

Financial Attest Auditing Guidelines

for audit of

State Government Accounts

Comptroller and Auditor General of India

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Preface

The Constitution of India enjoins upon the Comptroller & Auditor General the responsibility of preparing the reports on the accounts of the Union and State Governments. This responsibility is discharged by the CAG by providing an assurance on the Finance and Appropriation accounts, after conducting financial attest audit of these accounts. The broad guidance for conduct of the accounts audit has been available in Manual of Standing Orders (Audit), Manual of Standing Orders (A&E) and other supplementary instructions. The Financial Attest Audit Manual (FAAM) brought out by the Department in June, 2009 provided the principles and concepts applicable to various financial attest audits conducted by the Department. However, specific guidance for conducting financial attest audit of State Government Accounts was not available in a consolidated form. This document aims to fill this gap. These guidelines have been specifically designed after considering the unique position of Indian Audit and Accounts Department in preparation and audit of State Government Accounts, where AG (A&E) is the compiler of the accounts and AG (Audit) is the auditor, both these authorities working under the aegis of CAG of India. The guidelines recognize the roles of AG (A&E), AG (Audit) and State Government and aim at establishing synergy in their working.

A systemic and process oriented approach with focus on scientific sample selection, internal control environment, management assertions and robust documentation requirements make these guidelines not only complete and comprehensive, but also easy to implement. The guidelines ensure optimum utilization of the Voucher Level Computerization (VLC) software by leveraging on the technological capabilities of the software, thereby reducing the burden of carrying out the numerous manual checks, without compromising on the audit quality.

I am sure that the implementation of these guidelines would lead to better audit practices, support the assurance being given to external stakeholders and strengthen professional practices. These guidelines would certainly enhance the capabilities of this Department in fulfilling its mandated duties in the best possible manner.

It needs to be acknowledged that these guidelines have been formulated when the State Governments are moving towards a virtualised accounting environment, which necessitates that these guidelines are reviewed at an appropriate time in future to keep pace with the evolving accounting environment.



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1. Introduction

1.1 Financial Attest Audit (FAA) is concerned with expression of audit opinion on a set of financial statements. FAA is required to be carried out to reduce the possibility of the material misstatement in a financial statement and thereby, provide credibility to such a statement. The Financial Attest Audit Manual 2009 (FAAM) of Indian Audit & Accounts Department lays down the framework for the process of Financial Attest Audit within the Indian Audit and Accounts Department. This Manual was brought out in June, 2009 with the objective of bringing the Indian practice at par with the international best practices as far as applicable.

1.2 Presently, the audit of State Government accounts is being done as per instructions under MSO (Audit) and supplementary instructions given by the competent authority. A need has been felt to provide detailed operational guidelines to make the audit of State Government Accounts compliant with FAA requirements, and also to support the requirements of the FAA manual.

1.3 These guidelines provide a comprehensive set of instructions keeping the following in mind:

- The unique role of CAG in compiling the accounts of State Governments through offices of AG (A&E) and audit through offices of AG (Audit)
- The principles of FAA and compatibility with applicable ISSAIs
- The capabilities available in the Voucher Level Computerisation System for automating audit checks
- The checklists available as part of instructions under MSO (A&E) and MSO (Audit), Manual of Instructions on Central Audit (MICA) and other instructions
- Report of the task force instituted for this specific purpose, and report of subsequent committees created to draft guidelines
- The lessons learnt, feedback received and suggestions offered by the field offices which piloted audit as per the draft guidelines

1.4 Henceforth, the financial attest audit of State Government accounts has to be conducted as per these guidelines. All other existing instructions relating to audit of State Government Accounts get superseded. These guidelines are intended to operationalise the FAAM 2009, which provides conceptual clarity for all financial attest audits being undertaken by the Department.

Financial attest audit of State Government accounts

1.5 CAG of India has the responsibility of certifying and providing assurance on the accounts of Union and State Governments. The CAG acts as the sole auditor, by the virtue of the provisions in the Constitution of India and the Legislation (Act). The audit of these accounts is conducted in accordance with the requirements of Articles 149 and 151 of the Constitution of India and Section 13 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

(1) The reports of the Comptroller and Auditor General of India relating to the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of Parliament

(2) The reports of the Comptroller and Auditor General of India relating to the accounts of a State shall be submitted to the Governor of the State, who shall cause them to be laid before the Legislature of the State

Article 151 of the Constitution of India

1.6 Section 13 of the CAG's (DPC) Act 1971 requires the CAG to audit all transactions of the Union, of the States and of the Union Territories having a Legislative Assembly, relating to the Consolidated Fund, the Contingency Funds and the Public Accounts and to audit all trading, manufacturing, profit and loss accounts and balance sheets and other subsidiary accounts kept in any department of the Union or of a State or a Union Territory. This Section also enjoins on the CAG the duty to report on the accounts, expenditure or transactions so audited by him.

Sec 13 of the Act enjoins on the C&AG the duty to audit all expenditure from the Consolidated Fund of India, of each state and each Union Territory having a Legislative Assembly, all transactions of the Union, of the States and of the Union Territories having a Legislative Assembly, relating to the Contingency Funds and Public Accounts and to audit all trading, manufacturing, profit and loss accounts, balances sheets and other subsidiary accounts kept in any department of the Union or of a State or a UT. This Section also enjoins on the C&AG the duty to report on the accounts, expenditure or transactions so audited.

Sec 13 of the CAG's (DPC) Act 1971:

1.7 Regulations 33-42 of the Regulations on Audit and Accounts -2007 of the Comptroller and Auditor General of India provides guidance on conducting financial audit. These guidelines have been prepared to detail out the process for financial attest audit of State Government Accounts keeping the aforementioned Regulations in view.

1.8 Accounts in so far as the Union and State Governments are concerned denote the Finance Accounts and Appropriation Accounts (FA&AA). FAA of State Government accounts is about expressing an audit opinion on the FA&AA. It requires audit of financial systems and transactions, including evaluation of compliance with applicable statutes and regulations. The objectives of FAA are to:

- verify whether the accounts of the Government are properly prepared, are complete in all respects and are presented with adequate disclosures;
- assure that there is no material misstatement in annual accounts certified by audit; and
- certify that the annual accounts provide a true and fair financial status of the State Government.

1.9 The accounts thus certified provide for better transparency in financial management, encourage financial discipline and continuous improvement in system of accounting of the State Governments.

1.10 The annual FA&AA are prepared by the respective Accountants General in the states and Union Territories with legislatures with the exception of Goa, Delhi and Puducherry which have their own Directorate/Controller of Accounts. The Audit office has the responsibility of certifying the annual accounts prepared by the A&E office from the transaction details furnished by the various accounts rendering units of the State Government. The audit office exercises checks

on selected transactions of every month and finally issues audit certificate after checking the annual accounts in the form of FA&AA. The certification of accounts, however, is not an absolute one, it is subject to audit observations appearing in CAG's other compliance and performance audit reports related to the State Government, especially, the Report on State Finances.

Structure of the Guidelines

1.11 These Guidelines for audit of Finance Accounts and Appropriation Accounts of the State Governments help in planning, implementing and reporting on the year long process of FAA starting from getting an assurance on internal control environment, assessing the robustness of the VLC system, checking of vouchers/challans, other accounting transactions, substantive testing of selected sample transactions, monthly civil accounts, Report on Monthly Expenditure (Monthly Appropriation Accounts) and finally audit of Finance accounts and Appropriation accounts.

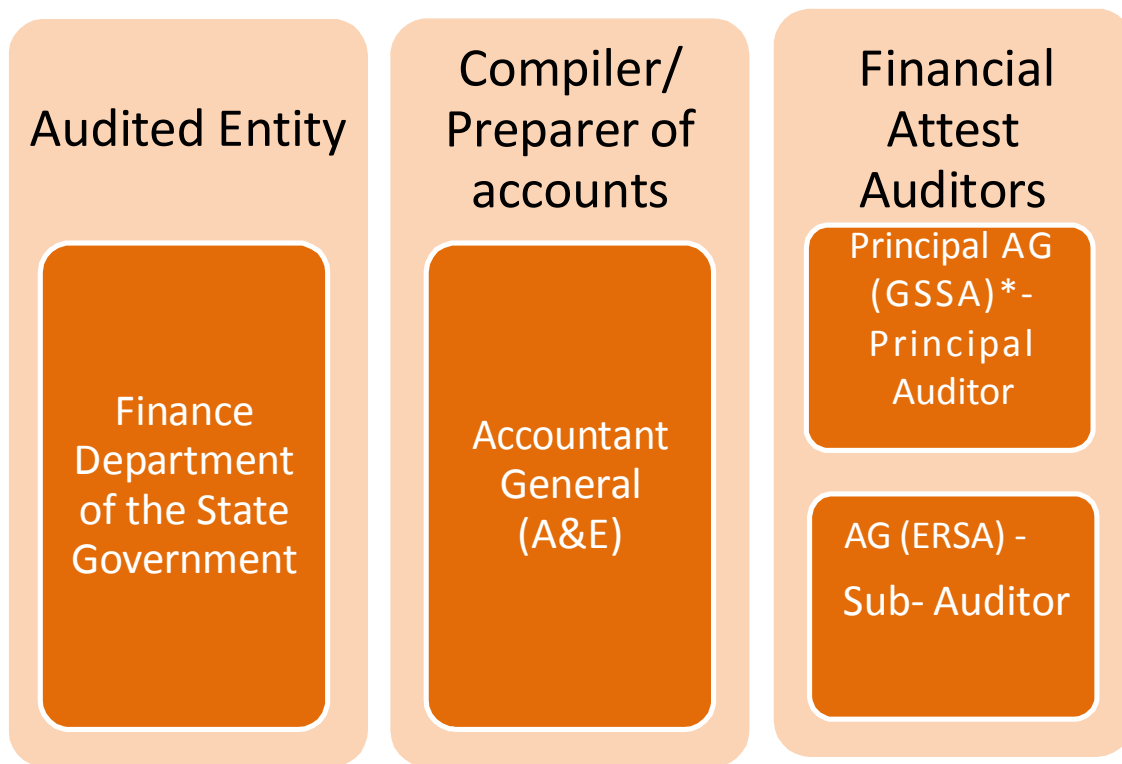
1.12. The Guidelines lay down the timelines for the audit, procedures to be followed for the audit, responsibility centers for the audit and the audit checks to be exercised by the audit teams for proving the correctness of assertions made in audit. The guidelines have been structured as under:

1. Audit Planning
2. Audit implementation
3. Documentation and Reporting

1.13 The detailed audit checks to be carried out on the Vouchers, Monthly Civil Accounts, Report on Monthly Expenditure (Monthly Appropriation Accounts), Finance Accounts and Annual Appropriation Accounts have been annexed to the guidelines. Instructions on selection of sample of vouchers and other inputs of the accounts for substantive audit tests have also been annexed to the Guidelines.

2. Audit Planning

2.1 Audit planning for the FAA of State Government Accounts is the responsibility of the Accountant General in charge of audit of FA&AA and preparation of Audit Report on State Finances, henceforth, referred to as the Principal Auditor. The other audit offices which contribute to audit of FA&AA would be referred as Sub-Auditors for the purpose of these guidelines. The office of Accountant General (A&E), as compiler and preparer of State Government accounts is a major partner in this exercise. The Finance Department of the State Government would be the audited entity for the purpose of this audit.



- Where Pr. AG (GSSA) is not in-charge of audit of FA&AA, AG (ERSA) would be the Principal Auditor

2.2 Audit of FA&AA of States would now be a year-long process and not merely a year-end exercise. Hence, there should be a dedicated section in the Audit offices to audit the FA&AA or to contribute to FA&AA. Central Audit sections in Offices of the Principal Auditor and the Sub-Auditors should be renamed as -Financial Audit Wingø (FAW) and should be given the responsibility of contributing to FAA of State Government Accounts. However, audit functions other than those related to FAA, currently being carried out by the Central Audit sections would continue to be carried out by FAW. These guidelines are therefore equally applicable to the Sub- Auditors.

2.3 Within FAW of the Principal Auditor's office, Financial Attest Audit Team (FINAT) is to be constituted. FINAT has to be headed by a Senior Audit Officer and should be assisted by two Assistant Audit Officers and supporting auditors. The Principal Auditor may entrust any additional work to the FINAT, if considered necessary, but the FAA of the finance accounts and appropriation accounts, monthly civil accounts and Report on Monthly Expenditure (Monthly Appropriation Accounts) should be the primary responsibility of FINAT. The FAW should be under the supervisory control of the Group Officer in charge of Administration as stated in the orders on restructuring of IA&AD. The Principal Auditor is at liberty to supplement the FAW as per the requirements. This may be necessary and advisable during Phase II of the audit process discussed later.

2.4 The planning, execution, reporting and documentation of audit of FA&AA as well as coordination with the other teams in the Financial Audit Wing dealing with scrutiny of vouchers, sanctions, etc., would be the responsibility of FINAT. FINAT should also co-ordinate with audit teams of Sub-Auditors contributing to FAA, local audit parties responsible for substantive audit as part of FAA and Treasury Inspection teams of office of Accountant General (A&E). While preparing the Annual Audit Plans of different audit offices (contributing to Financial Attest Audit of State Government accounts) within the State, the requirements of Financial Attest Audit Team (FINAT) should also be ascertained and included in the plan of these offices. For this purpose, the coordinating wings in the offices of the Sub-Auditors within the state responsible for preparing the Audit Plan should interact with FINAT.

Timelines for audit

2.5 The audit of FA&AA currently commences with the issue of a time schedule by the Government Accounts wing of the Headquarters office (C&AG's office) in consultation with the PPG wing. The process of financial attest audit of State Government gets completed with finalization of audit certificate and signing of Report on State Finances by the CAG. It is expected that this process is completed by mid of December of the ensuing year to enable the State government to take on board important concerns before the next year's budget. The various stages leading up to the certification of Accounts are given below.

Stage

Flow of statements from A&E to Audit

Return by Audit

Stage

1. Vetting of Notes to Accounts (NTAs) by GA wing
2. Return of vetted NTAs by Audit
3. Draft certification by AG(Audit)
3. Vetting of Audit certificate by RS wing-Approval of HQ
4. Modify accounts based on audit comments and print ready
5. Signing of audit certificate by CAG
6. Bond copy of Report on State Finances
7. Clearance of SFR by Report States
8. Signing of Report on State Finances by CAG

Co-ordination between the offices of Principal Auditor & AG (A&E)

2.6 The FA&AA are prepared in accordance with the requirements of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. These accounts are compiled from the vouchers, challans and initial and subsidiary accounts rendered by the treasuries offices and departments responsible for the keeping of such accounts functioning under the control of the State Government, certain Statements received from the State Government or its parastatals and the statements received from the Reserve Bank of India. In states where the treasuries render Compiled Accounts, the accounts are compiled/consolidated from the Compiled Accounts rendered by the treasuries. The treasuries, offices and departments functioning under the control of the State Government are primarily responsible for preparation and correctness of the initial and subsidiary accounts as well as ensuring the regularity of transactions in accordance with the applicable laws, standards, rules and regulations relating to such accounts and transactions. AG (A&E) is responsible for preparation and submission of Annual Accounts to the State Legislature. The audit of these accounts is independently conducted through the office of the Principal Auditor in accordance with the requirements of Articles 149 and 151 of the Constitution of India and the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, for expressing an opinion on these Accounts based on the results of such audit.

2.7 It is imperative that there is a close interaction and coordination between these two offices and the State Government. In addition to direct coordination about the finalization and certification of accounts, some other areas where interaction between these offices is of crucial importance are:

- Budget review including review of new heads etc. by Accountant General (A&E)
- Inspection of treasuries by Accountant General (A&E)
- Review of Works and Forest Accounts prepared by Accountant General (A&E)

Co-ordination among the audit offices

2.8 As discussed above, the overall responsibility of audit of State Government accounts lies with the Principal Auditor. The responsibility of designing the audit strategy for audit of accounts, preparation of audit plan, level of assurance required, the method of selection of vouchers for substantive testing, communication with the AG (A&E) and the State Government and finally deciding about the audit observations would lie with the Principal Auditor. Sub-auditors engaged in the audit of transactions forming part of monthly accounts or financial statements of State Government are to work in co-ordination with the Principal Auditor finally issuing audit certificate on the State accounts. Audit of accounts rendering units, (e.g. Public Works and Forest Divisions), Pay and Accounts Office in some states, etc. are to be integrated in the certification process of State accounts. The Principal Auditor is expected to provide detailed audit plan, other relevant details and timelines to the Sub- Auditors well in advance, so that the audit requirements are built into the annual audit plan of their offices.

Audit Planning Activities

2.9 Planning for FAA helps to develop an audit approach which will ensure that sufficient and appropriate evidence is gathered to support the audit opinion given in FA&AA in the most effective manner. The audit planning process for audit of State Government accounts would have the following elements:

- Internal Control Assurance
 - Assurance from A&E Office
 - Assurance from State Government
- Risk analysis
- Determining materiality levels & sample selection
- Deciding documentation requirements

Internal Control Assurance

2.10 The whole system of financial and other controls, including the organizational structure, methods, procedures and internal audit, established by the Government, to assist in conducting the business of the audited entity in a regular economic, efficient and effective manner; ensuring adherence to management policies; safeguarding assets and resources; securing the accuracy and completeness of accounting records; and producing timely and reliable financial and management information is known as the internal control environment.

Assurance from A&E Office

2.11 The accounts of the State Governments are compiled and prepared by the AG (A&E) through the Voucher Level Computerization (VLC) system from the primary records and accounts maintained by the State Government. It is important that the Principal Auditor assesses the robustness of the internal control environment, as the process of audit is only a test check and the extent of such test check is dependent on the internal control assessment. While compiling the transactions and preparing accounts, computer aided validation check can and have been built in the VLC system and assurance on this can be obtained. Inclusion of all accounts rendering units in monthly accounts, ensuring of budget data against each unit of appropriation, etc. are some of the assurances that can be obtained from A&E office. Checks and validation in VLC system can be enhanced to suit this requirement and work load in audit process can be reduced accordingly. However, the Principal Auditor is expected to validate the internal control assurance given by AG (A&E) by independent test checks.

Assurance from State Government

2.12 Similar to the assurance from AG (A&E) office, Audit needs to have assurance from other information rendering units of State Government for annual accounts. Some information other than the statements compiled by the A&E office forming part of financial statements, are also included in the accounts certified by Audit. Information on guarantees given by State Government, investment in Statutory Corporations/ Government Companies, incomplete works, etc., are some of the information furnished by Finance Department, which appear as part of the financial statements. In these cases, an assurance from the Finance Department/other departments should be obtained, through A&E Office or directly, on the correctness of the data depicted in the annual accounts to be certified by the Principal Auditor. However, the Principal auditor should conduct independent test check for confirming the robustness of the systems prevalent in these departments for completeness and accuracy.

Risk analysis

2.13 Audit planning requires conducting of risk analysis of account areas, accounting information, and accounts rendering units, expenditure incurring units and revenue collection units. The decision on selection of appropriate sampling method, materiality levels and risk parameters are left to the professional judgment of the Principal Auditor. However, guidelines for statistical sampling using IDEA application are given in Annexure-D.

2.14 The Principal Auditor should, however, ensure that risk analysis of account areas, accounting information, accounts rendering units, expenditure incurring units and revenue collection units are decided prior to commencement of audit and should be an input for preparation of the annual audit plans of the office of the Principal Auditor as well as of the Sub - Auditors and the annual treasury inspection program of Accountant General (A&E).

2.15 An indicative list of sources of information is placed at Annexure-A for various accounts areas/accounting information/accounts rendering units.

Determining materiality levels & sample selection

2.16 Prescribing and planning materiality level in the form of monetary thresholds and other criteria for selection of sample vouchers, sample account areas and sample transactions for substantive testing is one of the major audit planning activities. The selection of samples for substantive testing of accounting inputs like vouchers, challans, classified abstracts, consolidated abstracts, transfer entries, settlement accounts, clearance memorandum and different transactions forming part of the accounts will be done by Principal Auditor adopting any appropriate statistical sampling methods. Similar activities are required to be done by Sub- Auditors in their respective audit jurisdictions.

2.17 It will be the responsibility of FINAT to apply the appropriate sampling methodology as decided by the Principal Auditor to draw the sample transactions for conduct of FAA and communicate the same to the FAW, field audit parties and treasury inspection teams. The sampling may be done after stratifying the VLC data of transactions into revenue receipts, capital receipts, revenue expenditure, capital expenditure, deposits & advances and remittances (Annexure-D). Detailed guidance, in this respect is available in the FAA Manual (Chapter 2 and 4).

2.18 The following transactions forming part of the monthly civil accounts and Report on Monthly Expenditure (Monthly Appropriation Accounts) of the State are recommended to be considered *Material by Nature and Context*, and hence 100% checking of these transactions and related Heads of Accounts as detailed below is suggested:

- Loans under *Major Heads 6075 to 7615(except 7610-Loans to Government servants, etc.)*;
- Public Debt under *Major Heads 6003 and 6004*;
- Contingency Fund under *Major Heads 7999 and 8000*;
- Reserve Funds booked under *Major Heads 8115 to 8235*;
- *Minor Heads 101–Pay and Accounts Office-Suspense, 102–Suspense Account (Civil), 109– Reserve Bank Suspense (Headquarters), 110–Reserve Bank Suspense (Central Accounting Office), 111–Departmental Adjusting Account under major Head 8658 – Suspense Accounts*
- Cash Balances booked under *Major Head 8999 – Cash Balances*
- *Deposits of local funds under Major Head 8338 – Deposits of Local Funds*
- Cash Balance Investment Account ó 8673
- Minor Head 800-Other Expenditure (especially if schemes like flagship programmes are booked here)

2.19 Any other Head of Account for which field offices feel that 100 per cent check has to be conducted can be added to the above list. However, if 100 per cent check of any class of transactions mentioned above is considered impractical due to large number of transactions (vouchers), sample selection method can be adopted. This decision can only be taken by the Head of field audit office.

Deciding documentation requirements in form of Matrix & Information Sheet

2.20 The FINAT would prepare a ‘*Matrix*’ showing the assertions sought to be proved, samples of transactions and vouchers selected for carrying out the test, substantive audit tests to be carried out and the responsibility centre for the substantive audit test. A sample matrix is at Annexure-B.

2.21 FINAT would also monitor receipt of *Information Sheet* based on the *Matrix* supplied to all the audit teams involved in the FAA of FA&AA showing the nature of substantive audit test, the units/account area/account information on which the test was carried out and results of the substantive audit tests carried out by FAW, Local Audit Parties and Treasury Inspection units. While this *Information Sheet* should be received from FAW on a monthly basis, the local inspection parties and treasury inspection units should attach this *Information Sheet* as a separate appendix to the regular inspection reports. The Information Sheets will be forwarded to FINAT after vetting by the concerned headquarters section. A sample Information Sheet linking audit planning with execution and reporting is at Annexure-C

3. Audit Implementation

3.1 The basic process for conducting Financial Attest Audit is discussed in this chapter with brief listing of the kind of audit checks to be conducted placed as annexures to the Guidelines.

Preparatory work for commencement of FAA

3.2 The implementation of FAA of State Government accounts should appropriately start from review of the State budget. Since the office of AG (A&E) as the compiler and preparer of accounts conducts this activity in a comprehensive manner, the office of the Principal Auditor may rely on the budget review report prepared by AG (A&E).

3.3 Before the commencement of the audit of transactions from the first month of the financial year, Audit has to ensure that budget provisions/estimates, included in the Demands for Grants and other budget documents have been correctly carried over into the Voucher Level Computerization (VLC) system and records maintained in the Book Section. In States, where the A&E office has been getting data in electronic format and has been importing it electronically to the VLC system, Principal Auditor need not check correctness of the budget data transferred to VLC system. It is sufficient to seek an assurance in this regard from the A&E office. In States, where manual compilation system is existing and budget data received from State Government are manually copied in registers/records also an assurance may be obtained from A&E office on the reliability and correctness of the data. However, accuracy should be ensured through test check of data.

3.4 FINAT may conduct check of IT Controls in the VLC system and where possible in the Treasury Information System/IFMS as a preparatory activity to assess the reliability of the systems.

FAA implementation stages:

3.5 After carrying out the preparatory activities, the FAA through Finance Department of the State Government and all the auditing entities can commence. The FINAT will select the sample of vouchers for substantive audit of the underlying transactions using scientific sampling principles and techniques. FINAT will also direct substantive audit based on inputs from central audits done in Principal Auditor and Sub- Auditors/ FAWs and treasury inspection reports received from AG (A&E). The audit teams within FAW or the local audit parties will carry out the audit with reference to records available in the audited entity in respect of cases referred/intimated by FINAT. Audit observations pertaining to audit of transactions required by

FINAT, are also to be communicated to the Principal Auditor for consideration while certifying the annual accounts.

3.6 The FAA can be organized in two Phases:

(A) Phase I - Year Long Activities

1. Examination of Sanctions
2. Examination of Vouchers
 - i. Received in the Principal Auditor's office
 - ii. Retained with the Account rendering units
3. FAA using Inputs from Inspection of Treasuries
4. Analysis of inputs by FINAT
5. Audit of the Monthly Civil Accounts and Report on Monthly Expenditure (Monthly Appropriation Accounts)
6. Comprehensive review of Grants

(B) Phase II - Year End Activities

1. Entry Conference
2. Audit of Statements and Appendices of Finance Accounts
3. Audit of Appropriation accounts
4. Vetting of NTAs (Notes to Accounts)
5. Preparation of Draft audit comments
6. Exit Conference

(A) Phase I - Year Long Activities

Examination of Sanctions:

3.7 FAW would carry out Sanction audit with the objective of identifying deficiencies that may affect the accuracy and reliability of Finance Accounts and Appropriation Accounts. The following points should specifically be looked into by individual audit teams within FAW while auditing sanctions and the results of such audit communicated to FINAT. The audit checks required to be carried out by the individual audit teams while auditing sanctions for the purpose of audit of Finance and Appropriation Accounts are:

- *Whether the classification of heads of account indicated in the sanction is as provided in the Demands for Grants/Supplementary Demands.*

- *Whether the sanction issued complies with provisions of Government Accounting Rules with regard to classification into Revenue and Capital expenditure.*
- *Whether the sanction order correctly classifies the sanctioned expenditure into Voted/Charged categories where required.*
- *Whether the sanction is for drawal of budgeted funds merely to avoid lapsing of budget provision and if so, pursue the matter for appropriate comments.*
- *Whether the sanctions are issued by the competent authority and where required with the approval of Ministry of Finance/Cabinet of Ministers.*
- *Whether timelines are prescribed for submission of utilization certificates (e.g. in case of GIA sanction) or repayment schedules for loans and advances.*
- *Whether write-off sanctions are issued after following prescribed procedures.*

3.8 Financial Audit Wing may maintain a Register showing the irregularities noticed during audit of sanctions which may have a bearing on the accuracy of accounts and send a list of unsettled cases to FINAT after audit of vouchers for the month of March with copies of correspondence exchanged in the matter. In addition, any other cases which may have an impact on audit of annual accounts should also be reported to FINAT. FINAT will analyze their resolution and take appropriate decision while conducting audit of financial statements.

3.9 Copies of contracts endorsed to Audit would also require scrutiny. While the checks would be different from the audit checks performed on sanctions, in spirit, they would serve a similar objective of providing leads to conducting substantive audit of vouchers and accounts.

Examination of Vouchers

3.10 The primary objective of audit conducted by the FAW is to ensure the propriety and regularity of financial transactions. The FAA serves the purpose of providing assurance to the financial transactions and financial systems through conducting the desk audit of vouchers, abstract contingent bills etc., accompanying the monthly accounts. However, this activity hitherto being carried out by central audit, was not specifically aimed at feeding inputs and leading to the certification of FA&AA. To derive the benefits from this exercise, the results of **this** audit have to be programmed to serve as input for certification of FA&AA.

Examination of vouchers received in Principal Auditor's Office

3.11 In Government Accounting vouchers include not only Bills and Challans but other documents like Transfer Entry Documents, Reserve Bank of India Advice Memorandum, Inward Settlement Accounts, Outward Settlement Accounts and Approvals and Authorizations granted by Accountant General (A&E).

3.12 Audit of vouchers forming main part of the monthly civil accounts is the most important audit check in Phase I. Substantive audit checks on individual vouchers and transactions should be carried out by FAW and local audit parties immediately after the annual audit plan is approved and should end only after the accounts for March (Supplementary) are closed. Detailed guidance on audit of vouchers is at Annexure-E. The results of the central and local audit of vouchers would be communicated to FINAT in the Information Sheet (Annexure-C) on a monthly basis as mentioned in para 2.21.

Examination of vouchers-retained with the Accounts rendering units

3.13 While vouchers are sent along with the monthly accounts, sub-vouchers/challans are retained in the treasuries. There are also divisional offices of Public Works Department, Forest Department and PAOs that render compiled accounts but do not send the supporting documents, vouchers and challans to the AG (A&E) and their eventual transmission to the Audit Office. The audit methodology has therefore to be a little different in respect of these records. The FINAT would select the sample transactions to be checked in local audit and would communicate these to the designated audit parties. The Principal Auditor or Sub- Auditor may decide to entrust verification of original record pertaining to any audit finding noticed by FAW to the wing itself rather than relying on local audit parties. The results of the central and local audits should be communicated to FINAT by the audit teams in the Information Sheet prepared as suggested in para 2.21.

FAA using inputs from Inspection of Treasuries

3.14 Since the treasury is the nodal point through which all transactions of Government money are carried out, it is necessary to include the audit of the treasury in a program for audit of the FA&AA. Instead of a separate audit of treasuries by the audit teams of Principal Auditor for the purpose of FAA of FA&AA, it has been decided to leverage the inspection of treasuries carried out by inspection teams from the office of (A&E) for this purpose.

3.15 The inspections carried out by the (A&E) has two dimensions namely, review of the controls exercised by the treasury staff and inspection of the integrity of selected transactions. The Principal Auditor would share the sampling methodology being applied in selection of

vouchers, which can be adopted by AG (A&E) for selection of transactions during the treasury inspection. The Principal Auditor could also request specific examination of certain class of transactions during treasury inspections which are considered high risk. The details of the checks on the financial controls in a treasury and on the selected transactions are given at Annexure-F.

3.16 A quarterly report on the results of the above checks and any other issues emerging out of inspection of treasuries should be sent by the AG (A&E) to Principal Auditor. Significant issues emerging from these reports would provide important inputs to FINAT on accuracy and reliability of the primary records being received from the treasuries.

Analysis of inputs by FINAT

3.17 FINAT would analyse the inputs received from desk audit and local audit of selected vouchers, treasury inspection reports and monthly accounts to ascertain their impact on the financial statements. FINAT may conduct a wider audit of accounting areas where major deficiencies, weaknesses or inaccuracies were noticed during the above mentioned examinations. The objectives of such audits would be to identify underlying reasons of deviations and their impact on the financial statements. The results of this audit should be reported in the Report on State Finances, if considered significant or informed to the State Government in form of a Management Letter.

Audit of the Monthly Civil Accounts, Report on Monthly Expenditure (Monthly Appropriation Accounts)

3.18 As the next step, detailed audit of monthly civil accounts, Report on Monthly Expenditure (Monthly Appropriation Accounts) and their underlying transactions and vouchers is to be taken up. It is suggested that this audit could be scheduled immediately after the AG (A&E) shares the monthly civil accounts for the month of September with the Principal Auditor since this would provide half-yearly figures of expenditure and receipts. Detailed audit of the monthly civil accounts and the Report on Monthly Expenditure (Monthly Appropriation Accounts) may be carried out for the selected months of September, January, February, March (preliminary) and March (supplementary).

3.19 The objective of the audit checks in this phase are to identify errors, unauthorized expenditure etc. if any sufficiently early so that corrections can be carried out before the Accounts for the year are finally closed. FINAT will also test check transactions indicated in the Verified Date-wise Monthly Statement for each month. The audit checks to be carried out at this stage are indicated in Audit Checks for audit of Monthly Civil Accounts attached as

Annexure 6G. The audit checks to be carried out on Report on Monthly Expenditure (Monthly Appropriation Accounts) are indicated in the Audit Checks for audit of Report on Monthly Expenditure (Monthly Appropriation Accounts) attached as Annexure 6H.

Comprehensive Review of Grants

3.20 The FINAT should conduct a comprehensive review of at least two Grants every year. The results of this audit and the findings of audit of monthly civil accounts, Report on Monthly Expenditure (Monthly Appropriation Accounts) and the FA&AA should be used for reporting on the administration of the Grant by the departmental officers. Grants for such review should be selected by the Principal Auditor using professional judgement on the basis of substantial persistent savings/ excesses/other irregularities disclosed in past appropriation accounts. The scope of this review should inter alia include compliance with budgetary procedures and expenditure control exercised in respect of provisions made in the budget/ supplementary demands. The review should provide an insight not only into the nature of and reasons for the excess expenditure or savings in relation to the budgeted grants but also focus attention, more importantly, on the control failures and deficiencies, delays in decision-making, etc., that might have facilitated the excesses/savings and on the failure of superior authorities to detect and rectify them. Failure of the controlling and drawing & disbursing officers to restrict their expenditure within the allotted amounts would be requiring special attention and probe.

3.21 A separate Register may be maintained in FINAT to record errors and omissions noticed during audit of Report on Monthly Expenditure (Monthly Appropriation Accounts)/ monthly civil accounts for follow up action. The unsettled cases which may have impact on accuracy or completeness of FA&AA should be considered for audit comments and for qualification of accounts as well as for inclusion as comments in the Report on State Finances.

Phase II-Year End Activities

Entry conference

3.22 It is also advisable to organize an Entry conference with the State Government at an appropriate time, before the start of Phase- II of audit implementation. In such conference, the AG (A&E) and other Sub-Auditors should also participate. There is a possibility of organizing this conference along with the Exit Conference being organized by AG (A&E) to discuss finalization of accounts. It is of paramount importance that the audit objectives, scope, methodology are discussed with the Finance Department of the State Government, and also sent to them through a formal communication with a copy to the AG (A&E).

3.23 It is important to have a well laid out communication plan for conduct of audit of accounts. The Principal Auditor should have regular interactions with the AG (A&E) as the preparer of accounts, the Finance Department of the State Government as the audited entity and the Sub-Auditors among others. The documentation about the interaction should be maintained as part of the audit file.

Audit of Statements and Appendices of Finance Accounts

3.24 Implementation of Phase II of the audit process will commence after the AG (A&E) starts submitting the Statements of Finance Accounts to Audit for scrutiny. In addition to the audit checks prescribed, review of compliance with audit observations pointed out during earlier phase of audit will also be part of the scope of audit of this phase. In case, corrections are carried out later on monthly civil accounts already audited these corrections should be scrutinized and their impact on accounts assessed. The detailed audit checks to be carried out on each Statement and Appendix of Finance Accounts are indicated in the 'Audit Checks for audit of Finance Accounts' attached as Annexure - I.

Audit of Appropriation accounts

3.25 The audit of Annual Appropriation Accounts commences as soon as Grant Statements containing information relating to grant number, nomenclature of the heads of accounts up to sub-head level forming part of the particular grant and final grant against each sub head are received from AG (A&E). The correctness of grant number and nomenclature of heads of account should be checked at this stage with reference to those in detailed demands for grants and any corrigendum issued thereof as also the Supplementary Demands for Grants for the year. Further, information relating to the sanctioned provision (Original and Supplementary) and the effect of re-appropriation/resumption orders issued during the year against each sub-head should also be checked for correctness.

3.26 Audit of detailed appropriation accounts showing final Grant and expenditure figures should focus on verifying whether the expenditure incurred is within the sanctioned provision or is covered by re-appropriation orders issued to meet the excess expenditure. The audit relating to audit of Monthly Civil Accounts and Report on Monthly Expenditure (Monthly Appropriation Accounts) should aid the audit process at this stage. Finally the audit of the final Appropriation Accounts is to be taken up as per the audit checks attached as Annexure - J.

Use of Computer Aided Audit Techniques

3.27 Several of these audit checks are amenable to execution on the VLC Database through

use of Computer Aided Audit Techniques (CAATs) like IDEA. Audit checks required in various substantive audit tests are listed out in this document to facilitate easy development and adoption of CAATs in such audits by the Audit offices. The query to be used is dependent on the nature of Master Tables in the VLC Application in use at the A&E office. In fact, if the controls of VLC system are audited effectively and the Principal Auditor is of the opinion that reliance can be placed on the System, it is advisable to execute through CAATs the checks of verification of major head-wise/minor head-wise figures in the statements/ appendix with those in the VLC system, and checks of consistency of figures between different statements/appendix in finance accounts and between those in different statements/appendix of the finance accounts and corresponding figures in appropriation accounts. Though all the VLC systems of all the AG (A&E) offices are broadly similar, the Principal Auditor should keep in mind the specific table structure and programming while designing the audit checks through use of CAATs. Sample audit report which can be developed in the VLC system to facilitate audit check is included as Annexure-K.

3.28 The audit report module could be developed in the VLC system for automating the financial audit process itself. Computerization of the audit process either through in-house or off the shelf software would assist in better planning, execution and monitoring of Financial Attest Audit procedures and reporting. It would be advisable to develop Audit Report Module as per the requirements of individual Principal Auditor. A list of common sample Audit Report is given in Annexure-K.

Audit Checks – A recap

3.29 The guidelines include the audit checks to be applied in five separate annexures as given below:

- a. Audit checks ó Vouchers (Annexure óE)
- b. Audit checks ó Treasury (Annexure óF)
- c. Audit checks - Monthly Civil Accounts (Annexure-G)
- d. Audit checks ó Report on Monthly Expenditure (Monthly Appropriation Accounts) (Annexure ó H)
- e. Audit checks ó Finance Accounts (Annexure-I)
- f. Audit Checks - Annual Appropriation Accounts (Annexure-J)

3.30 Further, keeping in view the responsibilities of A&E and Audit offices, audit checks to be conducted as part of FAA process as referred in para 3.1 have been divided in following four categories to avoid duplication of effort and for optimum utilisation of available resources:

1. **Category-1: Automated Checks**– These are built in Audit checks in the VLC system, or can be built in the VLC system. After confirming the availability of these checks in VLC, and testing their reliability, these audit checks need no longer be done manually. A confirmation report on these audits checks should be obtained by the Principal Auditor from the AG (A&E).
2. **Category-2: Exception Report Based Audit** – The Principal Auditor would request AG (A&E) for generating an exception report on audit checks in this category for further audit scrutiny.
3. **Category-3: Report assisted check**- AG (A&E) would generate specific reports to enable conduct of audit checks referred to in this category.
4. **Category-4: Manual checks**- In case of these audit checks, the audit has to be done manually

Vetting of Notes to Accounts

3.31 Notes to Accounts (NTAs) are additional information/disclosures provided in Volume-I of the Finance Accounts that help explain specific items in the statements as well as provide a more comprehensive assessment of the financial position. These Notes can be information on accounting policies, contingent liabilities or contextual information explaining the financial numbers. These Notes can also be disclosures, in certain cases. These serve an important role of providing transparency, specifically because the accounts are compiled by AG (A&E) for the financial transactions done by the State Government.

3.32 The NTAs are an integral part of the Accounts and the Principal Auditor has to do the due diligence on the proposed NTAs. It has been an established practice that AG (A&E) proposes draft NTAs and these are vetted by the Principal Auditor before their inclusion in the Accounts. Even after vetting the NTAs there may be circumstances where audit observations elaborating and accentuating NTAs may be necessary for the reasons of materiality and context. In such cases, the audit observations should bring out the impact of the NTAs on the accuracy and reliability of Accounts. This is necessary because the NTAs made by AG (A&E) serve as disclosures or clarifications and not audit comments. Such audit observations should be communicated by the Principal Auditor to AG (A&E) and State Government and considered for inclusion in the Report on the State Finances.

Preparation of Draft audit comments

3.33 Based on the results of audit, the Principal Auditor would prepare the draft audit comments on the Finance and Appropriation Accounts and send it to Finance Department for

their replies with a copy to AG (A&E) and Sub- auditors.

Exit Conference

3.34 On conclusion of audit, FINAT shall arrange for holding an Exit Conference with the Finance Department of the State Government. The AG (A&E) and the sub-auditors may also be requested to participate in this conference. The draft comments on accounts and the issues relating to the certification should be discussed in this conference. Efforts should be made to get replies of the State Government on each of the issues raised as part of the audit of accounts. The minutes of the Exit Conference should be prepared and issued to the State Government.

4 Documentation and Reporting

Audit File

4.1 Documentation in a FAA requires maintenance of audit file along with the set of working papers. Audit file refers to one or more folders, in physical or electronic form, containing the records that describe the audit documentation for a specific engagement. The audit file to be maintained by the Principal Auditor should include the detailed audit plan, the sample selection, nature, timing and extent of procedures performed, results of such procedures and the evidence obtained. It should also mention significant matters arising during the audit, the conclusions reached thereon and significant professional judgments made in reaching those conclusions. Audit file should also include record of discussions of significant matters with Management, Government and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

4.2 Audit file should be properly indexed, referenced and supplemented by the set of working papers. In case of multiple audit files, a master index of the files may be maintained in addition to the index of each audit file. The auditor should complete the administrative process of finishing the audit file on a timely basis.

4.3 The responsibility of ensuring documentation of evidence in form of working papers, in support of all facts, figures and comments included in the audit report would rest with the respective audit offices conducting the audit. Documentation of working papers should include completion of *Matrix* including information sheets referred to in Para 2.20 and 2.21 above and should show specific accounts, accounts areas, nature of transactions chosen for proving the different assertions, samples of vouchers/documents chosen for substantive audit tests relating to each assertion, results of the substantive audit tests done and the overall conclusion drawn with cross referencing of audit evidence collected.

Assurance Memo

4.4 Assurance Memos have been prescribed in the guidelines to seek an assurance from the Principal Auditor and AG (A&E) to the compliance of these guidelines. These memos would provide the assurance to the controlling ADAI/ DAI about the completeness and robustness of the process being followed while compiling and certifying the accounts by the concerned authorities. The Memo to be signed by the Principal Auditor as given in Annexure L1 would be supported by an Assurance Memo about compilation of Finance and Appropriation Accounts as given in Annexure L2 to be signed by the Pr. AG/AG (A&E).

Results of Audit

4.5 The objectives of conducting FAA of State Government accounts are to provide an assurance on accounts to the stakeholders, improving quality of accounts, encouraging systemic improvements and enforcing financial discipline. The outcome of FAA can be in the following forms:

1. Revision / correction of Accounts
2. Management Letter
3. Audit opinion
 - Audit Certificate
 - Significant audit findings in Report on State Finances

The first two forms mentioned above are in addition of an audit opinion, which is mandatory.

Management Letter

4.6 A Management Letter should be issued by the Principal Auditor to the Principal Secretary in-charge of Finance Department (the audited entity) pointing out those audit findings which though not material enough to affect the audit opinion, need to be addressed to improve the quality of accounts. While developing findings, it is important to focus on underlying causes of problems rather than simply to report the problems and their results. It should be ensured that nothing communicated to the audited entity is inconsistent with the audit opinion. A copy of the Management Letter issued to the State Government should also be sent to the AG (A&E). A Management letter can also be issued to the A&E office for matters relating to compilation of accounts.

Audit Opinion

4.7 Audit of financial statements are "reasonable assurance" engagements. Given the inherent limitations of an audit engagement, the auditor can only provide a "reasonable assurance" and not an "absolute one" the result of which is that most of the audit evidence obtained by the auditor will be persuasive rather than conclusive. In general, reasonable assurance audits are designed to result in a conclusion expressed in a positive form, such as "in our opinion the financial statements present fairly, in all material respects (or give a true and fair view of) the financial position of í and its financial performance and cash flow í ..ö.

4.8 Accordingly, the results of this audit are communicated to the external stakeholders through an audit opinion which has two components:

- Audit Certificate
- Significant audit findings in Report on State Finances

Audit Certificate

4.9 The exact format of audit certificate will be governed by the instructions issued from the Headquarters Office. Detailed guidance about Auditor's Opinion is available in Chapter 7 of Financial Attest Audit Manual, 2009. Separate audit certificates are required to be given for the Finance Accounts and the Appropriation Accounts. The auditor may express various types of opinions as below:

Unqualified opinion

4.10 An unqualified opinion is given when, in the judgement of the Principal Auditor,

(i) For Finance Accounts:

The financial statements and accompanying notes give a true and fair view of the financial position, and the receipts and disbursements of the audited entity for the year under audit

(ii) For Appropriation Account:

A true and fair view of the accounts of the sums expended in the relevant year compared with the sums specified in the schedules appended to the Appropriation Acts passed.

4.11 An unmodified/unqualified opinion is given when, in the judgment of Principal Auditor, the financial statements fairly present/give a true and fair view and have been prepared in accordance with relevant accounting requirements. In forming this judgement, the Principal Auditor should be satisfied in all material respects that:

- (i) the financial statements have been prepared in accordance with relevant legislation, regulations, instructions of Finance Department, Government Accounting and applicable accounting standards (and that any departures are justified and adequately explained in the financial statements);

- (ii) there is adequate disclosure of all information relevant to a proper understanding of the financial statements;
- (iii) appropriate accounting policies have been consistently applied in the preparation of financial statements; and
- (iv) the financial statements are free from material irregularity.

4.12 In forming the judgment about absence of material irregularity, the Accountant General must be satisfied that in all material respects:

- (i) transactions comply with the legislation (both primary and secondary) governing them;
- (ii) transactions comply with any regulations relating to them issued by a body with the power to do so under the governing legislation;
- (iii) approval of Finance Department or any sponsoring Department has been sought and obtained as required;
- (iv) the financial transactions fall within the ambit of the Vote of the Parliament or Legislature.

Unqualified Opinion with Emphasis of Matter

4.13 An auditor may express an unqualified opinion and also include explanatory paragraphs, known as 'Emphasis of Matter' in the report. Emphasis of matter may be required in circumstances where the Principal Auditor is of the view that Financial Statements do present a true and fair view, but there are certain issues or concerns which must be brought to the notice of stakeholders as part of the audit opinion. The emphasis of matter may relate to appropriateness of accounting policies, adequacy of disclosures, internal control management issues or significant transactions to name a few. Normally, the emphasis of matter would feature issues of higher significance or materiality than audit findings that appear in Report on State Finances.

Qualified/Modified Opinion

4.14 The audit opinion should be modified where the Principal Auditor is unable to satisfy himself that the Financial Statements are free from material misstatement whether caused by fraud, error or other irregularity. For Appropriation Accounts, a modified opinion is also given on all excess votes.

The reasons for qualification fall into two groups:

- (i) The audit may have caused the Principal Auditor to be uncertain as to whether material error does, or does not, exist in the accounts

- (ii) The Principal Auditor may disagree with the way something has been dealt with in the accounts.

Significant audit findings in Report on State Finances

4.15 The results of FAA in form of audit comments are presented in the Report on State Finances. Significant irregularities noticed during audit of finance accounts and appropriation accounts should be presented as audit findings along with an analysis of underlying causes and their impact. The audit findings could relate to financial management weaknesses, internal control deficiencies or inappropriate accounting treatments etc. noticed during the audit checks performed as discussed in Chapter 3. These findings should be discussed with the State Government and their replies should be considered. These findings should also be discussed in the Exit Conference held to discuss the FA&AA and the Report on State Finances.

4.16 Some examples of audit findings which could be presented in Report on State Finances are:

Finance Accounts

4.16.1 Opaqueness in Accounts ó Operation of omnibus minor head 800, outstanding balances under major suspense heads

- Public funds lying outside Government accounts óin commercial savings accounts and similar arrangements, Operations of personal deposits accounts, moneys in commercial savings banks and cooperative schemes
- Funds lying outside the consolidated fund- non transfer of unutilized funds from personal deposit /treasury savings bank accounts at the end of the financial year.
- Continued adverse balance and static balances over a period of time
- Non transfer of funds collected to appropriate Reserve Funds and its non-investments
- Integrity and reconciliation issues Wrong classifications-pendency of detailed contingent bills and Utilization certificates
- Conversion of State Government Loans into Equity and writing off of Loans made by the State Government

Appropriation Accounts

- Expenditure incurred without budget line
- Failure to obtain legislative approval for augmenting provisions
- Incorrect classification ó voted & charged, revenue & capital
- Other misclassifications
- Deficient sanction orders

- Sanction of additional funds by executive orders
- Inappropriate advances from contingency funds
- Non furnishing or incorrect utilisation certificates

Supervision and Review

4.17 The responsibility of preparing draft audit opinion including draft Audit Certificate and draft audit comments which might find a place in the Report on State Finances would be of FINAT after conclusion of audit and after considering the replies received from the State Government. The Principal Auditor would send the draft audit opinion to the controlling DAI / ADAI for approval of CAG. This opinion would be supported by the Assurance Memos as discussed in para 4.4 above and an appreciation note about the process followed.