Chapter 21 “Audit of Insurance Companies” (Chart 1 – Audit of GIC - Basics)

### Legal Framework

| 1. | Insurance Act, 1938 |
| 2. | IRDA Act, 1999 |
| 3. | IRDA Regulations |
| 4. | Companies Act, 2013 |
| 5. | GIC (Nationalisation) Act, 1972 |

#### Regulatory Requirements of Insurance Act 1938

**Solvency Margin**

- **Requirement of solvency margin**: Every insurer and re-insurer shall at all times maintain an excess of value of assets over the amount of liabilities of, not less than 50% of the amount of minimum capital.
- **Non-compliance of solvency margin**: Insurer or re-insurer, who does not comply with requirement of solvency margin shall be deemed to be insolvent & may be wound-up by court on application made by IRDA.
- **Power of authority to prescribe level of solvency**: The Authority shall by way of regulation made for the purpose, specify a level of solvency margin known as control level of solvency on the breach of which the Authority shall act.
- **Submission of Financial Plan**: If, at any time, insurer or re-insurer does not maintain required control level of solvency margin, he shall, in accordance with directions issued by IRDA, submit a financial plan, indicating a plan of action to correct the deficiency within a specified period not exceeding 6 months.
- **Modifications to Financial Plan**: If the authority considers the financial plan inadequate, it shall propose modifications to the plan and shall give directions, including direction in regard to transacting any new business, or, appointment of an administrator or both.
- **Non-submission of financial plan**: An insurer or re-insurer who does not submit financial plan shall be deemed to have made default in complying with the requirements of this section.

**Reserve for Unexpired Risks**

IRDA (General Insurance-Claim Reserving) Regulations, 2013 requires creation of a minimum amount of unexpired risks reserve at a specified percentage of net premium as under:

- For marine hull insurance - 100% of net premium
- For fire, marine cargo and miscellaneous business – 50% of net premium.

*Note: Sec. 64V of Insurance Act, 1938 also specifies these percentages. Subsequent to Amendment Act of 2015, these percentages are no more specified in amended Section 64V.*

### Audit of GIC – Revenue Items

#### Premium Income

<table>
<thead>
<tr>
<th>Premium Income</th>
<th>Claims Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Review of Internal Control:</strong></td>
<td>1. <strong>Review of Internal Control:</strong></td>
</tr>
<tr>
<td>• Issue of proper cover notes</td>
<td>• Payment of only bona fide claims.</td>
</tr>
<tr>
<td>• Serial no. of cover notes</td>
<td>• Sanctioned by appropriate authority.</td>
</tr>
<tr>
<td>• Internal check on stamps, stationary etc.</td>
<td>• Collection of information from branches.</td>
</tr>
<tr>
<td><strong>2. Accounting:</strong></td>
<td><strong>2. Claims Paid:</strong></td>
</tr>
<tr>
<td>• Recognition of premium income for all risks incepted.</td>
<td>• <strong>Coincurrence</strong>: Proper booking</td>
</tr>
<tr>
<td>• Proper recording for Fire, Marine, Motor &amp; Other Ins.</td>
<td>• <strong>Settlement Amount</strong>: must include all incidental expenses</td>
</tr>
<tr>
<td>• Accounting for premium received in advance &amp; premium outstanding.</td>
<td>• <strong>Claims communicated after year end</strong>: accounting for provisions</td>
</tr>
<tr>
<td>• Recording at gross figure without providing for reserve.</td>
<td>• <strong>Accounting for Salvage and letter of subrogation</strong>: in accordance with procedure.</td>
</tr>
<tr>
<td><strong>3. Inception of Risk</strong>: Sec. 64VA</td>
<td>• <strong>Amount deposits with Court</strong>: not treated as claim till final decision.</td>
</tr>
<tr>
<td>• Issue of Policy Documents</td>
<td>• <strong>Unqualified Discharge Note</strong>: in case of final settlement.</td>
</tr>
<tr>
<td>• No risk w.r.t. premiums received in advance and outstanding.</td>
<td><strong>Claims Outstanding at year end:</strong></td>
</tr>
<tr>
<td><strong>4. Co-Insurance:</strong></td>
<td>• Provision for all unsettled Claims.</td>
</tr>
<tr>
<td>• Proper booking of share of premium.</td>
<td>• Provision for legally enforceable claims.</td>
</tr>
<tr>
<td></td>
<td>• Provisions should not be made in excess.</td>
</tr>
<tr>
<td></td>
<td>• Application of Average Clause.</td>
</tr>
<tr>
<td></td>
<td>• Consideration of salvage value.</td>
</tr>
</tbody>
</table>

#### Commission

<table>
<thead>
<tr>
<th>Commission</th>
<th>Receipt &amp; Payment A/c</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Vouching of disbursement entries.</td>
<td>Sec. 11 of Insurance Act, 1938 – F.S. to include Receipt and Payment Account (R &amp; P).</td>
</tr>
<tr>
<td>2. Proper Authorisation of disbursements.</td>
<td><strong>Auditor Duties:</strong></td>
</tr>
<tr>
<td>3. Calculation of commission.</td>
<td>• report whether the R &amp; P account of the insurer is in agreement with the books of account and returns;</td>
</tr>
<tr>
<td>4. Examination of agent’s ledger.</td>
<td>• express an opinion as to whether the R &amp; P account has been prepared in accordance with the provisions of the relevant statutes; and</td>
</tr>
<tr>
<td>5. Examine accounting of commission paid.</td>
<td>• express an opinion whether the R &amp; P account give a true and fair view of the receipts and payments of the insurer.</td>
</tr>
</tbody>
</table>

#### Vouching of entries:

- Claims Intimation Register
- Claims Paid Register
- Salvage Register

- Claim Dockets
- Report of Quality Assurance Team
- Claims Disbursement Book

Compiled by: CA. Pankaj Garg
### Chapter 21 “Audit of Insurance Companies” (Chart 2 GIC – Balance Sheet Items)

#### Investments

1. Physically verify the securities on the balance sheet date or a date as near as possible. Prepare a reconciliation statement where verification is carried out on date other than BS date.
2. Obtain separate lists of securities held physically and those held in demat form.
3. Examine the records for investments held at branches and request the respective branch auditors to issue a certificate to this effect.
4. Examine in detail investments on which income has not been received for a long period and those which have not been redeemed even after redemption date.
5. Where certificates are held by other persons such as nominees, share transfer agents etc. the auditor should obtain written certificates from such person.
6. Examine that norms relating to valuation and disclosure in F.S. have been complied with.
7. Examine whether income from investments is property accounted for.
8. Ensure that certificates of TDS are properly maintained.
9. Ensure compliance of Sections 27, 27A and 27B of the Insurance Act, 1938 as well as the guidelines issued from time to time by the Ministry of Finance through GIC.

#### Outstanding Premium

1. Scrutinize and review control account debit balances and their nature should be enquired into.
2. Examine in-operative balances and treatment given for old balances with reference to company rules.
3. Enquire into the reasons for retaining the old balances.
4. Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.
5. Check age-wise, sector-wise analysis of outstanding premium.
6. Verify whether outstanding premiums have since been collected.
7. Check the availability of adequate bank guarantee or premium deposit for outstanding premium.

#### Contingent Liabilities – Disclosure Requirements

1. Partly paid up investments.
2. Underwriting Commitments outstanding.
3. Claims, other than those under policies, not acknowledged as debts.
4. Guarantees given by or on behalf of the Company.
5. Statutory demands / Liabilities in dispute, not provided for.
6. Reinsurance obligations to the extent not provided for in the accounts.
7. Others (to be specified).

### Audit of GIC - Miscellaneous

#### Co-Insurance

**Meaning & Concept:**
Sharing of Business between more than one insurer at agreed percentages is known as co-insurance. The Lead insurer issues documents, collects premium and settles claims. Statement of accounts is rendered by the Lead insurer to the other co-insurers.

**Incoming Co-Insurance**
1. Ensure that the Premium Account is credited on the basis of statements received from the Lead insurer.
2. In case, the statement is not received, the premium is accounted for on the basis of advices to ensure that all premium in respect of risks assumed in any year is booked in the same year.
3. For this purpose, the auditor may examine the communication in the post-audit period and obtain a written confirmation to the effect that all incoming advices have been accounted for.
4. The auditor should also verify claims provisions and claims paid with reference to advice received from the Lead insurer.

**Outgoing Co-Insurance**
1. The auditor should scrutinise the transactions relating to the outgoing business, i.e. where the company is the Lead insurer.
2. These should be checked with reference to the relevant risks assumed under policies and correspondingly for debts arising to the co-insurer on account of their share of claims.

#### Trade Credit Insurance

Trade Credit insurance provides protection to suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country (domestic risk) or in another country (export risk) against non-payment as a result of insolvency of the buyer or non-payment after an agreed number of months after due date. Trade credit insurance product is offered subject to following requirements:

1. Policyholder’s loss arises due to non-receipt of trade receivable.
2. Policyholder is a supplier of goods or services for a consideration.
3. Buyer is liable to pay a trade receivable to the policyholder in return for the goods and services received by him from the policyholder.
4. Premium for the entire Policy Period has been paid.
5. Other requirement that may be specified by the Authority from time to time.
Chapter 21 “Audit of Insurance Companies” (Chart 3 Audit of GIC – Reinsurance)

Verification of reinsurance inward

1. Evaluate internal control system in the area of reinsurance accepted to ensure determination of correct amount for reinsurance accepted, proper valuation of assets and liabilities arising out of reinsurance transaction and adherence to legal provisions and regulations.
2. Ascertain whether adequate guidelines and procedures are established with respect to granting reinsurance.
3. Reconcile reinsurance underwriting returns received from various units with the figures of premium, claims paid and outstanding claims for the company as a whole.
4. Examine whether premium received and commission paid on reinsurance accepted is as per the terms of the agreement with the Principal Insurer.
5. Examine whether claims paid have been accounted on a regular basis.
6. Examine whether remittances from foreign Principal Insurer are as per foreign exchange regulations.
7. Examine whether confirmations have been obtained regarding balances with Principal Insurers.
8. Review individual accounts of Principal Insurers.

Verification of reinsurance outward

1. Evaluate internal control system in the area of reinsurance ceded to ensure determination of correct amount for reinsurance ceded, proper valuation of assets and liabilities arising out of reinsurance transaction and adherence to legal provisions and regulations.
2. Ascertain whether adequate guidelines and procedures are established with respect to obtaining reinsurance.
3. Reconcile reinsurance underwriting returns received from various units with the figures of premium, claims paid and outstanding claims for the company as a whole.
4. Examine whether commission on reinsurance ceded is as per the terms of the agreement with the re-insurers.
5. Examine the computation of profit commission for automatic treaty arrangements in the light of the periodic accounts rendered and in relation to outstanding loss pertaining to the treaty.
6. Examine whether loss recoveries have been claimed and accounted on a regular basis.
7. Examine whether outstanding losses recoverable have been confirmed by re-insurers.
8. Examine whether remittances to foreign reinsurers are as per foreign exchange regulations.
9. Examine whether confirmations have been obtained regarding balances with re-insurers.
10. Review individual accounts of re-insurers to evaluate whether any provision/write off or write back is required.

Facultative and Treaty Reinsurance

Facultative
Reinsurance whereby contract relates to one particular risk and is expressed in the reinsurance policy. Each transaction has to be negotiated individually. The Insurance is used when:
- Automatic cover has exhausted.
- Risk is excluded from treaties
- Reinsurance treaties have not to be overburdened.
- Insurer has no automatic cover.
- Technical guidance is required at each stage of acceptance of risk.

Treaty
A treaty type of coverage is in effect for a specified period of time, rather than on a per risk, or contract basis. For the duration of the contract, the reinsurer agrees to cover all or a portion of the risks that may be incurred by the insurance company being covered.

Proportional Treaty
- The reinsurer will receive a prorated share of the premiums of all the policies sold by the insurance company being covered. Consequently, when claims are made, the reinsurer will also bear a portion of the losses. The proportion of the premiums and losses that will be shared by the reinsurer will be based on an agreed percentage.
- In a proportional coverage, the reinsurance company will also reimburse the insurance company for all processing, business acquisition and writing costs.

Non-Proportional Treaty
- The reinsurer will only get involved if the insurance company’s losses exceed a specified amount, which is referred to as priority or retention limit. Hence, the reinsurer does not have a proportional share in the premiums and losses of the insurance provider.
- The priority or retention limit may be based on a single type of risk or an entire business category.
# Chapter 21 “Audit of Insurance Companies” (Chart 4 - Audit of Life insurance Business)

<table>
<thead>
<tr>
<th>Concept</th>
<th>Role of Auditor</th>
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</thead>
</table>
| **Actuarial Process** | - To certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the IRDA.  
- For this purpose, auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, he may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities. |
| - Role of Actuaries in life insurance business is to concentrate on following key areas:  
  1. **Product Development and Pricing.**  
  2. **Model Development.**  
  3. **Statutory Valuations and reserving.**  
  4. **Business Planning.**  
  5. **Solvency management.**  
  6. **Management reporting on various business valuations & profitability models.** | |
| **Underwriting** | - To review the process of acceptance of risk through the underwriting process.  
- Evaluate and test the effectiveness of internal controls in place to ensure timely and accurate Insurance policy, adherence to the IRDA Act and Rules and regulations made thereunder. |
| - Underwriter assesses the risk and determines the premium to be charged. The function of the underwriter is to:  
  (a) **acquire or to “write” business that will bring money to insurance company,**  
  (b) **to protect the company’s business from risks that they feel will make a loss.** | |
| **Reinsurance** | - To check and confirm that reinsurance premium calculation and payment is in accordance with the agreement with the reinsurer.  
- To check whether necessary provision has been made for outstanding reinsurance premium and is properly accounted for in books of accounts.  
- To verify the agreements entered with the reinsurer.  
- To verify whether Insurer has adhered to terms and conditions of agreement.  
- To verify payments made to the reinsurer. |
| - It is a risk mitigating tool adopted by Insurer whereby the risk underwritten by one Insurer is transferred partially to another Insurer. | |
| **Free Look Cancellation (FLC)** | - To check and confirm that Free Look Cancellation requests are received within 15 days from receipt of policy document by the policy holder.  
- To verify signatures of the policy holder and processing of Free look cancellation request within time defined by the insurer.  
- To check recording of appropriate accounting entries for refund. |
| - It is an option provided to policyholder wherein he has a period of 15 days from date of receipt of policy document to review the Terms & Conditions and in case of disagreement to terms & conditions, he / she has the option to return the policy.  
- FLC requests can be received through any mode - mail, fax and letters. In case of written letters, signature of policy holder should match with the original proposal form.  
- FLC request is processed only when policy holder is not satisfied with the terms and conditions of the policy document.  
- FLC refund is paid either by cheque or in case policy holder wants direct credit, then consent for direct credit along with cancelled cheque for bank a/c details is submitted. | |
| **Policy Lapse and Revival** | - To check and confirm that due dates are recorded and monitored properly and polices are marked as “lapsed” on non -receipt of renewal premium within due dates/grace period.  
- In case of revival request, check whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy. |
| - Discontinuation of policy owing to non-payment of premium dues is known as lapse. A lapsed policy ceases to provide insurance protection to the insured. It forfeits the benefits under the policy. Agents do not get renewal premium commission if the policy is lapsed.  
- Terms & conditions of the policy stipulate, that where the premium is not paid within the grace period, the policy lapses but may be revived during the life time of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than specified period. |
## Chapter 21 “Audit of Insurance Companies” (Chart 5 - Audit of Life insurance Business)

<table>
<thead>
<tr>
<th>Concept</th>
<th>Role of Auditor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policy Surrender</strong></td>
<td></td>
</tr>
<tr>
<td>- Voluntary termination of the insurance contract before expiry of the term of the contract is known as surrender of policy. A policy becomes eligible for surrender on completion of 3 years from the commencement of the policy provided that 3 years premium have been paid within the due dates.</td>
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</tr>
<tr>
<td>- The policy holder has to submit surrender request form duly signed off by him along with the original policy document and the discharge voucher.</td>
<td>(b) To check that adequate controls are in place to ensure proper verification process for checking of request, whether premiums are paid on regular basis.</td>
</tr>
<tr>
<td>- To check whether surrender amount is paid only to the policy holder and is paid only as per terms and conditions mentioned in the policy document</td>
<td>(c) To check whether surrender amount is paid only to the policy holder and is paid only as per terms and conditions mentioned in the policy document</td>
</tr>
<tr>
<td>(d) To check whether appropriate accounting entries are passed.</td>
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</tbody>
</table>

| Premium Collection | Collection of Premium | |
|-------------------|-----------------------|
| Premium refers to consideration received by insurance company from the policy holder. Premium income is recognized as: | (a) To check existence of appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis. |
| (1) New business premium – premium received for the first policy year and | (b) To check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank. |
| (2) Renewal premium – premium received for subsequent policy years. | |
| Premium received but not identifiable against any policy would be treated as ‘unallocated premium’ /‘suspense amount’. | |

<table>
<thead>
<tr>
<th>Claims</th>
<th>Calculation of Premium</th>
<th>Recognition of Income</th>
<th>Accounting of ‘Advance Premium’</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary objective of Audit of Life Insurance Companies is checking of accuracy of processing and accounting of claims with focus on the following areas:</td>
<td>(a) Check that accounting system calculates premium amounts &amp; due dates correctly.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Claims lodgement and processing</td>
<td>(b) Check that system is equipped to calculate all types of premium modes correctly.</td>
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<tr>
<td>- Authority for approval of claims</td>
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<tr>
<td>- Review of payouts and disbursements</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Review of compliance to Statutory Requirements and applicable IRDA Regulations.</td>
<td>(a) Ensure that premium is recognised only on the basis of ‘Issued Policies’.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Review of Reinsurance claims</td>
<td>(b) To check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.</td>
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<td></td>
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<tr>
<td>- Review of reporting of claims.</td>
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<tr>
<td></td>
<td>(a) To check, whether system has capability to identify regular and advance premium.</td>
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<td></td>
<td>(b) To check whether there is a process of applying advance premium to a contract when premium is due.</td>
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<table>
<thead>
<tr>
<th>Investments</th>
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</thead>
<tbody>
<tr>
<td>- The investment portfolio of Life Insurance companies comprise of Shareholders' funds and Policyholders' funds.</td>
<td>(a) Review management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office.</td>
<td></td>
</tr>
<tr>
<td>- Policyholders' funds can further be segregated as linked and non-linked. Investment regulations are prescribed for different categories of investments.</td>
<td>(b) To review the operating procedures prescribed by the IRDA Regulations.</td>
<td></td>
</tr>
<tr>
<td>- IRDA (Investment) regulations, 2000 gives details of the pattern in which Funds of the Life Insurance business, should be kept invested at any given point of time.</td>
<td>(c) To review of investment policy.</td>
<td></td>
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<td></td>
<td>(d) To review the functioning and scope of Investment Committee.</td>
<td>(e) To check compliance of Investment regulations.</td>
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<tr>
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<td></td>
<td>(f) To review cash management system to track funds available for investment considering the settlement obligations and subscription and redemption of units, etc.</td>
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<tr>
<td></td>
<td></td>
<td>(g) To review fund wise reconciliation with investment accounts, bank, and custodian records.</td>
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<tr>
<td></td>
<td></td>
<td>(h) To ensure that there is split between Shareholders’ and Policyholders’ funds, and earmarking of securities between various funds namely Life, Pension, Group and Unit Linked Fund.</td>
</tr>
<tr>
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<td></td>
<td>(i) To review the arrangements and reconciliations of holdings with the insurer’s custodian.</td>
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<tr>
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<td></td>
<td>(j) To review and check insurer’s Investment Accounting and valuation policy.</td>
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<td></td>
<td>(k) To review the controls around personal dealings and insider trading.</td>
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</tbody>
</table>
Chapter 22 “Audit of PSU” (Chart 1 – Basics)

### Framework for Government Audit

#### Legal Framework of CAG

**Article 148**
- CAG shall be appointed by President by India.
- Tenure – 6 years or 65 years whichever is earlier.
- Remuneration – equivalent to that of a SC judge.
- Removal – only on grounds of proven misbehavior.

**Article 149**
- Powers and duties – prescribed under CAG (Duties, powers and Conditions of Service Act, 1971.)

**Article 150**
- Accounts of the Union and States will be maintained as per description given by President on advice of CAG.

**Article 151**
- Report of CAG shall be submitted to President/Governor.

#### Organisations Subject to CAG Audit

1. All Union & State Government departments.
2. Public Commercial Enterprises controlled by Union and State Governments.
3. Non Commercial autonomous bodies and authorities owned or controlled by Govt.
4. Authorities and bodies substantially financed from Union or States.

#### CAG Role in functioning of financial committees

- Reports of CAG form the basis of Committees’ working, i.e. committees examine the issues raised by C & AG Reports.
- Committees requires the assistance of C & AG for scrutinising the notes which the Ministries submit to the Committees in so far as to check the correctness of submissions to the Committees and facts and figures in their draft reports;
- Reports of the Financial Committees are being submitted to the Parliament/State Legislature with their observations and recommendations. The CAG assists various committees in suggesting the recommendations.

#### Scrutiny of Audit Reports

Audit reports & Annual accounts will be referred to specialized committees.

1. **Public Accounts Committee**
   - Examine the following:
     1. Money was disbursed for the purpose to which they were applied.
     2. Expenditure was authorised.
     3. Re-appropriation made in accordance with the provisions made.
     4. Statement of accounts of autonomous and semi-autonomous bodies, the audit of which is conducted by the CAG.

2. **Committee on Public Undertaking**
   - Examine the following:
     1. Reports and accounts of public undertakings.
     2. Reports of the CAG on public undertakings.
     3. Efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
     4. Such other aspects as allotted by Speaker
   - Examination of public enterprises takes form of comprehensive appraisal or evaluation of performance of undertaking.

3. **Estimates Committee**
   - Perform the following functions:
     1. to report that economies, improvements in organisation, efficiency or administrative reform, consistent with the policy underlying the estimates may be affected;
     2. to suggest alternative policies in order to bring about efficiency and economy in administration;
     3. to examine whether the money is well laid out within the limits of the policy implied in the estimates; and
     4. to suggest the form in which the estimates shall be presented to Parliament.

### Objective & Scope of Audit of PSU

#### 1. Objectives of Audit of PSU

(i) **Fiscal Accountability:** It includes audit of provision of funds, sanctions, compliances and propriety.

(ii) **Managerial accountability:** It includes audit of efficiency, economy and effectiveness.

Another equally important objective is to help government and the enterprise management to improve their efficiency and effectiveness by bringing out financial and operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance etc. and by analyzing the causes of shortfall from acceptable standards of performance.

#### 2. Scope of CAG Audit

Scope of CAG audit extends to;

(i) **Financial Audit:** to express an opinion on a set of F.S.

(ii) **Compliance Audit:** to determine whether specified compliance requirements are met or not.

(iii) **Comprehensive Audit:** assessing overall efficiency and effectiveness of Public Enterprises against pre-determined standards, objectives and criteria.

(iv) **propriety Audit:** verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.

(v) **Performance Audit:** examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function.

#### 3. Parts of Audit Report of CAG

(a) Introduction containing a general review of working results of Government companies and corporations.

(b) Results of comprehensive appraisals of selected undertakings conducted by the Audit Board.

(c) Resume of the company auditor’s reports submitted by them under the directions issued by CAG and that of comments on accounts of the Government companies.

(d) Significant results of audit of the undertakings not taken up for appraisal by the Audit Board.
Chapter 22 “Audit of PSU” (Chart 2 – Basics)

Elements of Audit

1. **Parties Involved**
   1. **The auditor:** In public sector auditing the role of auditor is fulfilled by Supreme Audit Institution, India and by its personnel delegated with the task of conducting audits.
   2. **The responsible party:** In public sector auditing, the relevant responsibilities are determined by constitutional or legislative arrangement. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations and may be individuals or organizations. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties.
   3. **Intended users:** The intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report. The intended users may be legislative or oversight bodies, TCWG or the general public. The intended user is primarily the Parliament or the Legislature which represents the citizens by determining the priorities of public finance, purpose and content of public spending and income.

2. **Subject Matter, Criteria and Subject matter Information**
   - **Subject matter** refers to the information, condition or activity that is measured or evaluated against certain criteria.
   - **Criteria:** Benchmarks used to evaluate the subject matter. Each audit shall have criteria suitable to the circumstances of that audit. In determining the suitability of criteria, the auditor considers their relevance and understandability for the intended users, as well as their completeness, reliability and objectivity.
   - **Subject matter information** refers to the outcome of evaluating or measuring the subject matter against the criteria.

3. **Types of Engagements – 2 types**
   - **Attestation engagements:** Responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.
   - **Direct reporting engagements:** It is the auditor who measures or evaluates the subject matter against the criteria.

Principles of PSU Auditing

1. **General principles**
   1. Ethics & Independence
   2. Professional Judgement, due care and skepticism
   3. Quality Control
   4. Audit Team Management & Skill
   5. Audit Risk
   6. Materiality
   7. Documentation
   8. Communication

2. **Principles relating to Auditing Aspects**
   - **Planning an Audit**
     1. Auditors shall obtain an understanding of the nature of the entity/programme to be audited.
     2. Auditors shall conduct a risk assessment or problem analysis and revise this as necessary in response to the audit findings.
     3. Auditors shall identify and assess the risks of fraud relevant to the audit objectives.
     4. Auditors shall plan their work to ensure that the audit is conducted in an effective and efficient manner.
   - **Conducting an Audit**
     1. Auditors shall perform audit procedures that provide sufficient and appropriate audit evidence to support the audit report
     2. Auditors shall evaluate the audit evidence and draw conclusions
   - **Reporting & Follow-up**
     1. Auditors shall prepare a report based on the conclusions reached.
     2. Follow up on reported matter as relevant.
Chapter 22 “Audit of PSU” (Chart 3 - Types of Audit)

### Financial Audit

<table>
<thead>
<tr>
<th>Meaning</th>
<th>Audit which is conducted to express an opinion on a set of F.S.</th>
</tr>
</thead>
</table>
| Coverage | (i) Examination & evaluation of financial records & expression of opinion on F.S.  
(ii) Examination of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations; and  
(iii) Evaluation of internal control and internal audit functions that assist in safeguarding assets and assure the accuracy and completeness of accounting records. |

### Compliance Audit

| Meaning | • Independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria.  
• Compliance audits are carried out by assessing whether activities, financial transactions and information comply in all material respects, with the authorities which govern the audited entity. |
|---------|-------------------------------------------------------------|
| Coverage | Compliance auditing may be concerned with  
1. **Regularity** - adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity  
2. **Propriety** - observance of the general principles governing sound financial management and the ethical conduct of public officials  
While regularity is the main focus of compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials. |

### Propriety Audit

<table>
<thead>
<tr>
<th>Meaning</th>
<th>Verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emphasis</td>
<td>Instead of too much dependence on documents, vouchers and evidence, it shifts the emphasis to the <strong>substance of the transactions</strong> and looks into the <strong>appropriateness</strong> thereof on a consideration of <strong>financial prudence, public interest and prevention of wasteful expenditure</strong>.</td>
</tr>
</tbody>
</table>

### Comprehensive Audit

<table>
<thead>
<tr>
<th>Meaning</th>
<th>Assessing overall efficiency and effectiveness of Public Enterprises against certain pre – determined standards, objectives and criteria.</th>
</tr>
</thead>
</table>
| Coverage | Areas covered vary from enterprise to enterprise depending on nature of enterprise, its objectives and operations. Major areas are:  
1. Comparison of overall capital cost of the project with the approved planned costs.  
2. Production or operational outputs vis-a-vis under-utilisation of the installed capacity.  
3. Systems of project formulation and implementation.  
4. Planned rate of return  
5. Cost control measures.  
6. Research and development programmes.  
7. System of repairs and maintenance.  
8. Effective and economical procedures  
9. Project planning  
10. Undue waste, unproductive time for men and machines, wasteful utilisation or even non utilisation of resources |

| Propriety elements in CARO | Para 3(iii) | Para 3(vii) | Para 3(viii) | Para 3(ix)  
Para 3(x) | Para 3(xi) | Para (3xv) |
Chapter 22 “Audit of PSU” (Chart 4 – Performance Audit)

Meaning and Elements

Objective & systematic examination of evidence for purpose of providing assessment of performance of govt organization, program, activity, or function in order to provide information to improve public accountability & facilitate decision-making by parties with responsibility to oversee/initiate corrective action.

Elements of performance Audit

| Economy       | Minimising the cost of resources used for an activity. |
|              | Evaluating economy implies forming an opinion whether resources have been used economically and acquired in due time, in appropriate quantity & quality at best price. |
| Efficiency    | Measurement of input-output, maximum output at minimum of inputs, or Minimum input for any given quantity of output. |
|              | Examining efficiency covers aspects of: (a) Sound procurement practices; (b) Efficiently used resources; (c) efficient operating procedures; and (d) meeting objectives, cost-effectively. |
| Effectiveness | Measurement of the extent to which objectives are achieved and the relationship between intended impact and actual impact. It will cover the following: (a) determine the extent to which a program achieves a desired level of results; (b) assess the effectiveness of the program; (c) determine whether management has considered alternatives to carry program at a lower cost; (d) assess the adequacy of the management control system; (e) ensure compliance with laws and regulations. |

Factors to be considered while planning performance

1. Significance and the needs of potential users of the audit report.
2. Obtaining an understanding of the program to be audited.
3. Legal and regulatory requirements.
4. Management controls.
5. Identifying the criteria needed to evaluate matters subject to audit.
6. Identify significant findings and recommendations from previous audits that could affect the current audit objectives.
7. Potential sources of data that could be used as audit evidence and consider the validity and reliability of these data.
8. Consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives.
9. Providing sufficient staff and other resources to do the audit.
10. Preparing a written audit plan.

Planning performance audit

UNDERSTANDING THE ENTITY /PROGRAMME
DEFINING AUDIT OBJECTIVE
DETERMINING SCOPE OF AUDIT
DETERMINING AUDIT CRITERIA
DECIDING AUDIT APPROACH
DEVELOPING AUDIT QUESTIONS
ASSESS AUDIT TEAM SKILLS AND REQUIREMENT OF OUTSIDE EXPERTISES
AUDIT DESIGN MATRIX
ESTABLISH TIME TABLE AND RESOURCES
INTIMATION OF AUDIT

Compiled by; CA. Pankaj Garg