

CHAPTER 2

CAG'S OVERSIGHT ROLE

2.1 Audit of Public Sector Undertakings

- 2.1.1 Under Section 619 of the Companies Act, 1956 (Act), the Auditor (hereinafter called the Statutory Auditor) of a government company including deemed government companies, appointed by the CAG conducts the audit of accounts of these companies. On the basis of supplementary audit conducted thereafter, the CAG issues comments upon or supplements the Audit report of the Statutory Auditor.
- 2.1.2 Statutes governing some Corporations also require their accounts to be audited by the CAG and a report to be given to the Parliament.

2.2 Appointment of auditors of government companies:

2.2.1. Objectivity in the appointment of auditors: Statutory Auditors for government companies including deemed government companies are appointed by the CAG* in exercise of the powers conferred under Section 619(2) of the Companies Act, 1956 as amended vide Companies (Amendment) Act, 2000. For this purpose a panel of firms of Chartered Accountants is maintained by the CAG by inviting applications biennially from eligible firms of Chartered Accountants. The panel so formed is used for the selection of auditors of PSUs for the ensuing financial year. In case of all PSUs, except where the accounts are in arrears auditors are appointed on a regular basis.

Selection of the auditors for appointment is made by correlating the point score earned by each firm of Chartered Accountants that applies for empanelment with the size of the audit assignment. The point score is based upon the experience of the firm, number of partners and their association with the firm and number of Chartered Accountant employees etc. for assessing that the antecedents of the firm are well established and the firm has capacity to handle the allotted audits. This system ensures that allotment of audit to Chartered Accountants' firm is done objectively based on merit and competence.

2.2.2 Timely appointment of Statutory Auditors of PSU for the year 2005-06

Under Sections 210 read with sections 166 and 230, of the Companies Act, 1956, the annual audited accounts of every company for the financial year is to be laid before the company at its Annual General Meeting to be held each year as per Section 166. As per Section 224 of the Companies Act, 1956 an auditor holds office from the conclusion of one Annual General Meeting until the conclusion of the next Annual General Meeting.

Clause 41 of the Listing Agreement with the Securities and Exchange Board of India (SEBI) provides that all the entities listed with the Stock Exchanges are required to publish their Quarterly Financial Review (QFR) with effect from quarter ending on or after June 2003, duly approved by the Board of Directors and subjected to a "limited review" by the auditors of the company (or by any Chartered Accountant in case of Public Sector Undertakings) and a copy of the Review Report to be submitted to the Stock Exchange within two months of the

* CAG also appoints the auditor for the Central Warehousing Corporation, a statutory corporation.

close of the quarter. Hence, the limited review of the 1st quarter (i.e. April to June) is to be carried out such that the results can be published by end-August of the year. Public Sector Undertakings (PSUs) also have the option of getting the limited review of QFR done by any Chartered Accountant other than the auditors of the company. In addition, a listed company is required to prepare the half yearly results in the same proforma with effect from half year ending on March 31, 2000 and the same shall be approved by the Board of Directors and subjected to a "limited review" by the auditors of the company (or by any Chartered Accountant in case of Public Sector Undertakings). A copy of the Review Report is required to be submitted to the Stock Exchange within two months of the close of the half year

In order to facilitate compliance with the provisions mentioned above, Statutory Auditors for the listed central government companies including deemed government companies, were appointed by the CAG for the year 2005-06 by August 2005. In respect of unlisted government companies including deemed government companies, Statutory Auditors were appointed by September 2005 for conducting the audit of accounts for the year 2005-2006. For the year 2006-07, Statutory Auditors of listed government companies including deemed government companies were appointed by 30 June 2006 and those of unlisted companies by 31 July 2006.

2.2.3 Independence of Statutory Auditors of government companies and deemed government companies

The Statutory Auditor has a fiduciary duty to provide independent, professional opinion on the financial Statements of the company he audits. In order to ensure independence of the auditors and to obviate any chances of conflict of interest, Section 226 of the Companies Act, 1956 prohibits the appointment of (i) an officer or employee of the company or their partner or employee, (ii) a person who is indebted to the company and (iii) a person who is the holder of any securities having voting rights etc. as the auditor of the company. Similarly, the Chartered Accountants Act, 1949 also contains provisions to ensure independence of the auditors. Paragraph 10 of the First Schedule of the Chartered Accountants Act, 1949 prohibits acceptance of fees, which are either linked to profits or otherwise dependent on the finding or the results of employment. Further, paragraph 4 of the Second Schedule, Part I, makes it an act of misconduct for a Chartered Accountant to express an opinion on the financial statements of a business in which he or his firm or a partner of his firm has a substantial interest unless disclosure of such interest is made.

In order to further ensure the independence of auditors of government companies, the following further safeguards have been provided by the CAG:

i) **Acceptance of non-audit assignments by the auditors** - In order to maintain the independence of the auditor as well as the quality of audit, partners or relatives (husband, wife, brother, or sister or any lineal ascendant or descendant) or associates* of the auditors of a government company, are prohibited from undertaking any assignment for internal audit or consultancy or other services to the government company during the year of audit and for one year after the firm ceases to be the auditor. Acceptance of non-audit assignments that involve performing management functions or making management decisions are also prohibited during the year of audit and for one year after the firm ceases to be the auditor.

* *The term 'Associates' includes (a) other firms of Chartered Accountants in which any employee or partner of the Audit firm has an interest and (b) any employee or partner of the audit firm practicing as a Chartered Accountant in his/her individual capacity.*

(ii) **Rotation of audit** – A system of rotation of the auditors of government companies every four years has been adopted as a good practice.

2.3 Arrears of accounts by the PSUs

2.3.1 Need for timely submission

As per the provisions of the Act, companies are required to lay their audited annual financial statements for adoption in the Annual General meeting within six* months of the close of the relevant financial year. The financial year for all the companies is defined as year ending 31 March. Therefore, the companies are required to prepare their accounts and get them audited well in time so that the AGM for adoption of accounts can be held by 30 September each year. Under Section 619-A Annual Reports of government companies including deemed government companies are required to be prepared within three months of the Annual General meeting and as soon as maybe after such preparation, laid before both houses of Parliament together with a copy of the audit report and any comments upon, or supplement to, the audit report, made by the CAG. The provisions under various statutes governing statutory corporations separately provide for dates of submission of accounts for audit or placing audited accounts in the Parliament.

For compliance of the statutory provisions relating to audit of the accounts and placement of Annual Report of the respective PSUs on the tables of both the House of Parliament in time, the CAG has been stressing upon the Managements of the PSUs the need for presentation of the accounts for audit within the time schedule.

2.3.2 Timeliness in preparation of accounts by government companies and deemed government companies

As of 31 March 2006, there were 304 central government companies and 94 deemed government companies in the purview of CAG's audit. Of these, accounts for the year 2005-06 were due from 294 government companies and 90 deemed government companies. Accounts were not due from 14 companies (10 government companies and 4 deemed government companies) which were new. 227 government companies and 62 deemed government companies submitted their accounts for audit by CAG on or before 30 September 2006. Accounts of 67 government companies and 28 deemed government companies were in arrears for different periods, the majority were in arrears for one year (2005-06). Details of the arrears in accounts of central government companies are shown in the table below:

* *except in the case of the first year when nine months are allowed*

Table 12

| Particulars | | Central government companies where CAG conducts Supplementary Audit | | | | | |
|---|-------------------------------|--|----------------|-----------------------------|----------------|--------|----------|
| Number for the year 2005-06 | | 398 | | | | | |
| | | Government companies | | Deemed government companies | | Total | |
| | | 304 | | 94 | | 398 | |
| | | Listed | Unlisted | Listed | Unlisted | Listed | Unlisted |
| | | 42 | 262 | 5 | 89 | 47 | 351 |
| Less: New companies from which accounts for 2005-06 were not due | | 0 | 10 | 0 | 4 | 0 | 14 |
| Companies from which accounts for 2005-06 were due | | 42 | 252 | 5 | 85 | 47 | 337 |
| Companies which presented the accounts for CAG's audit by 30 September 2006 | | 41 | 186 | 5 | 57 | 46 | 243 |
| Audit of Accounts in Progress as on 30 September 2006 | | 2 [∞] | 5 [∞] | 0 | 6 [♥] | 2 | 11 |
| Accounts in Arrears | | 1 | 66 | 0 | 28 | 1 | 94 |
| Break-up of Arrears | (ii) Under Liquidation | 0 | 13 | 0 | 6 | 0 | 19 |
| | (iii) Defunct | 0 | 0 | 0 | 4 | 0 | 4 |
| | (iii) Others | 1 | 53 | 0 | 18 | 1 | 71 |
| Age-wise Analysis of the arrears against 'Others' category | One Year (2005-06) | 1 | 40 | 0 | 9 | 1 | 49 |
| | Two Years (2004-05 & 2005-06) | 0 | 6 | 0 | 2 | 0 | 8 |
| | Three Years and More | 0 | 7 | 0 | 7 | 0 | 14 |

The majority of the government companies having accounts in arrears related to the Ministry of Tourism and Ministry of Chemical and Fertilizers with 10 companies each, followed by the Ministry of Textiles and the Ministry of Heavy Industry and Public Enterprises with eight companies each.

The reasons for delay in presentation of the accounts for CAG's audit as noticed in audit were mainly companies being sick or under liquidation, lack of coordination between the Managements and the Statutory Auditors and delay in approval of the accounts by the Board of Directors.

[∞] Bharat Petroleum Corporation Limited and ITI Limited.

[∞] Air India Limited, Bharat Heavy Plates and Vessels Limited, Heavy Engineering Corporation Limited, HMT Watches Limited and Housing and Urban Development Corporation Limited.

[♥] Calcutta Haldia Port Road Company Limited, Chennai Ennore Port Road Company Limited, Mumbai-JNPT Port Road Company Limited, Muradabad Toll Road Company Limited, Tuticorin Port Road Company Limited and Visakhapatnam JNPT Port Road Company Limited.

2.3.3 Statutory Corporations

Audit of six Corporations, shown in **Appendix XI**, is conducted by the CAG. Of the five statutory corporations in whose case CAG is the sole auditor four viz. Airport Authority of India, Inland Waterway Authority of India, Damodar Valley Corporation and National Highways Authority of India presented their accounts for the year 2005-06 for audit in time. The accounts of Food Corporation of India for the year were awaited as on 30 September 2006.

2.4 Impact of CAG's oversight of audit of accounts and the supplementary audit

2.4.1 Financial reporting framework

Companies are required to prepare the financial statements in the format laid down in Schedule IV to the Companies Act, 1956 besides adhering to the mandatory Accounting Standards issued by the Institute of Chartered Accountants of India and other statutory provision prescribed in the Companies Act, 1956. The statutory corporations are required to prepare their accounts in the format prescribed under the rules, framed in consultation with the CAG and any other specific provision relating to accounts in the Act governing such Corporations.

2.4.2 CAGs oversight of audit of accounts of government companies and Statutory Corporations

The Auditors appointed by the CAG under Section 619(2) of the Companies Act, 1956 (Act) conduct audit of accounts of the government companies for submission of a report thereon in accordance with Section 619(4) of the Act. The CAG plays an oversight role by monitoring the performance of the Auditors with an overall objective that the Auditors discharge the functions assigned to them properly and effectively. This function is discharged by exercising the power to supplement or comment upon the Auditors' report under Section 619(4) of the Act and to issue directions to the Auditors under Section 619(3) of the Act. The directions issued by CAG under Section 619(3)(a) are primarily aimed at ensuring compliance with Accounting Standards and evaluating internal controls relating to financial reporting in the auditee organisation.

2.4.3 Results of audit of accounts of government companies/deemed government companies under Section 619 of the Companies Act, 1956

Financial statements for the year 2005-06 were received from 227 government companies (including 41 listed companies) and 62 deemed government companies (including five Listed companies) and five statutory corporations by 30 September 2006. Of these, accounts of 181 Government companies (including 41 listed companies) and 53 deemed government companies (including five listed companies) and five statutory corporations were reviewed in audit by the CAG.

2.4.3.1 Revision of Accounts and its impact

As a result of supplementary audit of the accounts for the year ended 31 March 2006 conducted by the CAG, 12 unlisted government companies revised their accounts. The impact of revision of accounts is indicated in the following table:

Table 13

Unlisted government companies:**2.4.3.1 Decrease in Profit**

| Sl.No. | Name of the company | Rupees in crore |
|-----------------------|-----------------------------|-----------------|
| 1. | Bharat Coking Coal Limited | 51.86 |
| 2. | Central Coalfields Limited | 8.01 |
| 3. | Coal India Limited | 0.92 |
| 4. | Eastern Coalfields Limited | 8.03 |
| 5. | Hindustan Shipyard Limited | 0.31 |
| 6. | Mahanadi Coalfields Limited | 5.84 |
| 7. | MECON Limited | 3.07 |
| 8. | Western Coalfields Limited | 18.59 |
| Total Decrease | | 96.63 |

2.4.3.2 Increase in profit

| Sl.No. | Name of the company | Rupees in crore |
|-----------------------|-------------------------------|-----------------|
| 1. | Hindustan Aeronautics Limited | 1.61 |
| Total Increase | | 1.61 |

2.4.3.3 Increase in Loss

| Sl. No. | Name of the company | Rupees in crore |
|-----------------------|---------------------|-----------------|
| 1. | ITI Limited | 5.59 |
| 2. | NTC(APKK&M) Limited | 0.04 |
| Total Increase | | 5.63 |

Unlisted deemed government companies**2.4.3.4 Increase in profit**

| Sl.No. | Name of the company | Rupees in crore |
|-----------------------|---|-----------------|
| 1. | UTI Infrastructure and Services Limited | 0.09 |
| Total Increase | | 0.09 |

2.4.3.5 Apart from the above, one listed government company viz. HMT Limited, one unlisted government company viz. HMT Watches Limited and one unlisted deemed government company viz. Canbank Venture Capital Fund Limited revised their accounts for the year 2005-06 without any impact of revision.

2.4.4 Findings of Audit under Section 619

Listed companies

2.4.4.1 Qualifications on the accounts of listed government companies including deemed government companies by the Statutory Auditors

A resume of significant qualifications made by the Statutory Auditors in their audit reports on the accounts for the year 2005-06 of 10 government companies and deemed government companies is given below:

Andrew Yule & Company Limited

Non-provision for interest free advance of Rs.1.15 crore granted to a company floated by two associated companies in the group though the recovery of the advance was doubtful.

Bharat Earth Movers Limited

Accounting of sales was not as per accounting policy 4(i) of the company. Consequently, sales were overstated by Rs.196.82 crore.

Hindustan Organic Chemicals Limited

Provision was not made in respect of claims of JNPT which include minimum guaranteed through put charges of Rs.7.87 crore payable to JNPT authorities.

HMT Limited

- Compensation paid under VRS had been deferred over a period of 10 years instead of five years as recommended by the Institute of Chartered Accountants of India. This resulted in overstatement of profit by Rs.32.23 crore.
- Provision towards erosion in the value of carrying cost of Long Term Investments made in respect of Shares held in subsidiary companies whose net worth had been eroded was not provided. The consequent effect on the accounts was not ascertainable.

India Tourism Development Corporation Limited[∞]

Claims against the company not acknowledged as debts included the following liabilities which were not provided for: (a) property tax of Rs.44.26 crore payable to NDMC in respect of three units; and (b) royalty of Rs.17.56 crore payable to Airports Authority of India in case of Duty Free Shops at International airports at Delhi, Mumbai, Chennai, Kolkata and Thiruvananthapuram.

ITI Limited

- No provision had been made in the accounts for: (i) sundry debtors outstanding for three years and more – Rs.316.44 crore; and (ii) other recoverables such as claims, Loans & Advances and other outstanding for three years and more – Rs.109.70 crore.
- Inventory comprising dormant stock, work-in-progress and stock in trade held for two years and more – Rs.128.35 crore.

[∞] Relates to 2004-05

Kudremukh Iron Ore Company Limited

The company had recognised income on loans advanced to Kudremukh Iron and Steel company Limited (KISCO) in which it had substantial interest as a joint venturer and also some of the directors were common. Interest for prior years to the extent of Rs.58.60 crore not accounted on accrual basis.

Madras Fertilizers Limited

- The current year's loss and accumulated losses had been understated by Rs.26.40 crore due to non accounting of internal consumption of manufactured urea (Rs.22.26 crore), non provision of sum deposited with ESI (Rs.0.63 crore) as advance which was doubtful of recovery, gratuity to ex-employees (Rs.1.18 crore), amount included under claims recoverable from ex-C&F agents (Rs.0.78 crore) and for refund of customs duty (Rs.1.55 crore) etc.
- The net worth had been fully eroded and the company was consistently making significant losses in the past few years. The viability of the company appeared to be doubtful as it could not recover even the variable cost in respect of its major product NPK Complex Fertilizer.
- The company had defaulted in payment of interest to financial institutions. As on 31 March 2006, the overdue interest due to financial institutions amounted to Rs.25.58 crore. The period of default ranged from 1 to 22 months.

Mahanagar Telephone Nigam Limited

- Pending resolution of dispute, an amount of Rs.1,044.84 million (being amount deposited with the company) was booked as income in respect of bills of Rs.3,412.74 million raised earlier on one UASL operator, though the matter was sub judice. The profit of the company was overstated by Rs.1,044.84 million with understatement of current liabilities by an equivalent amount.
- The profit and the current assets were overstated by Rs.2,481.67 million each due to booking of income of Rs.2,481.67 million on account of charges for use of MTNL Trunk Automatic Exchange (TAX) by BSNL for the period from 1 February 2004 to 31 March 2006, though the charges had been rebutted by BSNL.
- The profit and fixed assets were overstated by Rs.275.40 million each due to the scrapped/decommissioned assets not being valued at lower of the net book value or net realisable value by the Delhi unit.
- In spite of the opinion from the Expert Advisory Committee of the Institute of Chartered Accountants of India, installation charges received from the subscribers were accounted for as income and not adjusted against the cost thereon.
- One time lumpsum payment received from subscribers for life long connections under Trump pre-paid mobile connections was booked in the year of receipt, in contravention of Significant Accounting Policy No.1 (ii).

Neyveli Lignite Corporation Limited

Withdrawal of depreciation charged in earlier years had resulted in increase in profits and fixed assets to the extent of Rs.148.25 crore.

2.4.4.2 Impact of CAG's comments issued as supplement to the Statutory Auditors' reports on listed government companies

Based on the supplementary audit conducted by CAG subsequent to the audit of the financial statements for the year 2005-06 by Statutory Auditors, comments were issued on accounts of government companies. The impact of these comments on Assets, Liabilities, Profit and Loss (details in **Appendix XII**) of eight listed government companies including one listed deemed government company, was as given below:

- *Assets were overstated by Rs.0.24 crore and understated by Rs.156.65 crore.*
- *Liabilities were overstated by Rs.191.21 crore and understated by Rs.22.10 crore; and*
- *Profit was overstated by 39.12 crore and understated by Rs.27.55 crore.*

2.4.4.3 Observations on financial statements reported by the Statutory Auditors in the supplementary reports in compliance with directions issued under Section 619(3)(a) of the Companies Act, 1956.

It was brought out in the observations made by Statutory Auditors in their supplementary reports that in three[♥] listed government companies, there was deficiency in the system of obtaining confirmation of balances of debtors/creditors.

Unlisted companies

2.4.4.4 Qualifications on the accounts of unlisted government companies including deemed government companies by the Statutory Auditors

A resume of significant qualifications made by the Statutory Auditors in their audit reports on the accounts for the year 2005-06 on 35 unlisted government companies and deemed government companies is given below:

Bharat Bhari Udyog Nigam Limited

Non-provision of Rs.49.95 crore on loss on sale of shares in Jessop & Co. Limited in the earlier year.

Bharat Gold Mines Limited

- Union Cabinet in its meeting held on 27 July 2006 approved, *inter-alia*, a proposal which had financial implications relating to: (i) reopening of Special Terminal Benefit Package (STBP) to employees of the company involving an expenditure of Rs.72.45 crore and (ii) ex-post fact approval of STBP in the company with effect from 20.12.2002 for a period of one month.

Bharat Refractories Limited

The company had considered penal interest, damages on delayed and non payment of provident fund to appropriate authorities as contingent liabilities for Rs.5.12 crore which should have been provided for in the accounts.

[♥]*Madras Fertilisers Limited, Scooters India Limited and India Tourism Development Corporation Limited (2004-05).*

Bharat Sanchar Nigam Limited

- No adjustment was made for the difference of Rs.289.69 crore between the General Ledger and Subsidiary Ledger of Sundry Debtors and the difference between similar sets of accounts in respect of loans and advances pending reconciliation.
- Frauds were reported in nine circles amounting to Rs.18.36 crore.

Brahmaputra Valley Fertilizer Corporation Limited

The company did not recognize possible impairment loss to the extent of Rs.23.49 crore in respect of unviable Ammonia-I Plant.

Braithwaite & Co Limited

Non-amortization of VRS expenses of Rs.2.82 crore during the year

Burn Standard Company Limited

- Non-provision of Rs.20.21 crore for permanent decline in value of investment in subsidiary companies.
- Non-provision of estimated liability of arrears of salary of Rs.23 crore on implementation of pay revision of officers.

Cement Corporation of India Limited

The relief accrued consequent on one time settlement of dues with banks and waiver of interest on loans by central government, amounting to Rs.935.38 crore had been accounted for as other income instead of extra ordinary items.

Cochin Shipyard Limited

Non-cumulative preference shares of Rs.119.14 crore included in the share capital were over due for redemption.

Electronics Corporation of India Limited

The company recognised income of Rs.71.59 crore on accrual concept by accounting for the same as material cost though the material was to be procured and imported as on 31 March 2006. This resulted in overstatement of turnover, consumption, debtors and creditors by Rs.71.59 crore.

General Insurance Corporation of India

In respect of properties costing Rs.32.03 crore, conveyance deeds were yet to be executed or share certificates of the cooperative housing societies were yet to be received.

Heavy Engineering Corporation Limited

- Sundry debtors included Rs.26.45 crore which were long overdue and for which provision had not been made in spite of dues pending for over three years.
- Bills of Bihar State Electricity Board and Jharkhand State Electricity Board for delayed payment surcharge amounting to Rs.401.81 crore were not provided for.
- Damages of Rs.95.02 crore levied by the Regional Provident Fund Commissioner under Section 14B of the Employees Provident Fund and Miscellaneous Provisions Act, 1952

for delayed remittances during the period March 1976 to September 1999 had not been accounted and provided for.

Hindustan Antibiotics Limited[∞]

- Provision for non moving inventory for more than three years was short by Rs.2.40 crore.
- Provision was not made in respect of Rs.3.92 crore of overdue penal interest for the year and aggregating to Rs.22.64 crore payable to IDBI and Canara Bank, penal interest of Rs.87.44 lakh on unpaid statutory dues etc for the year and aggregating to Rs.4.07 crore and service charges, over due interest and penal interest of Rs.5.22 crore payable to Kirloskar Investment and Leasing Limited for the year and aggregating to Rs.16.28 crore.

Hindustan Fertilizer Corporation Limited

The company did not make provision of Rs.7.30 crore against Debtors Outstanding for more than three years.

Hindustan Insecticides Limited

Provision had not been made in respect of Sundry Debtors of Rs.6.86 crore and loans and advances of Rs.2.21 crore which were outstanding for more than three years and considered doubtful.

Hindustan Shipyard Limited

The company had not provided for: (a) income tax liability along with interest amounting to Rs.34.65 crore under Section 234B of Income Tax Act,1961 for the Assessment Year 1998-99 (b) counter claims of a party for liquidated damages, penal interest etc., amounting to Rs.59.95 crore; (c) liability towards penal rate on guarantee fee on government guaranteed loans and advances for the period from April 1995 onwards amounting to Rs.25.39 crore; (d) interest on SBI term loan on account of Rs.69.28 crore; (e) interest on government of India loans of Rs.37.76 crore and guarantee fee of Rs.11.61 crore (f) non-implementation of capital restructuring proposal approved by the government of India and non-reflection of its impact in the books of the company, which included write off of Government of India loans, interests, guarantee fee to the tune of Rs.470.93 crore and conversion of the Government of India loans into equity share capital to the tune of Rs.120.20 crore and non provision for consequential liability.

Hindustan Steelworks Construction Limited.

Sundry debtors included claims of Rs.104.96 crore outstanding for a long time. Full provision for the amount should have been made instead of Rs.69.69 crore made by the company.

HMT (I) Limited

Declaration of dividend was not in conformity with the provisions of the Companies Act, 1956.

HMT Machine Tools Limited

- Compensation paid under VRS had been deferred over a period of 10 years instead of five years recommended by the Institute of Chartered Accountants of India resulting in

[∞] Relates to 2004-05

understatement of loss to the extent of Rs.20.09 crore and overstatement of deferred revenue expenditure to this extent.

- Deferred revenue expenditure was overstated by Rs.39.76 crore in contravention of Accounting Standard 15 consequent to accounting of gratuity, settlement allowance and leave encashment in respect of employees retired under VRS.
- The company had defaulted in repayment of Government of India loan.

Hotel Corporation of India Limited

The company had not provided for additional liability for lease rentals, turnover levy and interest thereon amounting to Rs.20.01 crore including additional liability for the current year amounting to Rs.3.47 crore payable to Airports Authority of India. As a result, net loss for the year was understated by Rs.3.47 crore. Also the credit balance of Profit & Loss account was overstated by Rs.20.01 crore and current liabilities were understated by the same amount.

Karnataka Agri Development Finance Company Limited

The company did not commence its operations since inception (February 1997) and failed to achieve the main objectives of the incorporation envisaged in the Memorandum of Association of the company.

MECON Limited

Sundry debtors and profit for the year 2005-06 were overstated by Rs.6.46 crore.

M S T C Limited

The company did not account for deferred tax assets resulting in understatement of General Reserve by Rs.8.05 crore and profit after tax by Rs.2.30 crore.

National Bicycle Corporation Limited

- The company carried constant and static Inventory portfolio of Rs.one crore for the past six years and no valuation report on the inventories to arrive at the net realizable value and to provide shortfall, if any, had been obtained
- Preparation of the accounts on the basis of the fundamental accounting assumption of 'going concern' was not in accordance with the facts since winding up proceedings of the company had been initiated by the BIFR.

National Handicapped Finance and Development Corporation^N

The company had not framed prudential norms for the purpose of identifying non-performing assets and creation of provision in the books of accounts for the overdue installments of principal amount of loans and interest overdue thereon.

National Hydroelectric Power Corporation Limited

A debit of Rs.53.18 crore to profit and loss account instead of profit and loss appropriation account towards self insurance reserve, being a notional entry, resulted in understatement of net profit to that extent.

^N Relates to 2004-05

National Scheduled Tribes Finance and Development Corporation

The company was neither filing its return of income since inception nor was complying with the provisions of Section 44AB of Income Tax Act, 1961.

NTC (APKK&M) Limited

- As per the scheme sanctioned by BIFR for revival of the company, the Government of India was to write off interest of Rs.126.92 crore outstanding as on 31 March 2001 on loans lent to the company through its holding company and not to charge any interest subsequently during the rehabilitation period. However, pending formal order from the Government of India to this effect, the company had charged interest of Rs.52.53 crore for the year 2005-06 alongwith accumulated interest of Rs.341.69 crore as on 31 March 2006 on the said loans. Resultantly, accumulated loss had been overstated by Rs.341.69 crore.
- Stock of Stores, Dyes and Chemicals were valued 'at cost' less ad hoc provision as against cost or net realisable value which ever was lower as required by AS-2. The company had not ascertained the net realisable value of these items.

NTC (TN&P) Limited

The company had granted bonus advance to employees during the years 1997-98 to 2004-05 and incentive advance during 2005-06 and the amount outstanding as on 31 March 2006 was Rs.8.76 crore. These advances were irrecoverable in nature.

Nuclear Power Corporation of India Limited

- Quantification could not be done in respect of rebate given on payments received from State Electricity Boards (SEBs) in the absence of Bulk Power Supply Agreement and provision to be made in respect of shortage and obsolescence of spares which are non moving or slow moving.
- Reimbursement of Income Tax from the SEBs and delayed payment charges are accounted on cash basis as against accrual basis and the amounts have not been ascertained.
- Fuel adjustment charges payable to SEBs on account of downward revision of rates for fuel in earlier years in respect of a unit amounting to Rs.4.01 crore were not provided for.

Rehabilitation Industries Corporation Limited

Short term funds to the tune of Rs.737.35 crore had been used to finance long-term assets.

Rail Tel Corporation of India Limited

- Penalty of Rs.3.38 crore levied by Department of Telecommunications was not provided for.
- Remission of liability amounting to Rs.30.24 crore by the Railways in lieu of the income recoverable from the company had not been adjusted.

State Farms Corporation of India Limited

One fraud at Jetsar farm had been noticed by the company during the year. It involved improper utilization of Rs.9.24 lakh due to mismanagement in plantation of Jatropha plants.

The Cotton Corporation of India Limited

The profit is overstated due to non provision of Rs.1.21 crore being the unsecured loan sanctioned to the National Jute Manufacturers' Corporation in August 1991 (Rs.1.11 crore) and advance of Rs.10 lakh given to Swadeshi Polytex Limited in which significant uncertainty existed on ultimate collection.

Western Coalfields Limited

Proper title documents in respect of land acquired under various Acts were not available with the Wani North, Majri, Wani and CWS Tadali areas of the company.

2.4.4.5 Impact of CAG's comments issued as supplement to the Statutory Auditors' reports on unlisted government companies

Based on the supplementary audit conducted by CAG subsequent to the audit of the financial statements for the year 2005-06 by Statutory Auditors, comments were issued on the accounts of government companies. The impact of these comments on Assets, Liabilities, Profit and Loss (details in **Appendix XII**) of 40 unlisted government companies (including 11 unlisted deemed government companies) was as given below:

- *Assets were overstated by Rs.41.90 crore and understated by Rs.33.94 crore**.
- *Liabilities were overstated by Rs.22.61 crore[♦] and understated by Rs.851.35 crore[♥];*
- *Profit was overstated by Rs.159.41 crore[♠] and understated by Rs.268.41 crore;*
- *Loss was understated by Rs.67.67 crore[≈].*

2.4.4.6 Observations on financial statements reported by the Statutory Auditors in the supplementary reports in compliance with directions issued under Section 619(3)(a) of the Companies Act, 1956.

Observation on quality of financial statements

The significant observations made by Statutory Auditors in their supplementary reports that reflect the quality of accounts and systems of accounting of the companies are reproduced below:

Deficiencies in accounting policies and practices

Bharat Coking Coal Limited

The existing system of recording of liabilities and provisions on the basis of supply bills did not ensure cut off controls with regard to booking of all liabilities.

Bharat Sanchar Nigam Limited

The value of work in progress was Rs.1,365.46 crore for an unduly long period.

* Includes Rs.26.76 crore for the year 2004-05.

♦ Relates to the year 2004-05.

♥ Includes Rs.91.77 crore for the year 2004-05.

♠ Includes Rs.32.89 crore for the year 2004-05.

≈ Includes Rs.7.98 crore for the year 2004-05.

Can Bank Financial Services Limited

Actuarial valuation of the retirement benefits was not done and provisions were made on accrual basis for actual liability up to the year end.

Delhi Metro Rail Corporation Limited

The system of recording the traffic earnings needed to be streamlined.

Export Credit Guarantee Corporation of India Limited

- Accrual concept of accounting was not followed in respect of premium income which resulted in premium income relating to one accounting period being accounted for over subsequent years.
- The system of accounting and control relating to reinsurance accounts needed comprehensive review to be in conformity with the accepted accounting principles.

HMT Watches Limited

System of accounts required strengthening in the areas of income recognition, accrual expenses and provisions for debtors, stock and warranty.

Indian Vaccines Company Limited

The status of work in progress valuing Rs.15.59 crore remained the same for the last 12 years.

Mazagaon Dock Limited

Lease agreement was yet to be executed in case of land at Nhava and land at MBPT, Mumbai.

National Backward Classes Finance and Development Corporation

The policy of making provisions for over due loan needed to be reviewed.

National Insurance Company Limited

Premium on policies extended for more than one year was recognized as income in the year of receipt.

National Seeds Corporation Limited

Purchases were not recorded on accrual basis pending completion of some formalities.

Confirmation of balances of debtors and creditors

Based on the observations made by Statutory Auditors in their supplementary report, it was noticed that in seven[▼] unlisted government companies, the system of obtaining confirmation of balances of debtors/creditors was deficient.

▼ *Hindustan Organic Chemicals Limited, HMT Watches Limited, Indian Airlines Limited(2004-05), National Insurance Company Limited, HMT Bearing Limited, Praga Tools Limited and Rashtriya Chemicals and Fertilisers Limited.*

2.4.4.7 Statutory Corporations where CAG is the sole auditor

The net impact of the audit observations as contained in the Audit Reports issued by the CAG on the accounts for the year 2005-06 of the statutory corporations where CAG acts as the sole auditor was as under:

Airports Authority of India

Assets and Liabilities were understated by Rs.12.37 crore and Rs.33.38 crore respectively and the Profit was understated by Rs.67.92 crore.

Inland Waterways Authority of India

Assets were overstated by Rs.5.83 crore.

National Highways Authority of India

Assets were understated by Rs.174.76 crore and Liabilities were understated by Rs.16.00 crore.

2.4.4.8 Statutory Corporation where CAG conducts supplementary audit

Qualifications of Statutory Auditors

Central Warehousing Corporation

- Title deeds in respect of 96 freehold/leasehold land sites had not been executed in favour of the Corporation (land value Rs.84.74 crore). The title deeds of 75 land sites were pending for execution for more than 15 years.
- Residential flats included expenditure of Rs.9.32 crore towards cost of 86 flats at Dronagiri node, Jawahar Lal Nehru Port acquired by the Corporation during the year 1998-99 of which only two flats had been occupied by employees of the Corporation.
- The Corporation had been transferring one per cent of the profit after tax to the Benevolent Fund for the purpose of staff welfare since 1990-91. However, the constitution of the Trust and the Rules and Regulations for its operation had not been finalised.

2.5 Internal Control over Financial Reporting

Internal control is the process designed and effected by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of the entity's objective with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations and to check fraud and misappropriation. Internal control measures may vary with the size and complexity of the organization. Effective and efficient internal control measures ensure that the financial statements prepared give a true and fair view and the degree of reliance that an auditor can place on the financial statements for the purpose of reporting. In accordance with the directions issued by the CAG under Section 619(3)(a) of the Companies Act, 1956, the Statutory Auditors are required to submit a report on adequacy or otherwise, of internal control measures followed by of the company and to suggest improvement, if any, in the areas of management, safeguarding and verification of fixed and current assets including debtors, cash and bank balances.

The deficiencies reported by the Statutory Auditors with regard to non-maintenance of fixed assets register, lack of physical verification of fixed assets, non-fixation of inventory stock holding norms and lack of monitoring the recovery of outstanding dues and absence of policies for prevention and detection of frauds in the government companies including deemed government companies are given below:

Table 14

| Sl.No. | Area of Deficiency | Number of companies |
|--------|-------------------------|---------------------|
| 1. | Fixed Assets | 9 |
| 2. | Investments | 4 |
| 3. | Debtors | 22 |
| 4. | Inventory | 21 |
| 5. | Cash Verification | 2 |
| 6. | Internal Audit | 28 |
| 7. | Delineated Fraud Policy | 9 |

The particulars of the companies indicating lack of internal controls in the above mentioned areas are given in the **Appendix XIII**.

2.6 Compliance with Accounting Standards

With an objective to harmonise the diverse accounting practices, adherence to the Accounting Standards (AS) is imperative for preparation of financial statements in accordance with the generally accepted accounting principles. Section 211(3A) of the companies Act, 1956 read with Section 211(3C) of the Act requires that every profit and loss account and balance sheet of the company shall comply with the accounting standards recommended by the Institute of Chartered Accountants of India (ICAI) or as may be prescribed by the central government in consultation with the National Advisory Committee on Accounting Standards. However, during course of audit Statutory Auditors and the CAG observed deviations from the provisions of Accounting Standards by the PSUs (**Appendix-XIV**). A gist of such cases is given below:

2.6.1 Government companies[†]

2.6.1.1 AS-2 relating to ‘Valuation of Inventories’

Listed companies Bharat Earth Movers Limited, India Tourism Development Corporation Limited[∞], Madras Fertilisers Limited and Steel Authority of India Limited.

Unlisted companies Bharat Sanchar Nigam Limited, National Bicycles Corporation Limited and Rashtriya Ispat Nigam Limited.

2.6.1.2 AS-3 relating to ‘Cash Flow Statements’

Listed companies Mahanagar Telephones Nigam Limited.

[†] Includes deemed government companies.

[∞] Relates to 2004-05.

Unlisted companies BOB Shareholding Limited, Indfund Management Limited, NABARD Consultancy Services Private Limited and NTC (WBAB&O) Limited

2.6.1.3 AS-5 relating to ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies’

Listed companies Mahanagar Telephones Nigam Limited.

Unlisted companies Bhartiya Reserve Bank Note Mudran Limited, Cement Corporation of India Limited, Cotton Corporation of India Limited, HMT Machine Tools Limited, National Insurance Company Limited, Power Finance Corporation Limited and UTI Technology Services Limited.

2.6.1.4 AS-6 relating to ‘Depreciation Accounting’

Listed companies India Tourism Development Corporation Limited^o and Mahanagar Telephone Nigam Limited.

2.6.1.5 AS-9 relating to ‘Revenue Recognition’

Listed companies Bogaingaon Refinery and Petrochemicals Limited, Mahanagar Telephones Nigam Limited and India Tourism Development Corporation Limited^o.

Unlisted companies Hindustan Antibiotics Limited^o, NABARD Consultancy Services Private Limited and State Farms Corporation of India Limited.

2.6.1.6 AS-10 relating to ‘Accounting for Fixed Assets’

Listed companies Mahanagar Telephones Nigam Limited and GAIL India Limited.

Unlisted companies Bharat Sanchar Nigam Limited, Konkan Railway Corporation Limited and Nuclear Power Corporation of India Limited.

2.6.1.7 AS-13 relating to ‘Accounting for Investments’

Listed companies India Tourism Development Corporation Limited^o, Eastern Investment Limited and Mahanagar Telephone Nigam Limited.

Unlisted companies All Bank Finance Limited, and State Farms Corporation of India Limited.

2.6.1.8 AS-29 relating to ‘Provisions, Contingent Liabilities and Contingent Assets’

Listed companies Madras Fertilisers Limited.

Unlisted companies Agriculture Finance Corporation Limited, Industrial Investment Bank of India Limited, Zenith Securities and Investment Limited, Maharashtra Electros melt Limited and NTC (Maharashtra North) Limited.

2.6.2 Statutory Corporations

| Sl.No. | Corporation | No. of the AS | Subject matter of the AS |
|--------|---|---------------|--|
| (i) | <i>Airports Authority of India</i> | 19 | Leases |
| | | 28 | Impairment of Assets |
| | | 29 | Provisions, Liabilities and Contingent Liabilities |
| (ii) | <i>National Highways Authority of India</i> | 15 | Employee Benefits |