable Entity.

6.11 The responsibility of preparing and ensuring the quality of the Compliance Audit Report

before it is submitted to CAG for approval would be with the head of the field audit office.

6.12 The Compliance Audit Report could be brought out as a separate Audit Report or alternatively could be included as distinct Chapter(s) in a consolidated Report with findings of other types of audit. The decision with regard to the manner of featuring the compliance audit report shall vest with the respective DAI/ADAI.

**Follow up**

6.13 A follow up process facilitates the effective implementation of corrective actions and provides useful feedback to the Apex Auditable Entity/ audit units and at the same time facilitates the auditors to plan future audits. The need for follow up will vary with the nature of non-compliance and the particular circumstances. While some findings pointing out deviations from authorities and violations of principles of sound financial management may have to be followed up at the audit unit level the audit findings warranting systemic changes may have to be followed at higher levels of the organisational hierarchy. Further some findings may be fully/partially accepted by the apex auditable entity/ audit units while there may be findings that have not been accepted by the apex auditable entity/ audit units.

6.14 The following process shall be adopted by field offices for follow up of audit findings and conclusions included in the Inspection Report and the Compliance Audit Report:

**Inspection Report**

The outstanding paragraphs of previous Inspection Reports shall be reviewed during the conduct of audit and their status included in the current Inspection Report as envisaged in para 6.5 above. The responses to paragraphs included in the Inspection Report shall be pursued by regular reminders to the respective audit units. There shall be a regular interaction with the Departmental Audit Committees to review and settle old paragraphs as per extant orders.

**Compliance Audit Report**

The receipt of explanatory notes/ Action Taken Notes (ATNs) to the paragraphs that have appeared in the Compliance Audit Reports shall be monitored in all field offices and Heads of Department shall be impressed upon to send explanatory notes/ATNs within the prescribed time frame as per extant orders.

Accountants General may encourage the Heads of Department to send suo moto replies to all observations which have appeared in the Compliance Audit Reports but have not been discussed by the Public Accounts Committee/Committee on Public Undertakings.