

# Compliance Audit Guidelines

(For internal use of OCAG Bangladesh)



**Office of the Comptroller and Auditor General  
of Bangladesh**

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## Foreword

The Constitution of Bangladesh has entrusted the Comptroller and Auditor General (CAG) of Bangladesh with onerous audit responsibilities. Article 128(1) of the Constitution of Bangladesh mandates that the public accounts of the Republic and of all courts of law and all authorities and officers of the Government shall be audited and reported by the Auditor General. Section 5(1) of the CAG (Additional Functions) Act, 1974 further mandates audit by CAG of statutory public authorities, public enterprises and local authorities.

Compliance Audit is one of the most important types of public sector audit. It focuses on whether a particular subject matter is in compliance with authorities identified as criteria. The subject matter can be activities, financial transactions or information. The audit is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities that govern the entity. These authorities may include laws, rules and regulations, budgetary resolutions, policy, established codes, agreed terms or the general principles governing sound public sector financial management and the conduct of public officials.

With the promulgation of Government Auditing Standards of Bangladesh, which are based on the International standards of Supreme Audit Institutions (ISSAI), it is necessary to incorporate new materials relating to Compliance Audit in consonance with the new Auditing Standards in our guidelines.

The guidelines have been prepared to enable the audit personnel of Office of the Comptroller and Auditor General (OCAG) Bangladesh to undertake compliance audit engagements of high quality. Drawing from the international best practices, which ISSAI and the Government Auditing Standards of Bangladesh reflect, these guidelines contextualise them in our country. They take into account the Constitutional and other mandate of the CAG and are designed to meet the challenges that the public sector audit in Bangladesh face.

The guidelines emphasize planning, performance and documentation of audit processes and procedures resulting in audit reports of high quality which will not only assist the members of Parliament to discharge their responsibilities, but also inform the citizens of the state of public finance management in our country.

OCAG has continually strived to improve its processes and practices. The promulgation of Government Auditing Standards, Code of Ethics and Quality Control System is significant step in this direction. The issuance of these guidelines will further enhance our efficiency and effectiveness.

I put on record my deep appreciation of the officers and staff who have worked hard to prepare these guidelines. The guidelines are gender neutral. Words and expressions denoting masculine gender include feminine gender also.

**Mohammad Muslim Chowdhury**

27 May, 2021

Comptroller and Auditor General of Bangladesh  
Dhaka, Bangladesh.

## Preface

With the promulgation of new Government Auditing Standards of Bangladesh, Code of Ethics and Quality Control System, it is necessary to issue fresh guidelines for Compliance Audit. OCAG Bangladesh has a strong tradition of compliance audit, which focuses on regularity and propriety through inspection audit. Historically, the inspection audit emerged as supplementary to central audit but over the long years took centre stage as governmental activities expanded, transactions increased manifold and changes took place in the way the transactions were processed. The audit reports of the CAG of Bangladesh featured many important deviations and irregularities discovered during compliance audit of entities. The object of these guidelines is to introduce further improvements in the practices so that quality service can be delivered to the stakeholders.

CAG of Bangladesh draws his mandate from the Constitution and CAG (Additional Functions) Act, 1974. Detailed rules relating to public audit are issued by him in the form of Audit Code. The Government Auditing Standards of Bangladesh promulgated by him reflect the mandates of the Constitution and the Act as also the directions provided in the Audit Code. The Compliance Audit Guidelines presented here are expected to assist the staff of OCAG to carry out quality audit in accordance with the mandate, directions and standards. These are further supplemented by the office-wise and subject-wise manuals.

It is expected that the guidelines will assist the officers and staff of the Office of the CAG of Bangladesh in carrying out better and improved compliance audit of different types of entities, activities and transactions. While these guidelines are prescriptive in nature, they do not in any way replace initiative, application of professional judgement and knowledge of the officers and staff of OCAG.

These guidelines will be updated periodically or as and when necessary by Rules and Regulations Unit (RRU) of OCAG.

# Chapter 1: Nature of Compliance Audit in OCAG Bangladesh

## *Introduction*

- 1.1 Compliance audit is an independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. Compliance audits are carried out by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities which govern the audited entity.
- 1.2 While compliance audit can be either an attestation engagement or a direct reporting engagement, the Government Auditing Standards of Bangladesh treat all compliance audit engagements as direct reporting engagements. This signifies that the reports of such audits will not be opinions but findings, conclusions and recommendations, if any.
- 1.3 Compliance audit is primarily concerned with regularity and propriety. Regularity is defined as adherence to formal criteria such as relevant laws, regulations and agreements whereas propriety is defined as observance of general principles governing financial management and the conduct expected from the public officials. Both regularity and propriety are considered as main focus of compliance audit.
- 1.4 While compliance audit may cover a wide range of subject matters, primarily OCAG's compliance audit strategy will remain entity oriented. Entity for this purpose is defined as the organisation which is at the apex level and control units under its ambit. The entity may frame policies and take decisions that are applicable to units under its control. From the system point of view, the relation between the entity and units under it resembles parent-child relationship. The balance between thematic cohesiveness and necessity of audit footprints to ensure transparency and accountability among the entities delivering public service by using public resources will be the main objective of OCAG's compliance audit strategy. OCAG intends to meet the challenge through strategic and tactical planning by drawing annual audit plans divided into half yearly tactical audit plan.
- 1.5 Compliance audit can be conducted from different perspectives. It can be conducted in relation to financial audit and performance audit. However, the emphasis will be to conduct compliance audits separately from financial and performance audits and to provide feedback for the purpose of financial and performance audit if the findings are of relevance to the other types of audit. For example, for the purpose of financial audit, such compliance with laws and regulations are important which have a direct and material bearing on the financial statements. Similarly, a string of similar observations found in more than one entity which impact economy, efficiency and effectiveness may be featured in performance audit reports if thematically relevant.



## *Elements of Compliance Audit*

### **Authorities and Criteria**

- 1.6 Authorities are the most fundamental element of compliance audit. Audit criteria in case of compliance audit are derived from authorities. While specific laws, rules and regulations will constitute criteria, equally important are the canons of financial propriety and general principles of public sector management, particularly relating to financial management.
- 1.7 Criteria are the benchmarks against which the subject matter is measured and evaluated. In case of compliance audit, such criteria are provided by the external authorities which are often issued by the Government of Bangladesh or specific entities. These authorities may vary widely. While some like the General Financial Rules are applicable to most public sector entities, there can be specific rules applicable to select types of entities. The principles of financial propriety are also well enunciated. In rare cases, the OCAG may be required to develop criteria against which the activities and transactions of an entity may be evaluated.

### **Subject Matter**

- 1.8 In cases of most of the entities, the subject matter of the compliance audit will be the activities of the entity and units under its control with emphasis on the financial transactions. Since such engagements are not viewed as attestation engagements, the necessity to provide opinion on any subject matter information will not normally arise. However, on occasions, OCAG may be required to attest a statement of compliance prepared in accordance with an established and standardised reporting framework.
- 1.9 The mandate of the CAG of Bangladesh in terms of the Constitution as well as the CAG (Additional Functions) Act, 1974 does not prohibit undertaking compliance audit on any subject matter. OCAG will therefore is free to undertake any audit of any subject matter related to any entity covered by Article 128(1) of the Constitution and Section 5(1) of the CAG (Additional Functions) Act 1974. Such subject matters strictly speaking need not be confined to financial transactions alone but can cover wide range of topics of public interest.
- 1.10 It however needs to be kept in mind that the expertise of OCAG is primarily related to finance. The expectations of the intended users as well as citizens in general from CAG and OCAG relate to financial management and hence compliance audit undertaken by OCAG should not stray far from the financial. This includes the financial aspects of public interest as also possibility of future financial liabilities of the Government.

- 1.11 OCAG does not treat compliance audit as attestation engagements and hence is not required to provide opinion. For the purpose of compliance audit engagements, thus, the subject matter will be reflected in a number of information expected to be maintained by the audited entity. These may range from simple registers to complex information that are to be maintained. Records and Documents, ledgers and journals, cash books and registers of valuables- all will constitute information related to the subject matter for the purpose of compliance audit.

### ***Principles of Compliance Audit***

- 1.12 The essential principles of compliance audit are no different from those related to other types of audit. Scoping of audit keeping in mind the subject matter and criteria is the most important step in planning and performing any compliance audit engagement. Auditors must have an adequate understanding of the audited entities and should have more than adequate understanding of the internal controls of the entity and the control environment in general.
- 1.13 All compliance audit engagements will be undertaken by OCAG with risk assessment to identify risks of non-compliance. The concepts of Audit Risks as enumerated in the Government Auditing Standards of Bangladesh are equally applicable to compliance audit engagements. Audit Risks are seen as functions of Inherent Risks and Control Risks and is reduced to an acceptable level by calibrating the Detection Risks.
- 1.14 While carrying out risk assessments, audit engagement teams of OCAG will consider the risks of fraud. It is reiterated that the audit engagement teams should have sufficient knowledge to identify the indicators of fraud but is generally not expected to have the expertise of a person whose primary responsibility is to detect and investigate fraud.
- 1.15 Similarly, the primary objective of compliance audit engagement is not to identify cases of corruption but to assess the risks of corruption and identify the indicators of corruption and financial malfeasance and report accordingly.
- 1.16 The audit engagement teams will perform audit procedures to obtain sufficient and appropriate audit evidence as is required to cover the audit scope. To achieve this, the team will develop audit strategy and audit plan and determine the audit procedures that are required to obtain sufficient and appropriate audit evidence.

- 1.17 The audit engagement team will exercise professional judgement and scepticism to evaluate the audit evidence and form appropriate conclusions. The main point of the evaluation will be to determine whether sufficient and appropriate audit evidence has been obtained to reduce audit risks to an acceptably low level. The evaluation process entails considering evidence that both supports and contradicts the conclusions. It also requires consideration of materiality. This is a continuing and iterative process during the engagements and the team will expand the audit scope or audit procedures as deemed necessary in the light of such evidence and its evaluations.
- 1.18 The audit engagements are required to maintain rigorous audit documentation, which will include every activity of a team. Such documentation will inter-alia include the audit strategy and audit plan, audit procedures carried out, evidence obtained, application of professional judgement in evaluating the evidence and reporting including basis of such reports.
- 1.19 OCAG will continue to undertake follow up audit to ensure that matters raised in the reports by CAG of Bangladesh submitted under Article 132 of the Constitution are acted upon and corrective action as desired and recommended, are taken.

## Chapter 2: Audit Universe of OCAG and Annual Audit Plan

- 2.1 In the Constitutional framework of Bangladesh, CAG and his office is the watchdog over the public finances of the country. The challenge of compliance audit, one of the principal watchdog functions in the public sector audit domain, is to achieve the balance between thematic cohesion and the need to conduct audit in as many audit units as possible, the latter to ensure accountability of public officials in every government office in every corner of the country, as entrusted by Article 128(1) of the Constitution. It is necessary to ensure that the audit reports do not become a string of disjointed descriptions of individual events which neither give a total picture nor do pass the test of materiality. The key to achieve this is sound entity based audit planning.
- 2.2 The audit directorates in OCAG are organised based on sectors and functions. While there are many things common among these sectors and functions, as for example the organisation of the bureaucratic set up, these also possess unique characteristics- in organisation, services and financial administrations. The department/sector dichotomy needs to be addressed effectively to achieve effectiveness and quality in compliance audit.

### *Entity-based approach to audit planning*

- 2.3 In order to achieve the twin objectives of thematic cohesion in audit reports and coverage of as many auditable units as possible, each audit directorates will prepare entity-wise annual audit plans. Entity for this purpose is defined as a Ministry/Division or Attached Department of the Ministry at sufficiently high level in the hierarchy, under whose control, a good number of units function to deliver public services. The annual audit plan should include entities and units in such a manner that policies, planning and implementation relating to a subject matter are covered adequately so that the audit reports provide the intended users with a comprehensive picture of the compliance aspects of the subject matter.
- 2.4 The audit directorates are the focal points for preparation of annual compliance audit plans. Such plans are required to be prepared as per the time schedule circulated by the Accounts and Reports (A&R) wing of OCAG every year well in time. The audit plans will be implemented only after approval by CAG or an officer delegated with powers in his office. It is expected that the plans are discussed in detail before approval.

## **Entities for Compliance Audit**

- 2.5 The whole gamut of entities which form the audit universe of OCAG are divided into four categories:

### **Category I: Budgetary Central Government**

Budgetary Central Government refers to entities and units, whose revenue and expenditure are regulated by means of budget approved by Parliament. Appropriation Act and Finance Act are used respectively to deal with expenditure and revenue. These entities are covered by Government rules and regulations. The transactions are recognised mostly on cash basis.

Under this category, there will be the foreign aided projects. These may follow normal government rules and/or specific provisions in the conditions for such aid. These are audited either under Article 128(1) and/or as per the agreement for such aid. These are normally project based and can have their own procedures governing financial transactions.

### **Category II: Statutory Public Authorities other than Corporations**

Section 5(1) of the CAG (Additional Functions) Act, 1974 mandates the CAG to audit the accounts of any statutory public authority. Statutory public authorities are organisations which are established through specific law or an instrument having the force of law. Autonomous bodies established by the delegated administrative powers by the Ministries are to be covered within the ambit of statutory public authorities.

### **Category III: Local Authorities**

Section 5(1) of the CAG (Additional Functions) Act 1974 also mandates the CAG to audit the accounts of any local authority. Local authorities are defined in Article 59 of the Constitution and General Clauses Act 1897.

### **Category IV: Public Enterprises and Corporations**

For the purpose of CAG's audit, a public enterprise is defined as a company or a firm, whether incorporated or registered or not, in which the Government has at least fifty percent share or interest. Corporations established by statutes engaged predominantly in commercial activities are also covered by this category.

- 2.6 All four categories of entities come under the compliance audit jurisdiction of CAG. However, these entities, organisationally are complex and comprise of many layers of administrative hierarchy often with Ministries/ Divisions dealing with policy levels and units at the last mile to implement schemes and programmes to provide services to the people. It is essential for effective compliance audit to capture these units at all levels of hierarchy in compliance audit planning.

### ***Criteria for determination of auditable entities and units***

- 2.7 The “auditability” of entities and units will be determined by both quantitative and qualitative factors. The significant factors will be:
- (a) Financial powers of these entities: Such financial powers can be powers to incur expenditure or powers to allocate budget allotment to lower formations. Entities with powers to incur expenditure are of more significance to audit for the purpose of compliance audit.
  - (b) Volume of financial transactions during the last three to five financial years except for routine administrative expenditure which includes pay and allowances.
  - (c) Significant expenditure on procurement of stores and stocks including financial transactions which include payments for goods and services received.
  - (d) Operational significance in achieving outcome: While a particular unit may not have significant operational and financial significance, its value in implementation of policies or role in achieving overall outcome can be important.
  - (e) Functional autonomy and delegation of powers: Units having substantial functional autonomy and powers- financial powers in particular- are important from the point of view of compliance audit.
  - (f) Complexity of transactions: While volume and number of transactions are important factors, often the transactions may not be voluminous or in huge numbers but extremely complex. Transactions in the financial and banking companies, insurance or involving future contingencies need special attention during compliance audit.
  - (g) Significant devolution of administrative and financial powers including powers to allocate sums of money to lower formations and attendant powers to re-appropriate allocated sums.
  - (h) Operational significance of the unit in the overall scheme of service delivery.
  - (i) The unit being recipient of significant amount of stores and stocks like drug depots and stores.
  - (j) Role of the unit in providing critical services to other branches of the government or to the people in general.

- (k) Role of the unit in exploiting public resources including natural resources or allowing others to exploit such resources e.g. licensing units, Public Private Partnership Cell etc.
- 2.8 Preparation of audit universe identifying all units will be the responsibility of each directorate. The list of all audit units as a master list, whether to be audited or not, will be maintained by the directorates and periodical updation of the list will be carried out.

### ***Source of Inputs for Annual Plan***

- 2.9 The sources from which inputs may be gathered to prepare annual audit plan are:
- (i) Budgets and appropriations;
  - (ii) Annual Development Programmes and Plans;
  - (iii) Annual Reports of the Ministries/Divisions and Departments;
  - (iv) Policy announcements of the Ministries/ Budget announcements/ introduction of new schemes and programmes;
  - (v) Trends of expenditure/ receipts/ Unusual spikes or dips in expenditure or receipts from iBAS++ and any other source;
  - (vi) Suggestions of PAC and other Parliamentary Committees;
  - (vii) Media Reports;
  - (viii) Past Audit findings/ Audit reports/ Follow up of past audit reports;
  - (ix) Annual Reports of Companies and Statutory public authorities;
  - (x) Geographical locations and distance from the unit from the Capital or district headquarters;
  - (xi) Finance Accounts and Appropriation Accounts/ financial statements of the authorities.

### **Risk based approach to Compliance Audit Planning**

- 2.10 At the heart of the annual plans, is the risk based approach to compliance audit. While determining the audit universe in any sector and more importantly, choosing units for compliance audit, high risk areas and activities must attract attention and should be prioritised. The overall objective of selecting units for compliance audit thus should be a meaningful audit report which provides a fuller picture rather than highlighting individual sporadic transgressions.
- 2.11 Primarily the risk based approach should determine the importance of the sector in the overall scheme of governance. Welfare and social measures are important enough but other important areas can also include safety of citizens, defence preparedness, infrastructural readiness and long term financial goals of the government. All units selected for compliance audit must satisfy these rationales.

2.12 While identifying the audit areas and entities, the potential risk of non-compliance should be considered. The following considerations are suggested to be kept in mind in this exercise.

- (a) Public or legislative expectations;
- (b) Impact on citizens;
- (c) Significant public funds involvement;
- (d) Beneficiaries of Public Funds;
- (e) Significance of certain provisions of law;
- (f) Principles of good governance;
- (g) Potential breaches of applicable laws and other regulations which govern public entity's activity or public debt, public deficit and external obligations;
- (h) Public Resources like land handed over to private parties for general benefit of citizens;
- (i) Impairment of commons and public goods;
- (j) Potential of creation of future liabilities for the government.

### Financial Transactions as *focus of Compliance Audit*

2.13 The primary focus of compliance audit will continue to be financial transactions. This includes not only the transactions that have occurred but those that have not occurred but should have. These would cover delays and losses, wastes and leakages.



## Chapter 3: Important Authorities

- 3.1 Compliance audit is defined as examination whether a particular subject matter is in compliance with authorities identified as criteria. Criteria are benchmarks to evaluate the subject matter. Authorities have been considered as the most fundamental element of compliance audit. They are considered as the foundational structure of compliance audit as they form the basis of how the audit is to proceed under a specific constitutional arrangement.
- 3.2 It is important for an audit engagement team to be well-conversant with the set of authorities that govern a particular entity and units under its control or associated with it. Statutory Public Authorities, Local Authorities and Public Enterprises may have separate set of authorities which would govern their functions. A public enterprise, for example, is bound by Companies Act, 1994.
- 3.3 The following paragraphs provide a survey of authorities which will be essential for conducting compliance audit. These are not exhaustive and there may be additional authorities which will be applicable to the entities.

### General

- 3.4 The general authorities are:
- (i) Constitution of Bangladesh: The Constitution of Bangladesh is the Supreme law of the Republic. All individuals and entities are required to abide by the Constitution and uphold the values and the provisions of the Constitution in letter and spirit.
  - (ii) Rules of Business 1996: Rules issued for allocation and transaction of business of Government of Bangladesh.
  - (iii) Official Secrets Act 1923(as amended): Law related to management of official secrets of Bangladesh.
  - (iv) Right to Information Act 2009: An act to ensure free flow of information and people's right to information.
  - (v) Public-interest Information Disclosure Act (Provide Protection), 2011: Also known as Whistle-blowers Protection Act, this act provides for legal protection to persons disclosing information relating to public interest.
  - (vi) Contracts Act 1872 (as amended): All contracts are covered by this act.
  - (vii) Public Procurement Act 2006: The act provides for procedures to be followed for ensuring transparency and accountability in the procurement of goods, works and services using public funds.
  - (viii) Public Procurement Rules 2008: The rules are pursuant to the Public Procurement Act 2006.
  - (ix) Public Demand Recovery Act 1913 (as amended): The act relates to recovery of public demands of Bangladesh.

- (x) National Integrity Strategy 2012: The document lays down the road map to prevent corruption and promote integrity.
- (xi) Treasury Rules and Subsidiary Rules made thereunder: The Rules lay down rules of receipts and payments into government account (exchequer).

### **Acts specific to class of entities**

3.5 The following are the Acts which are applicable to specific class of entities. These do not include individual acts relating to statutory public authorities as defined in Article 152 of the Constitution of Bangladesh reproduced in Section 5(1) of the CAG (Additional Functions) Act, 1974:

- (i) Companies Act 1994: All public enterprises as defined in Section 5(1) of the CAG (Additional Functions) Act, 1974 are governed by this Act.
- (ii) Bank Companies Act 1991: The act governs all banks.
- (iii) Financial Reporting Act 2015: Establishes a council to provide a structure to the financial reporting systems; for the organisations as stipulated in the Act to promulgate accounting and auditing standards and their adherence.
- (iv) Financial Institutions Act 1993: The act relates to licensing financial institutions and other related matters.
- (v) The Bangladesh Bank Order, 1972 (President's order): Relates to Bangladesh Bank, the Central Bank of Bangladesh. Bangladesh Bank is the banker of the Government of Bangladesh and maintains Treasury Single Account (TSA).
- (vi) Bima Corporation Act 2019: Establishes the Insurance companies: Jiban Bima and Sadharan Bima.

### **Acts and Rules relating to service conditions of Public Servants**

- (i) Sarkari Chakri Ain, 2018.
- (ii) Government Servants (Conduct) Rules 1979.
- (iii) Government Servants (Discipline and Appeal) Rules, 2018.
- (iv) Provident Funds Act 1925, General Provident Fund Rules, 1979 and Contributory Provident Fund Rules 1979.
- (v) Bangladesh employees welfare board act. 2004
- (vi) Bangladesh Service Rules.
- (vii) Prescribed Leave Rules 1959.

## **Acts, Rules and Documents governing financial transactions and other business of government**

- (i) The Public Moneys and Budget Management Act, 2009
- (ii) The Public Debt Act, 1944 (as amended)
- (iii) Fundamental and Supplementary Rules.
- (iv) General Financial Rules (GFR)
- (v) Treasury Rules.
- (vi) Delegation of Financial Powers.
- (vii) Development Projects Fund Release Order.
- (viii) Budget Documents.
- (ix) Citizens' Charters.
- (x) Bangladesh Accounting Standards.
- (xi) Account Code Volume I to IV.
- (xii) Appropriation Acts and Finance Acts.

## **Acts, Rules and Codes specific to Sectors/ Departments**

### **Defence**

- (i) Army Regulations Volumes I & II.
- (ii) Joint Service Instructions.
- (iii) Rules regarding TA/DA, Leave, Passage Regulations, Provident Fund.
- (iv) Military Account Code.
- (v) Military Audit Code.
- (vi) MES Regulations.
- (vii) Financial Regulations I and II

### **Railways**

- (i) Railway Establishment Code Volumes 1& 2.
- (ii) Railway Fundamental and Supplementary Rules.
- (iii) Railway Servants (Discipline and Appeal) Rules, 1968.
- (iv) Railway General Code.
- (v) Railway Engineering Code.
- (vi) Railway Stores Code.
- (vii) Railway Code for Accounts Department.

**Public Works Department**

- (i) CPWD Code.
- (ii) Book of Specification and Code of Practice.
- (ii) CPWA Code.

## Chapter 4: Audit Strategy and Audit Plan

- 4.1 Audit strategy and audit planning of individual units are closely linked to the annual plan. The overall objectives of the annual plans segmented into half-yearly plans are to be achieved by audit of individual entities and units. The annual plan in that sense is of the nature of strategic plan and the half-yearly plans are in the nature of tactical plans and the audit of individual units must serve the purpose of the strategic and tactical objectives.
- 4.2 As has been stated earlier, risk based audit planning is at the heart of audit plans. Seen from this point of view, audit strategy of each individual audit engagement is essentially a response to the risks of non-compliance with authorities by the audit unit. The considerations that should determine the audit strategy are the objectives of the engagement, subject matter and criteria and resultant scoping of the audit.
- 4.3 Compliance audit strategy must address four basic questions namely (i) whom to audit (ii) what to audit (iii) when to audit and (iv) where to audit. Essentially this would mean the scoping of audit. Treating each engagement as a disparate exercise without any thematic cohesion will defeat the purpose of the strategic and tactical audit plans and should be avoided.
- 4.4 Audit strategies in case of compliance audit can adopt any of the two basic approaches. The thematic approach endeavours to achieve thematic cohesion by undertaking theme based compliance audit in one or more entities and units. For example, to examine the functioning of Primary Health Centres (or even a narrower subject in these PHCs), a good sample of PHCs can be taken up for compliance audit in a year and results reported under one heading. The entity-based approach covers units under one entity to examine the functioning of the units under its control in general. The office of the DGHS and units under him can be undertaken for compliance audit. Multiple themes may emerge in these audits.
- 4.5 Peripatetic inspection parties without an overall objective should be avoided at all costs. The risk of audit reports being records of exceptions and of minor transgressions devalue the audit process and trivialise the audit reports. The overall purpose of any audit strategy in compliance audit must be substantive “takeaways” for the intended users, policy planners, members of the Parliament and citizens in general. Sporadic transgressions are forgiven easily.
- 4.6 The close linkage between the annual plan, half-yearly plan and the audit of individual units is, therefore of utmost importance. While determining the audit strategy for the individual units, the primary focus should be to fulfil the overall planned objectives.

## Period of audit

- 4.7 Topicality and relevance are two important aspects of compliance audit. No compliance audit should cover a period of more than three financial periods preceding the current period. In case the audit engagements are general in nature without any thematic content, the period covered should be from the last audit to the time of the current audit. Normally such periods should not cover more than three financial periods for important units.
- 4.8 If the risk assessment for the unit calls for intensive audit covering more financial periods than recommended above, the same should be mentioned in the audit strategy and audit plan document by the audit engagement team.

## Criteria

- 4.9 Determination of criteria is one of the most important steps of compliance audit. Criteria are benchmarks against which the audit evidence is evaluated and conclusions drawn. Part of the audit strategy will be to determine the audit criteria for the theme or the entity. No compliance audit engagement- either thematic or entity-based will be undertaken without determining the criteria.
- 4.10 It is possible that during the audit engagement, in view of the new evidence emerging, criteria may be revised and audit procedures expanded.
- 4.11 The following characteristics of criteria should be kept in mind:
- (i) **Precision:** The criteria adopted by the audit engagement team must be precise and implementable for the subject matter of audit. Laws, Rules and Codes are normally precise but guidelines and advisories, manifestos and calls for actions can often be vague and unimplementable. Guidelines issued by many supranational organisations are normative in nature and unless supported by national directives cannot be treated as precise criteria.
  - (ii) **Relevance and Reliability:** The criteria must be relevant to the subject matter of audit. The criteria must also have the force of an authority applicable to the audited entity. The audit engagement team should be well advised to follow concepts of (canons) standards of financial propriety as described in the GFR rather than bringing in their own ideas as to what the standards should be.
  - (iii) **Clarity:** The criteria must be clear in as much as all reasonably knowledgeable persons should interpret the criteria in the same way. Normally, criteria for compliance audit should not have interpretational differences between the audited unit and the audit engagement team. However, should such a case arise, the audit engagement team must in its report document the criterion, the interpretational difference and the basis of interpretation by the audit.
  - (iv) **Objectivity:** The criteria must be objective and free from bias. Such criteria should be applicable to all units of similar nature and not to one unit in particular. Similarly, any criterion should be known to the responsible party and to the audit team.

## Exceptions in case of IT systems

- 4.12 In several areas, particular in compliance audit of IT systems, suitable criteria may not be found in government directives. The principle of equifinality in developing systems lead to systems being developed following different methodologies. The System Development Life Cycle methodologies can also differ from system to system. Similarly, aspects like IT security may take different forms.
- 4.13 Criteria to be adopted by the audit engagement team in compliance audit of IT systems may face problems of acceptability. Often steps of additional IT security need substantial investment.
- 4.14 In such a situation, the audit engagement team will adopt a consistent benchmarking framework and evaluate the systems against the benchmarks. Frameworks like COBIT<sup>1</sup> are internationally accepted and audit engagement teams will use this framework to perform compliance audit of IT systems.

## Audit Calendar

- 4.15 Each year, A&R wing of OCAG will issue audit calendar containing timelines for a full audit cycle from audit planning to reporting.

Form1/CA/OCAG Bangladesh

## Audit Strategy Form for Compliance Audit

### Part I

<b>Name of the Entity</b>	
<b>Financial Period to be covered (MM/YY to MM/YY)</b>	
<b>Directorate</b>	
<b>Annual Plan Reference No</b>	
<b>Thematic/Entity Based</b>	
<b>Audit Engagement Code</b>	
<b>Audit Engagement Team</b>	

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<sup>1</sup> Control Objectives for Information and Related Technologies (COBIT) is an IT Governance Framework by ISACA.

<b>Team Leader</b>	
<b>Officer responsible for Direction, Supervision and Review</b>	

## Part II

<b>Brief Description of the Subject matter of the Engagement</b>	
<b>Authorities</b>	
<b>Category as per the guidelines (I/II/III/IV)</b>	
<b>Proposed Commencement Date of the Audit</b>	
<b>Proposed End Date of the Audit</b>	
<b>Experience of Previous audits of the entity</b>	
<b>Locations and Units to be visited for Field Work</b>	
<b>Audit Inspection Report to be submitted by (Date)</b>	
<b>Preliminary Inherent Risk Assessment</b>	
<b>Preliminary Control Risk Assessment</b>	



**Part III**

<b>Period to be covered in Audit</b> <b>(MM/YY to MM/YY)</b>	
<b>Judging by preliminary Inherent and Control Risk assessment, efforts required of the engagement team</b> <b>(High/ Medium/Low)</b>	
<b>Whether expert from outside is necessary</b>	
<b>Range of Transactions required to be verified</b>	
<b>Range of documents required to be verified</b>	
<b>Range of other information to be verified</b>	
<b>Whether data are available on IT and to audit</b>	
<b>Preliminary assessment of the possibility of carrying out substantive procedures on data available to audit by using CAATs</b>	
<b>Proposed Date of meeting management/ entity personnel to set up the audit (DD/MM/YY)</b>	
<b>Other important points including significant industry development/ changes in laws or any other relevant development</b>	

# Audit Plan Form for Compliance Audit

## 1. Preliminary Information

1.1 Name of the Entity

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1.2 Financial Period to be covered (MM/YY to MM/YY)

--

1.3 Period of Audit

From

(DD/MM/YY)

--

To

(DD/MM/YY)

--

1.4 Name of the members of the Audit Engagement Team in terms of Seniority( Team Leader at Sl No 1)

Sl No	Name	Revised
1		
2		
3		
4		
5		

1.5 Document No of Audit Strategy

--

1.6 Total Number of Working Days

Original
Revised
Actual

2. Knowledge of the Entity

2.1 Important Characteristics of the Entity

2.2 Revision/ Addition

2.3 Financial Performance/Parameters

	Initial	Revision/ Addition
1		
2		
3		
4		
5		
6		
7		
8		

2.4 Inherent Risk Assessment

2.5 Control Risk Assessment

2.6 Detection Risk

2.7(i) Overall Materiality Benchmark

2.7(ii) Overall Materiality in Bangladesh Taka

2.8 Complex Transaction Areas (Attach Additional Sheet, if necessary)

[illegible]

**3. Main Audit Areas (Attach Additional Sheet, if necessary)**

[illegible]

**4. Procedure Details (EMH: Estimated Man Hours; AMH: Actual Man Hours)**

Proposed Analytical Procedures	EMH	AMH	Detailed Testing Procedures	EMH	AMH

**5. Documents consulted before preparation of the Audit Plan**

Sl No	Description
1	
2	
3	
4	
5	
6	
7	

(Signature of the Team Leader)

Audit Engagement Team

(Signature of the Officer in charge of Direction, Supervision and Review)

### Suggested Main Areas for Compliance Audit

Audit Area	Audit Objectives
Cash and Cash Book Management	<p>To examine whether the entity has managed the cash available to it on a day to day basis in accordance with rules and sound financial judgement.</p> <p>To examine that the cash book has been closed daily and balances struck and tallied with physical cash available in cash chest.</p> <p>To examine that the cash chest has been physically verified by a person other than the cashier and his supervisors.</p> <p>To examine that no unauthorised cash advances have been made from the cash chest.</p>
Spot(cash) purchase	<p>To examine that the spot(cash) purchases have been made as per rules and sound financial judgement.</p> <p>To examine that the procurements have not been split to bring them within the permissible limit of local purchases.</p> <p>To examine that proper price discovery process has been resorted to in such purchases.</p>
Maintenance of Registers and Records	<p>To examine that all Registers and Records that are required to be maintained have been maintained.</p>
Submission of Reports and Returns	<p>To examine that all reports and returns that are required to be submitted to higher authorities have been submitted.</p>

### Suggested Main Areas for Compliance Audit

Audit Area	Audit Objectives
Plant and Machinery Efficiency (Particularly relevant in Welfare infrastructure like Health, Education, Community Development etc.)	<p>To examine whether infrastructure available are being used properly or lying idle.</p> <p>To examine whether the entity has suffered any loss due to non-functioning of any equipment (e.g. X-Ray machine for lack of UPS/ Voltage Stabiliser).</p> <p>To examine whether both Hard infrastructure and soft infrastructure are available. (Doctors are available but OT is not; OT is available but Nurses are not).</p> <p>To examine that the infrastructure that are available are in working condition and serviceable.</p> <p>To examine that the personnel are available to utilise the infrastructure.</p> <p>To examine that Health professionals or Educational professionals are available to run the Health and Educational infrastructure.</p>

Audit of Sanctions	<p>To examine that the sanctions are within the delegated powers.</p> <p>To examine whether funds are available.</p> <p>To examine requirements have not been split to avoid referring the case to higher authority.</p>
Stocks and Stores	<p>To examine whether all registers related to stocks and stores have been maintained properly.</p> <p>To examine that regular physical verifications are carried out.</p> <p>To examine that the unserviceable stores and stocks are verified.</p> <p>To examine the consumption of stocks and stores</p>

## Typical Records that are required to be checked during compliance audit<sup>2</sup>

Acquittance rolls.

Agreements.

Bill Registers.

Book of Indents of Stores.

Cash book.

Cheque Register

Contingent register.

Contractor's ledger.

Day Book<sup>3</sup> of Cash Sales

Day Book of Credit Sales

Day Book of Realisations.

Estimates

Log Book of Vehicles.

Lease Deeds.

Purchase Order Book.

Receipt books and Register of receipt books.

Register<sup>4</sup> of Condemned Vehicles.

Register of Deposits

Register of Lapsed Deposits.

Register of Law Suits.

Register of liveries.

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<sup>2</sup> This lists most of the possible documents that may be required to be audited. However actual inspection will depend on the scope of audit and the risk assessment of the audit engagement team. Not all Registers etc. may be required in all offices.

<sup>3</sup> Normally in Departments with very small manufacturing units like Jails etc.

<sup>4</sup> The term Register is used to denote information. There may not be a Register in a traditional sense but the information should be available in any form including electronic form.

Register of Permanent Advances.

Register of tools and plant (drawing and mathematical instruments, etc.).

Register of receipts on account of sale.

Register of remittances into Treasury

Register of sanctions to estimates.

Register of Security Deposits.

Register of temporary advances.

Register of Trees.

Register of undisbursed pay.

Register of Unserviceable Articles.

Register of unpaid wages.

Register of Valuables.

Register of Vehicles and Vehicles maintenance.

Register of Works

Service books and register of service books.

Stamp account.

Stock accounts.

Stock registers.

Stock Registers of Arms, Ammunition and Accoutrements.

Stock Registers of Bill Books and Receipt Books;

Storekeeper's cashbook.

Tenders and contracts.

Works abstract



## Chapter 5: Common checks for Audit of Expenditure

- 5.1 Audit of expenditure constitutes significant part of compliance audit. As Government expenditure increases, so do the number of transactions. A transaction related to expenditure is normally recorded in the instrument of voucher. The main objects of audit of expenditure are to ensure:
- (a) that the expenditure has been incurred by an officer competent to incur it;
  - (b) that the expenditure has received the sanction of the authority competent to sanction it;
  - (c) that if it is a votable expenditure, it is covered by an allocation from a grant voted by the Parliament or by re-appropriation within such a grant or by a supplementary grant by the Parliament;
  - (d) that if it is a non-votable expenditure, there is provision of funds sanctioned by the competent authority to cover it;
  - (e) that the expenditure does not involve a breach of any canon of financial propriety;
  - (f) that payment has, as a fact, been made and has been made to the proper person and that it has been so acknowledged and recorded so that a second claim against Government is impossible;
  - (g) that the charge is correctly classified and that if the charge is debit to the personal account of the contractor, employee or other individual or is recoverable from him, it is recorded as such in the prescribed account.
- 5.2 The primary information on subject matter for the purpose of audit of expenditure is the voucher or the record of information of payment in an IT system. It is the principle of the government expenditure that payment out of a government account cannot be made without a legitimate claim. A bill before payment is the claim and the same bill is treated as a voucher after payment for the purpose of recording. The Drawing and Disbursing officer prepares the claim in the form of the bill and submits the same before the payment authorities. Thus the sequence of expenditure can be described as a claim leading to payment, if the claim is found legitimate and then the accounting of the payment. Audit of expenditure is primarily concerned with the vouchers as record of payment and thus a competent audit of vouchers is the main component of compliance audit of expenditure. Audit of transactions therefore takes place at the point of the Drawing and Disbursing Officer (DDO).
- 5.3 Compliance audit of expenditure, therefore, primarily centres around the Drawing and Disbursing officer, who maintains all records of expenditure. A voucher, in whatever form, is the primary record of expenditure. It contains, inter-alia, the amount, nature and period of payment, chart of accounts under which the payment will be recorded and in addition contains a receipt or acknowledgement of acquittance of the person to whom the payment is due. As it is the duty of audit to verify the original records, the audit of vouchers is the first step and the most important step of compliance audit.
- 5.4 The primary audit examination of vouchers should ensure that:
- (a) A proper sanction, specific or general, signed by the competent authority, authorising the expenditure exists: No expenditure can take place without an express sanction of the competent authority relating to the specific expenditure unless such expenditures are covered by a general order e.g. pay and allowances of staff. The sanction should clearly

indicate the gross amount, the object of expenditure, conditions of payment, the classification code against which the amount would be accounted for, confirmations of budget availability and the payee.

- (b) The sanction is accompanied by requisite budgetary allocation: For meeting expenditure out of the consolidated fund, budgetary provisions are required. Often the one to one relationship between the grants as passed by the Parliament and specific DDO may be missing, as the allocation of various grants are further sub-divided into allotments for offices.
- (c) Vouchers and Sub-vouchers are available and the total of sub-vouchers add up to the amount shown in the voucher: Most importantly, vouchers and sub-vouchers should be available in proper form. The following attributes of vouchers are to be checked:
  - (i) That the vouchers are in prescribed form;
  - (ii) That they are numbered properly;
  - (iii) That they are signed in ink by the Drawing and Disbursing officer;
  - (iv) That they bear a Pay order;
  - (v) That the account classification codes are mentioned correctly and such codes represent the true nature of the expenditure;
  - (vi) That all details match the sanction;
  - (vii) Vouchers are arithmetically accurate: The details should work up to the totals.
  - (viii) Vouchers are supported by requisite documents: All supporting documents as required like sanctions, acquittance rolls etc. should be attached.
  - (ix) Payment is actually made to the proper person and proof of payment exists: There is Payees stamped receipt (PSR).
  - (x) Expenditure is not in the nature of advances withdrawn at the fag end of the financial year: Some of the crucial ingredients like PSRs etc. may be missing in such payments. However, in case of such vouchers, it is worthwhile to examine the nature of sanctions and whether such sanctions have been signed by the competent authorities. Another point for examination would be to identify the purpose of the expenditure.
  - (xi) Money withdrawn from the government account has not been parked in any other account outside the government account or to avoid lapse of budget has not been transferred to any account under Public Account of the Republic without any authorisation. The examination should specifically focus on the sanction, purpose and payee for the expenditure.
  - (xii) No money is drawn unless is required for immediate disbursement: The occasion for payment should have arisen before the bill is presented.
  - (xiii) There is no erasing or overwriting in handmade bills: All overwriting must be duly attested and should be valid. Chances of fraud are real in such cases.
  - (xiv) If the voucher relates to stocks and stores, all materials and stores in the vouchers have been entered in the relevant stock registers: For stores already delivered, the stores ledger numbers should be recorded.
  - (xv) The quality and quantity of stores are certified before payment: The competent

officer must certify the receipt of stores in correct quality and quantity.

- (xvi) The rates paid are not in excess of the rates accepted in the sanction and they do not exceed either the market rates widely or any other rate laid down by the Government;
- (xvii) The amount and quantity of stores and stocks agree with the entries in the stock register;
- (xviii) Acquittance rolls are maintained properly and amounts are disbursed to persons who are entitled to receive the amount.
- (xix) All Travels are duly approved by the competent authority and allowances have been drawn as per entitlement.

## Chapter 6: Audit Checks for Compliance Audit

- 6.1 While the audit checks of records mentioned in the previous chapter are common to all entities, a few important entities require checks of additional records. While the records listed are not exhaustive, these are important and in addition to the records mentioned in the previous chapter.

### *Educational Institutions*

- 6.2 Additional records that need to be checked in educational institutions, as applicable, are as follows:

- (1) Register of Fees collected from Students;
- (2) Counterfoils of Receipt Book of Fees;
- (3) Register of Refund of Fees;
- (4) Register of Scholarships;
- (5) Register of Stipends;
- (6) Caution Money Register;
- (7) Library Register;
- (8) Catalogue of Library Books;
- (9) Register of Books issued from Library;
- (10) Register of Fines;
- (11) Hostel Accounts;
- (12) Admission Register;
- (13) Register of concession to students;
- (14) Transfer Certificate Book.

- 6.3 The receipts of an educational institution may consist of the following:

- (1) Admission and Readmission Fees;
- (2) Tuition Fees;
- (3) Laboratory Fees;
- (4) Fines;
- (5) Recoveries on account of breakages;
- (6) Library and Laboratory Deposits;
- (7) Hostel rents and Rent for quarters allotted to academic faculty and staff;

- 6.4 Cash Book: In addition to the checks as mentioned in Chapter 9, the cash book of an educational institution should be reconciled with the various fees received as recorded in the relevant fee registers.

- 6.5 It should also be examined whether grants-in-aid received from any authority have conditions attached to it and whether those conditions have been fulfilled. No amount should be diverted for any reason without proper authority.
- 6.6 Refunds of caution money should be verified with the original deposits.
- 6.7 Stock registers of library books and laboratory consumables should be checked to ensure that these registers are properly maintained and there is no unusual issue of books or consumables.
- 6.8 Normally, institutions of higher education incur significant expenditure in purchase of library books. It should be ensured that books have been purchased by following laid down procedures. In case such procedures are not documented, audit may point out lack of documented procedures, which is lack of internal control.
- 6.9 An educational institution may also have non-government funds as fees collected for extra-curricular activities, games and sports, cultural fetes etc. It should be checked that the institution has dealt with these funds responsibly and such funds have not been mixed up with the main funds of the institution.

### ***Government Hospitals<sup>5</sup>***

- 6.10 All common checks in Chapter 5 should be carried out.
- 6.11 Additional records that need to be checked in Government Hospitals, as applicable are as follows:
- (1) Rent of Pay Wards;
  - (2) Hospital charges including fees for medical attendance, pathological and other examinations and laboratory charges, cost of operations and drugs, recovery of diet charges etc. including recovery of rent from staff provided with quarters;
  - (3) Sale proceeds of medicines;
  - (4) Ambulance Hire and log books of ambulances;
  - (5) Contributions from public bodies and income from endowments;
  - (6) Donations;
  - (7) Recovery of Charges for services provided to outside including blood bank services;
  - (8) Stock accounts (including Priced Stores Ledger Account) of Drugs and Medicines, Consumables, Sera and vaccines, Linens and Crockeries, Diet Materials;
  - (9) Stock accounts of Surgical Instruments and appliances;
  - (10) Log Books of HVAC (Heating, Ventilation and Air Conditioning) facilities and medicinal gas;

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<sup>5</sup> Does not include Mental Hospitals

## **6.12** *The following additional checks for Hospitals are recommended:*

- (1) Nominal registers of in-patients should be checked to ensure that these are filled in correctly and properly. These should be on a sample basis checked with reference to other information like issue of medicines, charges for pathological examinations, diet charges so that broad reconciliation is possible.
  - (2) The audit should examine thoroughly whether there are arrears in recovery of charges and reasons thereof.
  - (3) Dues from Governments/ Government Institutions as reimbursement of charges for patients otherwise entitled for cashless services should be examined.
  - (4) On a sample basis, it should be checked that recoveries have been made as per the rates laid down.
  - (5) That all receipts are brought to cash book promptly and deposited into Government Account promptly.
  - (6) Recoveries from staff have been made as per rules.
  - (7) Pay and Allowances of medical professionals should be checked in detail.
  - (8) All accounting books like bill books, receipt books, bill demand registers, bill collection registers etc. should be examined in detail and should be cross verified from other records.
  - (9) Local Purchase of medicines and other consumables should be examined in detail to ensure that the laid down procedures have been complied with, there is a price discovery mechanism for emergent local purchases and there is no undue delay in procuring life-saving drugs through local purchase.
  - (10) Wastage of medicines due to expiry may be examined in detail.
  - (11) The kitchen accounts should be examined in detail to ensure that the diets are provided as per recommendations of the dieticians and there is a price discovery mechanism for daily supplies.
  - (12) Stock book of diet articles should be examined in detail.
  - (13) The linen accounts including the accounts related to washing of linens should be examined in detail.
  - (14) The accounts relating to crockeries including those of breakages should be examined in detail.
  - (15) Stock accounts of Drugs and Medicines, Sera and Vaccines, surgical instruments and appliances should be examined to ensure that all stocks received from all sources have been recorded in the registers under signature of proper authority.
-

## ***Medical Colleges***

6.13 The audit of medical colleges will be a combination of audit of government hospitals and educational institutions.

## **Upazilla Health Complex/Sub Centres**

6.14 The records maintained in these health centres will map to the records mentioned in this chapter in respect of other audit units. The following audit checks are recommended:

- (1) Proper record of drugs and medicines is maintained and the same is physically reconciled regularly.
- (2) Log books of vehicles and other instruments, if applicable, are maintained properly;
- (3) The registers with regard to the patients are maintained properly;
- (4) The Centres with in-patient facilities should be checked with reference to audit checks, as applicable to the scale of the centre, for the government hospitals;

## ***Judicial Departments***

6.15 Apart from the normal compliance audit, judicial departments may have considerable deposits. The deposit register(s) will be the main items of audit. The checks are:

- (1) The credits in the registers should be agreed with the entries in the cash book and counterfoils of the receipt books;
- (2) The vouchers of repayment of deposits should be checked with the entries in the register of payment orders;
- (3) The repayment of deposits should be checked with the original credits;
- (4) That any repayment of deposits if paid from lapsed deposits, has been paid by following the extant rules and orders;
- (5) The methods of cash deposits should be checked to ensure that cash is deposited in the government accounts promptly;
- (6) The government accounts balance and deposit registers should be independently reconciled by the audit engagement team.

## ***Police Departments***

6.16 In addition to normal compliance audit, the following areas in the Police Departments should receive attention of the audit engagement team:

- (1) Police Transport, which inter-alia, should include examination (of):
  - (i) Register of vehicles and repair of vehicles;
  - (ii) Hire charges of vehicles;
  - (iii) Accounts of spare parts, unserviceable stores, condemned vehicles;
  - (iv) POL expenses;
  - (v) Contracts for repairs/ supply of POLs/ Spare parts;

- (2) Clothing equipment, which inter-alia should include examination (of):
  - (i) Stock registers tally with quantities received as shown in invoices, contingent bills and issues;
  - (ii) Articles are issued according to scale;
- (3) Arms and ammunition register, which inter-alia should include examination (of):
  - (i) That registers are maintained properly;
  - (ii) That arms are handed over to safe custody, when required and records are maintained

## ***Personal Ledger Account***

- 6.17 Personal Ledger Accounts are such accounts which are maintained on the principles of personal deposit accounts under the orders of the government. The most important aspect of these accounts is that money can be withdrawn from Consolidated Fund and transferred to Public Account of the Republic. Similarly receipts which should otherwise go to the Consolidated Fund can be kept in the Public Account of the Republic.
- 6.18 The object of audit of personal ledger account is to ensure that initial accounts of the amounts are properly maintained, that officers operating these accounts do not delay remittances into the accounts of moneys received by them and they do not make withdrawals to divert the funds to purposes unconnected with the account.
- 6 19 Apart from the general compliance audit, the following checks should be conducted by the audit engagement team in respect of personal ledger accounts:
- (1) Receipts for moneys received by the administrator of the account are promptly issued and these amounts are brought to account without delay i.e. on the same day;
  - (2) Withdrawals are for the purpose allowed for the account;
  - (3) Receipts and withdrawals agree with the amounts shown in the passbooks or similar records;
  - (4) All expenditures are supported by vouchers and sub-vouchers;
  - (5) All expenditures are in accordance with the objective of the personal ledger account;
  - (6) Regular reconciliation is done by the administrator of the account with the records maintained in the accounts offices and discrepancies are resolved without delay;
  - (7) The circumstances of opening the personal ledger account continues to exist;
  - (8) Annual balances are worked out properly and agree with the balances reflected in the finance accounts of the government.



## **Chapter 7: Audit of Procurement**

- 7.1 Procurement is defined in the Public Procurement Act 2006 and Public Procurement Rules 2008 of Bangladesh as purchasing of goods or hiring of goods or acquisition of goods through purchasing and hiring and the execution of works and performance of services by any contractual means. In other words, procurement would mean acquiring or hiring of goods and services. Contractual agreement whether for supply of goods or provision of services is the essence of procurement in public sector.
- 7.2 The fundamental aspect of procurement in public sector is to ensure transparency and accountability in the procurement of goods and services using public funds. The other equally important aspects are to ensure equal treatment and free and fair competition among all persons wishing to participate in such procurement. Inherent in the above aspects, is the principle of price discovery so that public procurement is carried out by ensuring value for money i.e. to procure quality goods and services at the least cost.

### ***Elements of Procurement***

- 7.3 The following elements must be present in a sound procurement system:
- (1) There should be graded financial powers i.e. officials of different hierarchy should have financial powers to approve procurement within those powers- i.e. a structured delegation of financial powers;
  - (2) There should be written down decision making process- either collegiate or individual based- the decision making process should involve determining necessity, price discovery process including tendering procedures, finalising the price and recommending the award of contract.
  - (3) There should be a mechanism to ensure contract management- that the goods and services required to be procured have indeed been procured in the quantity and quality envisaged;
  - (4) A payment system – that payments would be made on satisfactory fulfilment of the conditions in the contract;
  - (5) A dispute resolution system- to have an impartial dispute resolution mechanism involving third party, if necessary.

### ***Principles of Audit of Procurement***

- 7.4 The following principles must be kept in mind while auditing procurement cases:
- (1) **Materiality and Reasonableness:** The procedures adopted for procurement must commensurate with the value of procurement. Elaborate procedures for small value procurements are neither cost effective nor efficient. Audit should examine the economy,

efficiency and effectiveness of the processes. Small procurements can be defined both in terms of value of the procurement and the items. Audit should also examine the reasonableness of the price paid for the procurement. Auditor's own judgement about the value of the items will also play an important role in determining the reasonableness of the price paid in many small value procurements.

- (2) Rule based Vs Principle based: Normally all entities are expected to follow Public procurement act 2006 and Public procurement rules unless it is exempted by Government. However blind following of the rules may itself be self-defeating as financial interests of the entity can be compromised by merely following the rules in a literal manner. For instance by accepting lowest quotation, low quality goods can be bought at a high price by accepting the lowest one. Other factors like cartelisation and reasonableness of price are principles that should be kept in mind.
- (3) Difficulty of Measurement: There can be several procurements which cannot be measured precisely. Different audit techniques must be adopted to audit such procurements. (Beautification of a venue for a government function with flowers and flower pots, coloured banners and flags are difficult to be measured. Even if orders are placed for 10,000 flowers, it will be impossible to count 10,000 flowers.)
- (4) Objective of the Procurement: Finally, the objective of the procurement may be kept in mind. Each procurement is required to serve a purpose and the procured goods or services should serve the purpose.

### ***Points for examination of Procurement Cases***

7.5 Audit should be able to identify the following steps in a procurement process:

- (1) Determination of Necessity: This is the first step in the procurement process. The determination of necessity can be (i) requisitions from the users {as in production facility} (ii) periodical replenishment of stores {as in requirement of papers in an office} (iii) planned procurements {as in medical stores} (iv) one time procurements {as in armaments by Defence forces}. The necessity in important procurement cases are accepted by the competent authority. In many regular procurement cases, however, the acceptance can be implied in the procedures themselves and no separate formal acceptance of necessity may be necessary. Besides these, necessity of procurement also determined by the strategic documents like Five Year Plan, Sustainable Development Goals and other long term and short term goals.

One of the most important aspects of Public Procurement Act 2006 of Bangladesh is the requirement of preparation of annual procurement plan. (Section 11 of PPA 2006). The principles laid down in the Act need strict adherence.

It should be noted that approval of procurement, particularly in cases other than routine procurements may be based on some tentative cost estimates, as in the case of administrative approval of public works constructions.

Audit should also link the current procurement with past procurements to ascertain the stock levels, procedures and quality of the procurement.

- (2) Determination of method of procurement: While routine and small value procurements may be carried out by simple procedures such as quotation, limited tendering, in important procurements, this may involve several decisions. The method of procurement will require decisions on:
  - (i) Should it be a domestic or international tender?
  - (ii) What is more important: Quality or cost. Based on this the tendering procedure may involve a quality-cum-cost basis of consideration.
  - (iii) Should it be a two stage tendering method i.e. should the technical offer and price offer be submitted separately? Normally in these circumstances, the technical bids are considered first and the price bids of only the technically qualified tenderers are opened for consideration.
  - (iv) The technical specifications should be precise and comprehensive. It should not leave any doubt and should not be vague. Specification should be expressed in terms of performance or output requirements, rather than specifications linked directly to design or descriptive characteristics which may tend to limit competition. There shall be no reference, in technical specification of Goods, to a particular trade mark or trade name, patent, design or type, named country of origin, producer or service Supplier. Normally it is expected that after the technical qualifying stage, the price should be the only determining factor. Any change, particularly important change in technical specifications after the bids have been invited and specially after the technical bids are opened may be considered in audit as flawed technical specifications and indicative of lack of adequate due diligence.
  - (v) Should it be a limited tender by invitation or open tender? Limited tenders are normally called from pre-approved suppliers and such procedures are for goods and services which are complex or not freely available. Limited tender may also be resorted to for saving time.
  - (vi) Have all conditions of procurement been decided in advance, preferably when tender document prepared. Too many changes and too frequent changes after the bids are invited are normally indicative of bad planning and adhocism in procurement.
- (3) Decision making process: How the decision is proposed to be made? Will it be by the committees and if so, at what levels and what types of committees? The audit should

examine the expertise available in the committee. Based on Public procurement Rules the committees can be:

- (i) Committee for cost estimation
- (ii) Tender Opening Committee;
- (iii) Tender Evaluation Committee;
- (iv) Technical Sub Committee;
- (v) Enlistment Committee;

There may be other committee generally mentioned in the Tender document

- vi) Technical Inspection and Acceptance Committee;
- vii) Contract Termination and Review Committee.

- (4) **Nature of Services:** If services are proposed to be procured, what kind of services are proposed to be procured. The services can be:
  - (i) Physical services: the services with measurable outputs covering supply of goods or execution of works relating to operation and maintenance of facilities or plants, surveys, exploratory drilling; or individual service oriented contracts regarding security services, catering services, geological services or third party services;
  - (ii) Related services: the services related to contracts of supply of goods;
  - (iii) Intellectual and Professional Services: means intellectual and professional services to be performed by consultants, which may be technical, advisory or supervising, transfer of knowhow, development of computer software.
- (5) **Communication with the prospective bidders:** Whether there would be any pre bid meeting and any other consultation?
- (6) **Nature of the invitation:** Is the bidder required to offer a lump-sum price or indicated a percentage over the schedule of rates or any other method?
- (7) **Parameters decided to determine the quality** in a quality-cum-cost based selection. Are the parameters and evaluation criteria decided before hand to ensure fairness and impartiality?
- (8) **Consideration/Price:** Is the Price finally agreed upon with estimated cost and market price? Has the approving authority disagreed with the recommendation of the evaluation committee and if so, on what grounds?

## **Salient Points of the Public Procurement Act 2006, Public Procurement Rules-2008 to be complied with.**

- (1) Have the required tender documents been prepared? (Section 5/Rule 4)
- (2) Have the committees been formed? (Sections 6& 7/Rule 7, 8, 9 & 10 )
- (3) Have the procurement plan been prepared and approved for development procurements? (Section 11/Rule 15, 16 & 18)
- (4) Have adequate competition been ensured? (Section 13)
- (5) Have the features of the tender documents like validities, security deposits etc. have been decided? (Section 14/Rule 19 to 28)
- (6) Have the specifications etc. been prepared and approved? (Section 15/ Rule 29,30)
- (7) Have the approval procedures been adhered to and award of contract been awarded? (Section 20/Rule 36, 38)
- (8) Has the post procurement review been conducted? (Section 24/Rule 45, 46)
- (9) Have the provisions of Part 2 of the Act been followed in letter and spirit? (Sections 25-28/Rule 47,48,54, 55)
- (10) Has there been any complaint under Part 3 and has the complaint been properly disposed of? (Sections 29-30/Rule 56,57,58)
- (11) Has the procurement followed the methods prescribed by the Act? (Section 31-36/Rule 61 to 89)
- (12) In case the procurement is of intellectual and professional services, have the provisions of act and rules been followed?(Section 38-39/Rule 103 to 111)
- (13) In case the procurement is an international one, have the procedures of act and rules been followed in letter and spirit? (Section 33,39/Rule 83,84,84A, 84B, 84C, 84D, 85,86,88)
- (14) Have the procurement processes are in accordance with as applicable?(Section 40 to 53/Rule 90 to 102)
- (15) Is there any instance of any professional misconduct and offence and how it has been disposed of?(Section 64/Rule 128)

## Chapter 8: Audit of Works

- 8.1 Compliance audit of Public Works<sup>6</sup> is one of the most important areas of audit. Some of these are the oldest departments and have considerable literature to guide its work. Apart from significant annual expenditure, works divisions follow complex accounting mechanisms. Audit of works transactions is to be conducted in accordance with the general rules and principles of compliance audit described in the guidelines. However, works accounts present some unique features that need special attention and treatment in audit.
- 8.2 The most notable feature of the works expenditure is cheque-drawing powers and their functioning outside the treasury system. The basic checks before payment, which otherwise are carried out by the CGA's organisations in the treasury system, are done in the divisions themselves. Monthly accounts are prepared by the divisions and submitted to the Chief Accounts and Finance Officers (CAFOs). Monthly account is an abstract of entire receipts and disbursement of the month as detailed in various schedules and registers, depicting the opening and closing balances. Thus the divisions enjoy certain amount of financial autonomy.
- 8.3 The public works departments are essentially the construction agencies of the government. The important feature of the divisions, particularly the building and construction divisions is that they are the spending agency of all construction activities even though the budget allotment is indicated in a different grant. The establishment is also divided into two categories namely the regular and work-charged establishment. While the salaries and other expenses of the regular establishment is paid through the normal treasury system, the establishment expenses of the work charged staff is directly charged to the respective works.
- 8.4 The additional aspects of the works audit can be divided into the following sub parts:
- (1) Audit of Sanctions;
  - (2) Audit of Contracts;
  - (3) Audit of Receipts;
  - (4) Audit of Cheques and Bills;

### *Audit of Sanctions*

- 8.5 Expenditure on a work must be covered by:
- (1) Administrative approval: Administrative approval is accorded by the administrative departments based on the abstract estimates prepared by the works divisions. These abstract

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<sup>6</sup> Includes Public Works Divisions, Roads and Highway Divisions, Public Health Engineering Divisions and Military Engineer Service (MES). These enjoy cheque drawing powers. Divisions like Local Government Engineering Divisions, Health Engineering Divisions and Education Engineering Divisions do not enjoy cheque drawing powers.

Estimates are generally prepared on the basis of standardized rates available with the public works departments. Such estimates are tentative and indicative in nature more to assist the administrative authorities to have a broad idea of the expenditure involved in any particular project. Administrative approvals are provided by officials at different levels according the delegation of powers.

- (2) Preparation of official cost estimate: Before advertisement procuring entity shall prepare official cost estimate by 3-member committee based on design/specification and market price. Most of the case rate of items in the estimate derived from schedule of rate prepared by different agency. If the official cost estimate is higher than the estimate of the annual procurement plan, approval of head of procuring entity (HOPE) is required.
- (3) Technical sanction (where applicable): Technical sanction (where applicable) is accorded by the competent authorities in the departments dealing with public works based on detailed drawings and estimates. Mostly these estimates are again based on the standardised rates available in the department. Revised technical sanction will be necessary after the tenders are finalized and costs of the projects are firmed up. Technical sanctions are accorded according to the delegated powers of officials at different levels.
- (4) Appropriations and Re-appropriations: funds must be made available before any component of the project<sup>7</sup> is undertaken and expenditure incurred. It is not necessary that the total cost of the project must be made available to the divisions. However, timely flow of funds is an important issue and often contributes to the time and cost overrun of the project.

### ***Audit of administrative approvals***

8.6 The following points are required to be examined in audit of administrative approvals:

- (1) The administrative approvals have been accorded on the basis of realistic assessment of the costs: often approvals are accorded on the basis of lump-sum cost or on the basis of a precedent of a similar project. For big projects, it is a good practice that adequate homework is done before seeking administrative approval. The administrative authorities also should be wary of approving a project on the basis of unrealistic cost as that creates a liability for the government for many years.
- (2) For big projects, Development Project Proposal have been prepared: DPP or Development Project Proposal is an essential step for big projects. A good DPP should have not only the preliminary estimates but also analyse the pros and cons of the project including the risks to the projects. Such risks include risks of delayed clearances, non-availability of land (in particular, in cases of road projects), availability of materials, soil conditions. Audit should be particularly

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<sup>7</sup> A project is generally a large works comprising several smaller works as its components.

Concerned with calculation of rates of returns including internal rates of return and economic rate of return, which often are exaggerated to justify the projects.

- (3) Clearances including environmental clearances have been obtained/ there are reasonable and realistic chances of getting the requisite clearances. The administrative authorities should be wary of any particular situation in the project which may jeopardise the prospect of clearances (e.g. coastal zone clearances, forest clearance etc.).
- (4) Land required for the project is available/ reasonable prospects exist of availability of land: Risks of land availability including risks of protracted litigation on account of land is a major risk for any project. Risks of encroachment, requirement of shifting of existing buildings/ utilities etc. can pose major problems. There can be laws against felling of trees, which may jeopardise the project.
- (5) That the administrative approval has been accorded by the competent authority.
- (6) That the administrative approval is unconditional.
- (7) That the administrative approval has been accorded after considering on record, all aspects of the project including all important points in the DPP and the risks if any, mentioned in the DPP have been considered and adequate measures have been ensured to mitigate the risks.
- (8) That the wording of the approval is precise and unambiguous.
- (9) That the costing of the projects has been prepared on realistic basis taking into account the current market rates.
- (10) That the costs include rents, rates and taxes.
- (11) That overall, the project is viable and is in public interest.

### ***Audit of cost estimate and technical sanctions***

8.7 The following points are required to be examined in audit of cost estimate and technical sanctions:

- (1) During the preparation of official cost estimate market price as well as overhead, profit, risks, geographical location, VAT & AIT (where applicable) considered. That the estimates to which the technical sanctions have been accorded are realistic and drawn as per the latest orders and schedule of rates: the technical sanction is the most important phase of works execution and in particular in estimating the costs of the projects. The technical sanction is essentially an engineering sanction ensuring both quality and quantity of the works to be undertaken. Tenders are invited on the basis of the estimates prepared to which technical sanction has been accorded.
- (2) That the technical sanction has been accorded by the competent authority and the sanctions have not been split in order to get them approved by a lower authority.



- (3) That the official cost estimate and technical sanction has taken into account the risks that have been flagged at the time of administrative approval and previous experiences have been taken into account.
- (4) That the technical sanction covers all components of the works and if any component is left out, there are valid reasons for that and that the left-out components will not adversely affect the progress of the works. It should be ensured that technical specification aims to maximize the competition and there are no limiting criteria in its.
- (5) That the official cost estimate have to be based on drawings and estimates have been prepared by 3 member committee who are competent to do it.
- (6) That detailed testing, like soil testing, have been carried out before preparing the estimates.
- (7) That proper architectural advices have been taken where necessary.
- (8) That the Bangladesh National Building(BNBC) and other laws like environmental laws have been taken into account, where necessary.
- (9) That all drawings and other aspects have been inspected at two levels of maker and checker.
- (10) That the approval to the technical sanctions is unconditional and unambiguous.

8.8 To conduct an effective audit of the soundness of the technical sanctions, the audit should always be carried out periodically in order to check whether the official cost estimate prepared on realistic basis. It is recommended that any big project should be audited at four stages namely (i) at the stage when 20% of the administrative approval has been incurred (ii) at the stage of 50% expenditure (iii) at the stage of 75% of expenditure and finally (iv) before completion of the project. The stage audits should examine all aspects and early stage audit should enable audit in its report to provide warnings regarding the overall implementation of the project. The aspects relating to the soundness of technical sanctions are mentioned below:

- (1) The variations between the cost in annual procurement plan, official cost estimate, tendered cost. The reasons for such variations may be analysed. Normally the variations can be due to sudden anticipated price fluctuations or failure to estimate hindrances which caused the estimates to go awry. The price fluctuations are reflected in the tendered costs, though professional scepticism should be applied when the tendered costs submitted by more than one contractor are too close to the estimates and to one another. The presence of cartel cannot be discounted.
- (2) If there are significant cost over-run even at the 20% stage from the approved estimates, the estimates should be examined by audit to look into the reasons for variations. It is generally the experience that cost overrun at the early stages of the project implementation tend to aggravate further and rarely is made up. Some of the reasons for cost over-run at a very early stage are:

- (i) Soil testing reveal that the earlier soil testing done before preparing the estimates failed to provide an accurate picture thereby delaying earthwork;
- (ii) Reasons on account of tender processing including requirement of re-tendering.
- (iii) Legal problems including problems relating to land acquisition;
- (iv) Delay in getting clearances or clearances required were not known to the concerned authorities;
- (v) Delay in release of mobilisation advance due to paucity of budget allotment and/or overall budget crunch;
- (vi) Natural causes like monsoon etc.;
- (vii) Differences between authorities and contractor over interpretations of clauses in the conditions contract or specifications;
- (viii) Sub-contracting and disharmony among different contractors about starting the work of interdependent components;
- (ix) Lack of availabilities of capital equipment;
- (x) Delay in departmental supply to the contractors;
- (xi) Delay in providing facilities to the contractors as per the contract;

### ***Audit of Tendering Procedures<sup>8</sup>***

8.9 The following points should be examined while auditing tendering procedures:

- (1) That detailed estimates showing quantities, rates and amount of various items of work to be done with specifications for each item of work has been prepared, sanctioned and kept ready before calling for tenders;
- (2) That the tender documents have been kept ready before calling for tenders;
- (3) That the tender schedules show clearly and correctly, item-wise, the bill of quantities, specifications, rates arrived at by the authorities and the total amount of the tender;
- (4) That the tender notices have been publicised according to public procurement act and rules;
- (5) That the tender /proposal documents have been priced reasonably and have been made available to all claimants as per rules;

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<sup>8</sup> Though audit of tendering procedures is being featured in these guidelines under public works, the audit steps are applicable generally to all tendering procedures. Many of these points would be applicable for audit of procurements also.

- (6) That the pre-tender meeting has taken place if warranted;
- (7) That two stage tendering has been followed, where warranted;
- (8) That provisions have been made for any tenderer to attend opening of bids;
- (9) That the Earnest Money Deposit has been fixed correctly and reasonably;
- (10) That the tender, technical proposal and financial offer have been opened by tender/proposal opening committee
- (11) That the tender have been signed properly and there is no overwriting/ crossing:
- (12) That the tender have been opened at the appointed time and date;
- (13) That the attendance sheet at the time of opening the tender have been signed by everyone present;
- (14) That no clause/condition in the tender documents has been changed between the dates of invitation of the tender notice and opening of tenders; If there are any changes it should be compatible with act and rules.
- (15) That there are adequate reasons and justification if the method use other than open tendering method.

### *Audit of Contracts<sup>9</sup>*

- 8.10 Audit of contracts can be divided in two categories. The first category is the audit of the process of entering into contract, which ends with signing of the contract and second is the audit of contract management i.e. how the deliveries and other conditions are being fulfilled. Often the contract may be finalised following due process but the contract management turns out to be poor. From audit point of view, it should also be kept in mind that the contract may be signed by one party but the deliveries or provision of services may be to another party. Often in government a centralised contract is signed but the deliveries take place to different locations. This is as true of public works divisions as of many other government departments and entities. Supply contracts generally are signed centrally with supplies to be made at various places. It is important for audit to examine the process of contracts as also the management of the contracts.
- 8.11 A contract is a legal agreement between the government and the contractor. A public works contract can be of two types namely piece work agreement and lump-sum contract. A works contract essentially is an agreement in which the contractor agrees to execute the work as per

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<sup>9</sup> Though audits of contracts are being featured in the chapter relating to public works, the steps would be applicable to any contract entered by any other entity. Many of these points will be applicable for audit of procurements also.

specifications and drawings within a time schedule and is responsible for the technical excellence. A piece work agreement is such that the rates are determined for individual element of the work and the contractor is paid for completion of each part of the work as per the rates agreed to. Price escalation is determined for each part of the work. The risk of price escalation is normally carried by the department. In case of lump-sum contract, the contractor agrees to execute the contract for a lump-sum payment payable in instalments/stages. The risk of price escalation is borne by the contractor.

8.12 Normally contractors are classified depending on their technical and financial capacity. Tenders for particular work may be invited from among a particular class of contractors depending the technical nature of the work and the value. In case of open tenders, suitable conditions may be laid down to filter suitable contractors. These conditions normally should include both technical and financial abilities.

8.13 For the purpose of public works, contracts can be of different types. These normally are (i) civil contracts (ii) electrical contracts (iii) transport contracts (iv) fabrication and erection contracts (v) road contracts (vi) public health engineering contracts. It should be noted that all types of construction works are now getting extremely specialised and hence specialisation among contractors is very common. However, the risk of this to the government is that the contracts tend to get split on activities and co-ordination among the contractors becomes difficult to achieve. Often one contractor is allowed to undertake the work in its totality with permission to enter back to back contract with specialised contractors.

8.14 In audit of the process of entering into the contract, the following aspects need to be examined:

- (1) That the tender process followed is reasonable and as allowed by the rules;
- (2) That the tenders have been drawn in a manner that it does not favour any particular contractor;
- (3) That the bids have been opened as per the existing procedures;
- (4) That no condition in the tenders including specifications has been changed to favour, intentionally or unintentionally, any contractor;
- (5) That if such a condition has been changed due to some valid reason, it has been notified to all concerned and all have been provided with reasonable opportunity to revise their bids;
- (6) That solvency certificates and tax clearance certificates have been obtained from the contractor;
- (7) That the contractor finally awarded the contract satisfies all conditions mentioned in the tender documents;
- (8) That the contractor who has been awarded the contract is financially and technically competent to execute the work;

- (9) That the contractor in the past has satisfactorily executed the works awarded to him;
- (10) That the contractor has not been blacklisted by anybody or authority;
- (11) That the contract has been drafted properly and no loophole has been allowed;
- (12) That the contract is unconditional and unambiguous;
- (13) That the interests of the government have been safeguarded adequately;
- (14) That the payment schedules have been finalised keeping the interest of the government in mind;
- (15) That there are provisions to recover the mobilisation advances granted;
- (16) That the timeline of the execution of the work has been defined;
- (17) That the bank guarantee has been deposited by the contractor and is valid and correct;
- (18) That the price adjustment clauses are reasonable and based on objective conditions and does not favour the contractor;
- (19) That if the contractor is a foreign firm or any part of the contract has any links with the foreign supplier, adequate security clearance has been taken provided in the tender document;
- (20) That there are adequate provisions for liquidated damages;
- (21) That the government has been indemnified for any unlawful action of the contractor;
- (22) That there are adequate and reasonable provisions of penalty for dereliction by the contractor;
- (23) That there are provisions for recovery at the risk and cost of the contractor;
- (24) That the agreement contains satisfactory dispute resolution mechanism with arbitration as the last resort;
- (25) That the arbitration procedure is neutral and not unduly biased towards the contractor;
- (26) That the contractor has formally accepted the general conditions of contract and particular conditions of contract and the requisite papers have been signed by the accredited authority of the contractor;
- (27) That the contract is legally binding on all parties;

### ***Audit of contract management***

8.15 Audit of management of contracts is perhaps the most important phase of audit of contracts. A good audit examination at different stages of the contract can reveal procedural flaws and errors in judgement at every stage of the contracts. It is necessary for the audit engagement teams to be thoroughly conversant with the nature of the contract to perform a quality audit. Audit issues in contract management will depend on the nature of the contracts. Broadly, the contracts can be of the following categories:

- (1) Contract of permanent nature: such contracts may be for a longer period for supply of services, running facilities etc. Transportation contracts, canteen services, running of facilities etc. may be examples of such contracts.
- (2) Supply contract: such contracts may be for one time supply or supply for a continuous period.
- (3) Contingent contract: such contracts may be contingent on happening of an event. Maintenance contracts often are of this nature.
- (4) Execution contract: such contracts may be for executing works according to specifications;
- (5) Manpower contract: such contracts are for supply of manpower for different functions
- (6) Services contracts: Such contracts are for providing services. It can be with individual(s) or with an organisation to provide specific service either on a permanent basis or on specific occasions.

8.16 The audit strategy and audit plan will depend on the nature of the contract and the services envisaged in the agreement. Timing is the essence of any contract and so is the deliveries envisaged in it. Any audit examination of the management of contracts should include the following major points:

- (1) Has the performance of the contractor been as per the contractual terms and conditions? Broadly, examination of performance will emphasize the timing (whether schedule has been maintained?), quality (whether deliveries have been as per the specifications/ service conditions?). An analysis in audit will indicate the nature of such deviations and the reasons for them. Impact of delay in supplies should be one of the major areas of compliance audit.
- (2) Has any contract conditions been deviated from the original? (An analysis in audit of all deviations will indicate the reasons for such deviations. Some deviations may be reasonable but may point to lacunae in the original planning and assumptions.)
- (3) Has the supply been defective? What were the quality control measures? The impact of defective supplies should be one of the major areas of compliance audit.
- (4) Has any condition been changed after signing of the contract either formally or informally, that would have impacted other vendors' decision regarding price or any other condition in the tender at the time of bidding?
- (5) Has the price or any other payment conditions been changed from what is envisaged in the contract?
- (6) Has the payment been made after verifying the supplies/ actual execution of the work? Have the measurement books and other documents have been maintained properly?

- (7) Has the coordination between the department and the contractor or among the contractors been adequate? Has any work been delayed due to delay in work by some other contractor? (e.g. civil site not ready for installation of medical equipment.)
- (8) What are the contributing reasons for time and cost overrun?
- (9) Has the cost escalation been as anticipated in the contract? What are the reasons for deviation from the cost escalation formula?
- (10) Has the cost escalation formula been adhered to?
- (11) Has the fund flow (budget availability/ allocations) kept pace with the pace of execution of works?
- (12) Has the cost overrun been so much as to require revised administrative approval/ technical sanction?
- (13) Could all the hindrances be anticipated?
- (14) If the contract has been signed at the headquarters and deliveries are to be made at the field, roadside or sheds, do effective reconciliation mechanisms exist and have been activated?
- (15) Often in public works, road and highway divisions, materials are supplied at sites which are remote and roadside. The materials need to be measured and security need to be provided to avoid pilferage. What steps have been taken to safeguard the supplies?
- (16) Have the running account bills been supported by schedules, dockets, copies of measurement books and other dockets as required under the rules and codes?
- (17) Have the regular instalments of mobilization advance been deducted from the running account bills?
- (18) Have the deductions been made correctly for the departmental supplies?
- (19) Have the duties and taxes been deducted as required under the law?
- (20) Have the liquidated damages been recovered where applicable?
- (21) Has the recovery of the cost of materials issued to the contractor outside the contract conditions been recovered as per the market prices?
- (22) In case of lump sum contracts, the audit team should particularly examine whether all the conditions have been fulfilled and whether relaxation of any condition benefitted the contractor?
- (23) In case of works expenditure, the audit engagement team should carefully examine the transfer entries passed in the divisions. The check should include whether such transfer entries amount to misrepresentation and misstatement in the accounting records.

- (24) The audit engagement teams should examine all land acquisition cases and their impact on the pace and progress of major works in the division.
- (25) The audit engagement team should carefully examine whether all relaxations and compensations paid on account of “act of God” is justified.

## **Audit of Receipts**

- 8.17 The receipts of the public works departments are to be audited in accordance with the general principles of receipt audit. In other cases, where receipts are collected by general departments, the amounts are deposited into the TSA by the departments. Under codal provisions, departments following departmentalized system record receipts in their cash book as and when received. In their monthly accounts these receipts are incorporated and details of the receipts are required to be indicated in the schedules.
- 8.18 The unique receipts of public works divisions are the centage charges which are recovered when the public works divisions act as an agency. These are to be treated as government revenue and should not be offset with expenditure by reduction of expenditure.

## ***Deposit works***

- 8.19 This term is applied to works of construction or repair the cost of which is met, not out of government funds, but out of funds from non-government sources, which may either be deposited in cash or otherwise placed at the disposal of the Divisional Officer. Works executed for municipalities and other public bodies fall under this category. The following additional points will be included in the audit checks:
  - (i) Whether administrative approval has been obtained from the concerned agencies before commencing the works?
  - (ii) Whether the tentative estimates prepared for administrative approval are realistic and take into consideration all costs?
  - (iii) Whether the technical sanction and expenditure sanctions differ substantially from the administrative approval and reasons thereof.
  - (iv) Whether expenditure of one works has been booked under another works due to availability of budget.

## **Audit of cheques and bills**

- 8.20 The divisions being self-drawing officers, audit of cheques and bills, particularly of transmissions of cheques and encashment of cheques should be carefully verified. The steps suggested for financial audit may be followed. In case of cheques and bills, remittances, deposits (contractors' deposits, deposit work), records of CAFO (cheque bill register, remittance, contractors' ledger, deposit work) should be verified in addition to that of records kept at concerned division.



### ***Audit of Suspense Heads***

- 8.21 The suspense heads and balances under these heads should be carefully examined to ensure that amounts have not been kept under the suspense heads to hide lack of budget allocation.

### ***Consulting Manual of the Works Audit Department 1980.***

- 8.22 In addition to these guidelines, guidance may be taken where appropriate from the Manual of the Works Audit Department 1980.

## Chapter 9: Audit of Cash

- 9.1 Cash book is an important instrument to maintain accounts of cash and also acts as a control registers. Financial propriety entails that cash books are maintained properly and any cash transaction is entered in the cash book instantly. Cash books are required to be closed daily and any corrections or overwriting must be duly attested by competent authority. In entities where cheque drawing facilities are available, the blank cheque books are considered to be valuable. Accounts of all valuables are required to be maintained and these are also required to be audited. In Category II, III and IV entities, cash and bank balances would constitute an important area of audit. These assets are highly prone to misappropriations, embezzlement and fraud.
- 9.2 While auditing Cash and Bank Balances, the audit engagement team must obtain sufficient and appropriate evidence to corroborate management's assertions regarding the following:
- (a) **Existence:** that the Cash and Bank Balances as recorded in the cash books and other records existed;
  - (b) **Completeness:** that there are or were no unrecorded Cash and Bank Balances of the entity;
  - (c) **Availability:** That the liquid assets are available to the entity as and when required;
  - (d) **Matching:** That the cash transactions as recorded in the cash book or bank book match with day books and other journals.

### *Internal Control Evaluations*

- 9.3 It is important to examine the system of internal control procedures in the entity with regard to Cash and Bank Balances to determine the nature, timing and extent of other audit procedures. The following aspects should be considered for examination:
- (a) Segregation of duties relating to authorisation of cash transactions including handling of cash, writing of cheques, signing of cheques, issue of cheques and recording the issue of cheques in the accounting books;
  - (b) Policies relating to rotation of personnel responsible for the duties at (a) above;
  - (c) Cash Book maintenance including daily closing of Cash books and physical verification of Cash with the balances available in the Cash Book; in case of computerised maintenance of Cash Books, printing of daily scrolls and physical verification of the balances as per the Scrolls with the Cash available in the Cash Chest; provision of periodic surprise verification of Cash Balances;
  - (d) Policies and procedures regarding Cheque Books including safe keeping of Cheque Books and pre-printed stationery, where applicable, system of pre numbering of Cheques, periodical stock verifications;
  - (e) Necessity of multiple cash chests in the same location and premises should be examined in depth;
  - (f) Periodical reconciliation of Bank Balances and vigorous and timely pursuance of unreconciled outstanding items.

## ***Verification of Cash in compliance audit***

- 9.4 The following audit procedures will be performed by the audit engagement team in compliance audit to obtain sufficient and appropriate audit evidence with regard to Cash balance:
- (a) Examination of cash books to ascertain that all records pertaining to cash and bank balances are verified regularly by officials of the entity other than the cashier;
  - (b) The Audit engagement team may verify the cash balance for one day during the engagement. It should be ensured that all cash balances in the same location should be verified simultaneously;
  - (c) All Cash balances lying outside the Cash chest(s) and with officers or in their individual bank accounts should be thoroughly checked and necessity for maintenance of such Cash with individuals should be examined;
  - (d) All imprests with individual officers must be physically verified and accountal and adjustments of such imprests must be examined;
  - (e) Post-dated cheques on hand on the date of the Balance Sheet should be verified for encashment and unusual large scale withdrawals immediately after encashment should be examined thoroughly;
  - (f) All fixed deposit receipts and other documents relating to deposits and investments must be examined in original.
  - (g) All cheque books including unused leaves must be physically verified and those issued should be reconciled, on a sample basis, with payment scrolls received from the banks. If the counterfoil is not available, the cheque numbers should be taken from the cash books;
  - (h) Payments made in cash directly by the entity should be checked with muster rolls/ acquittance rolls on a sample basis. While choosing the sample, the whole of the acquittance roll/ muster roll should be checked. In other words, the population in this case should be the muster rolls and acquittance rolls and not individual payments. In case of cash payment to a large number of persons outside the entity, a sample beneficiary check should be conducted;
  - (j) A general visual check of the cash book should be carried out to identify corrections and overwriting. All such cases of corrections and overwriting should be examined. If the incidence of corrections is large, the matter should be examined in detail to ascertain the cause of such large number of corrections;
- 9.5 The engagement team should evaluate the evidence obtained as a result of such audit procedures and report suitably, where warranted, either as an emphasis of matter or in the Long Form Audit Report. The team should be particularly alert to the possibility of misappropriations, embezzlement or fraud and report the matter to the senior officials **ON THE SAME DAY**. While reporting conclusions on the audit evidence obtained, the following guidance may be kept in mind:

- (a) Unduly large balance of Cash in excess of normal requirement on a regular basis must be brought out in the auditor's report;
- (b) If the Cash in hand is not in agreement with the balance in the book, the same should be brought up in the auditor's report;

### ***Verification of Bank balance***

9.6 The following procedures will be used by the audit engagement team to obtain sufficient and appropriate audit evidence with regard to Bank balance:

- (a) The audit engagement team should advise the management of the entity in the very beginning of the audit engagement to send letters to all its bankers to confirm the balances on the date of the Balance Sheet, directly to the auditor. Such requests should include dormant accounts and accounts closed during the financial period.
- (b) The audit engagement team should examine the bank reconciliation statements in respect of all Bank accounts as on the date of the Balance Sheet as also should examine the reconciliation statements on other dates. The most important aspect of the bank reconciliation statements is to examine (i) the cheques issued by the entity but not presented before the bank and (ii) cheques deposited for collection by the entity but not credited in the bank account(s). The audit engagement team should also examine the reverse credits and debits and reasons for the same.
- (c) The audit engagement team should examine closely the long standing items in the reconciliation statements which are pending.
- (d) If a large number of cheques have been issued or deposited in the last days of the financial period and remain outstanding after the end of the financial period, the same might have been done to understate creditors or debtors and overstate bank balances. The audit engagement team should examine all aspects of these transactions and may seek independent confirmations from the parties concerned. The same is true if the entity has a large number of cheques on hand on the date of the balance sheet and such cheques have remained undeposited or uncleared in the subsequent period.
- (e) In case of fixed deposits or any other type of deposits, the audit engagement team must see the original receipts or certificates duly supported by bank advices.
- (f) Remittances shown in transit must be examined to ensure that they have been credited in the subsequent period.
- (g) In case the entity maintains accounts with foreign banks with exchange control restrictions, which are under liquidation or moratorium, the same should be disclosed appropriately.
- (h) If the number of bank accounts maintained by the entity is disproportionately large, the audit engagement team should examine the genuineness of the transactions and balances. The responsibility of operations of these bank accounts also should be examined.

## Chapter 10: Audit of Revenue<sup>10</sup>

- 10.1 The CAG of Bangladesh under Article 128(1) of the Constitution and Section 5(1) of the CAG (Additional Functions) Act of 1974 is mandated to audit of revenues into the public accounts of Bangladesh as also of the Statutory Public Authorities, Local Authorities and Public Enterprises. Such revenues are reflected in the financial statements and audit of financial statements will be conducted in accordance with the financial audit guidelines. In this chapter, the focus is compliance aspects of the revenues.
- 10.2 Revenues of the government can be tax-revenue and non-tax revenue. While tax revenue is charged to an individual or an entity, non-tax revenue is charged for services provided by the government agencies. Tax rates and attendant conditions are normally approved through legislation by the Parliament (Finance Act) because of not quid pro quo, whereas non-tax revenue may be departmentally levied through administrative orders, supported by general statutory powers. Though the contents of this chapter do not explicitly apply to the sales revenue of a commercial enterprise, audit examination of such revenues may include application of relevant guidelines, if apposite.
- 10.3 Broadly, the objectives of compliance audit of revenues are:
- (i) That adequate statutory authorities exist for the charge;
  - (ii) That adequate systems and procedures exist to assess, demand, collect and account the revenues earned;
  - (iii) That assessments where necessary, has been carried out in accordance with the statutory provisions;
  - (iv) That collections of revenues including advance tax, where applicable have been carried out efficiently;
  - (v) That revenues received have been accounted for correctly and without delay;
  - (vi) That revenues received have been deposited into government TSA, where applicable without undue delay.
  - (vii) That adequate controls are in place and active to avoid leakage of revenues;
- 10.4 In no case, should independent enquiries be made among the tax payers or general public. CAG's mandate as regards audit of revenues, does not allow OCAG to audit any tax payer or third party or seek information directly from a tax payer or third party. All information required in audit should be sought from the audited entity/unit and in case the required information or evidence is not forthcoming, the concerned directorate in OCAG would take up the matter with the higher authorities in the administrative set up.
- 10.5 Should a situation arise that despite best of efforts, the required information/evidence is not forthcoming or non-availability of information/evidence is recurring and has attained such a proportion that obtaining sufficient and appropriate evidence is adversely affected, the matter will be considered from the point of view whether a modified opinion needs to be provided or an emphasis of matter is required to be added to the opinion on the financial statements of the entity

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<sup>10</sup> This chapter deals with audit of important tax revenues namely Income Tax, Customs and Excise Duty and Value Added Tax and also non-tax revenue.

as part of financial audit and the matter be separately be reported in the compliance audit report.

- 10.6 The audit of revenues shall largely be regulated with reference to the statutory provisions or financial rules and order applicable to the particular class of revenues involved. If the audit examination reveals any defect in such statutes, rules or orders, the advisability of amendments may be brought to the notice of responsible party. Normally audit examination will not question an authoritative interpretation of such statutes, rules or orders. Similarly, in no case audit will question a judicial decision or a decision given by an administrative authority in a quasi-judicial capacity. This however does not debar OCAG from bringing to notice any conclusion deducible from the examination of a number of such decisions.
- 10.7 Several classes of receipts, notably belonging to the Public Account of the Republic are repayable. Government agencies act as a banker or a remitter. CAG has audit jurisdictions by virtue of Article 128(1) of the Constitution. Audit examination will therefore cover such receipts and repayments including checking each repayment against the original receipt.

### **Compliance Audit of Tax Revenue**

- 10.8 Compliance audit of tax revenues is an examination of effectiveness of systems and procedures relating to tax assessment and collection through individual assessment files as also overall performance of the concerned audited units. The following activities of the department should normally be examined during such audit:
- (a) Identification of potential assessees ensuring prevention and detection of tax evasion and better compliance;
  - (b) Follow-up of all demands and claims;
  - (c) Prompt and proper investigation of cases of losses, fraud, default or errors;
  - (d) Proper pursuance of cases by the department before appellate authorities;
  - (e) Recovery of arrears;
  - (f) Prevention of harassments of honest taxpayers;
  - (g) Prompt and correct assessments of returns, where such assessments are due;
  - (h) Rebates, Refunds and Exemptions are allowed as per law.
  - (i) Quantum and category of exemptions are in accordance with relevant statutes, rules and orders and are not allowed on ad hoc/discretionary basis.
- 10.9 Three most important aspects of any tax administration are (i) Assessment (ii) Collection and (iii) Accounting. The primary objectives of compliance audit of tax administration would therefore be to obtain assurance that (i) assessments have been carried out in accordance with the rules and regulations (ii) collections have been carried out promptly and (iii) such collections have been accounted for and promptly deposited into government treasury. This is true of all tax administrations.
- 10.10 With increasing self-assessment cases and systems of e-payments, audit should also examine such cases to ensure that self-assessments are reasonable and correct. Integrity of data including provisions of privacy and effectiveness of systems controls to prevent data loss and breach.
- 10.11 Audit shall have access to all assessment files, computerised facilities and data relating to tax administration. Denial of such access will be treated as violation of Article 128(1) of the Constitution.

- 10.12 It shall be the duty of the Director General, Directorate of Revenue Audit to effectively liaison with National Board of Revenue (NBR). The objectives of such liaison would be to keep track of latest SROs and other decisions including judicial and quasi-judicial decisions on income tax issues, effective audit planning and to ensure prompt replies to observations of the audit engagement teams.

## **Income Tax**

- 10.13 Income tax is a direct tax on the income of individuals and legal entities mainly business enterprises. Income tax on individuals is known as personal income tax and that on business entities is known as corporate income tax. Most important authorities for compliance audit of income tax are :
- (i) Income Tax Ordinance, 1984;
  - (ii) Income Tax Rules, 1984;
  - (iii) The Finance Acts;
  - (iv) Statutory Rules and Orders (SROs), Circulars and notifications issued by the National Board of Revenue (NBR)
  - (v) The Gift Tax Act 1990;
  - (vi) The Travel Tax Act 2003;
  - (vii) Income Tax Nirdeshika for the relevant year.
- 10.14 The key information on the subject matter for the purpose of compliance audit of income tax are income tax return submitted by the tax payer and the assessment report. The audit unit for the purpose is the circle, which is the administrative unit for the purpose of tax administration. There are at present 29 zones under which 638 circles are operational. There are 140 companies circles, dealing with companies, 86 salaries circle, 2 contractors' circles and the remaining are normal circles. Whiles circles can have mixed jurisdictions, the salaries circles deal with income tax cases of salaries and the contractors' circles with the cases of contractors. The normal circles are territorial dealing mainly with sole proprietorships and partnership businesses.
- 10.15 The annual audit plan and the half yearly audit plans must reflect the risk based approach towards audit planning. While figures of collections would be the main criteria for selection of audit units, other risk factors like numbers of cases, nature of assessees covered by a circle, potentiality of tax evasions, low collection against high expectation of tax revenue, past audit observations etc. should also be considered. Most importantly, selection of units should be such that all types of assessments should be represented in the audit reports to provide a comprehensive picture. All Large Taxpayers Units (LTU) must be taken up for compliance audit every year.
- 10.16 Records to be checked during the compliance audit of income tax:
- (a) Assessment orders under different sections of the Act and Rules;
  - (b) Income Tax Return submitted by the assessees with particular emphasis on computation of income by the assessee and the department;
  - (c) Accounts, where applicable;

- (d) Tax Audit Report;
- (e) Details of financial statements submitted by the assessee;
- (f) Agreements like sales deed, property deed, rent agreement etc.;
- (g) Documents relating to tax already paid;
- (h) Assessment of previous years;
- (i) Any other information relevant to assessment.

## **Audit checks for Income Tax**

10.17 The common audit checks in relation to income tax audit are as follows:

- (i) Are there arithmetical and transcription errors? Such errors do not automatically mean less computation of taxes as taxes are paid in advance. Audit should also check whether such errors have resulted in refund or wrong demand.
- (ii) Whether the rates of taxes have been applied correctly?
- (iii) Is there any period of default and whether penalty/interest have been levied?
- (iv) Whether all the disallowances have been calculated properly and whether they are in accordance with the law? Audit checks should also keep in mind that such disallowances, wrongly calculated may affect the taxpayer adversely. This also should be the concern of audit.
- (v) Whether all income earned from all sources have been taken into account in computation of income and the slabs of rates have been properly applied?
- (vi) Whether refunds including interest on such refunds have been calculated correctly?
- (vii) Whether interest on refunds of previous years is shown as income?
- (viii) Whether the incidence of refunds is on a high side hinting payment of higher advance tax by tax payers to fulfil the targets of the income tax office, if any?
- (ix) Whether expenditure claimed in the computation of taxable income is admissible and is actually forming part of the profit and loss account?
- (x) Whether amortization of expenditure, as claimed, is admissible?
- (xi) Whether exemptions and deductions have been correctly computed and correctly allowed?
- (xii) Whether such exemptions and deductions, losses from previous years set off against current taxable income, depreciations etc. match with Tax Audit Report?
- (xiii) Whether the provisions of tax deducted at source have been followed and Tax Deducted at Source (TDS) deducted have been deposited into government account promptly?
- (xiv) Whether accounts have been audited, where necessary?
- (xv) Whether the returns have been signed by authorised person?
- (xvi) Auditors should link up past assessment records to link the following information:
  - (a) Methods of valuations not accepted in the past requiring adjustment of opening stock and closing stock;
  - (b) Brought forward transactions of previous years not shown correctly in the return;
  - (c) Admissibility of deductions on the basis of past records.
- (xvii) If revised return has been submitted, the original return should have been submitted within time.



## **Specific Audit Checks: Income from Business**

- (xviii) Whether expenditure has been incurred for non-business purpose?
- (xix) Whether capital expenditure on which the benefits would accrue over a number of future years, has been wrongly classified as revenue expenditure?
- (xx) Most of the businesses maintain their account on accrual basis. The Tax Audit Report and other documents need to be examined to ascertain that the assertions are in accordance with the Income Tax laws. Notes on accounts also need to be checked thoroughly.
- (xxi) Specific attention should be given to amortization and claims relating to them.
- (xxii) Whether credits and debits for all receipts and expenditure that have become due during the financial year have been taken into account.
- (xxiii) Special attention should be paid to all provisions for which claims of deductions have been made.
- (xxiv) Whether there are caps for any kind of deductions and those caps have been implemented.
- (xxv) Whether remunerations have been authorised?
- (xxvi) Whether the conditions in the partnership deeds/ memorandum of association etc. having impact for the purpose of the income tax have been taken into account properly.
- (xxvii) Carrying forward of losses from previous years has been done as per rules.
- (xxviii) Special attention should be given to international transactions and tax implications of these transactions.

## **Checks for non-assessment activities**

- (xxix) Revisions and Rectifications have been done in time and as per rules.
- (xxx) Was any revision carried out suo-moto and reasons thereof.

## **Refunds**

- (xxxi) Entitlement of interest should be looked into.
- (xxxii) Refunds and interest have been calculated correctly.

10.18 Primarily, the audit of Income Tax is an audit of assessment files and orders. Controls and compliance with laws, rules and regulations will be examined with reference to individual assessment files and orders.

## Custom and Excise Duties

### Customs

10.19 Customs Duty is an indirect tax on merchandise imported into and exported out of the country. The main authorities governing customs are:

- (i) The Protective Duties Act, 1950;
- (ii) The Customs Act 1969;
- (iii) Bonded Ware House Licensing Rules, 2008;
- (iv) Transfer of Residence Rules, 2000;
- (v) Tourist Baggage Rules, 1981;
- (vi) Baggage Rules 2011;
- (vii) Statutory Rules and Orders (SROs), Circulars and notifications issued by the National Board of Revenue, Bangladesh (NBR);
- (viii) Tariff Schedules;
- (ix) Finance Act of relevant years;
- (x) Prescribed Bill of Entry and Bill of Export Order 2001;
- (xi) Import Policy Order.

10.20 The cases of non-compliance noticed in audit in relation to customs duties can be broadly categorised as

- (i) Incorrect application of General exemption notifications;
- (ii) Misclassification of imports;
- (iii) Incorrect levy of applicable rates and other charges;
- (iv) Non-compliance of provisions of various Export promotion schemes;

10.21 For imported goods into Bangladesh shipping agents submit manifests electronically to the Customs authority. Once the IGM (Import General Manifest) is submitted online, the nominated C&F agent or the importer himself completes the goods declaration i.e. Bills of Entry (BE) from their own premises and submits the goods declaration to Customs systems through ASYCUDA World. The BE is submitted in a specific format known as SAD (Single Administrative Document).

10.22 The following documents are submitted for release of goods from Customs. These documents are of primary interest to conduct compliance audit of customs duty:

- (i) Letter of Credit (L/C);
- (ii) Invoice;
- (iii) Bill of Lading/ Air Waybill / Truck Receipt/ Railway Receipt;
- (iv) Packing List;
- (v) "Country of Origin" certificate;
- (vi) Insurance Policy / Cover Note;
- (vii) VAT/ BIN<sup>11</sup> Certificate

## **Following additional documents are required for specific types of goods:**

- (i) A certificate from BSTI<sup>12</sup> to clear items for which BSTI certification is mandatory, if the import consignment does not have a certificate from an accredited laboratory of the exporting country;
- (ii) Radioactivity Test Report from the concerned authority of the exporting country for food items;
- (iii) Clearance certificate from Bangladesh Atomic Energy Commission for food items to the effect that the radioactivity level found in imported food stuff is within acceptable limits;
- (iv) Pre-shipment inspection test report for milk food products and powder milk, coal and hard coke, Break Acrylic, M.S. Billets and for items where the value of a single item authorised for import by public sector agencies is Taka fifty lac or above;
- (v) Approval letter of Chief Inspector of Explosives of the Ministry of Power, Energy & Mineral Resources for import of explosives;
- (vi) Copy of intellectual property certificate in the case of import of branded goods registered under any law relating to Intellectual Property Rights. Bangladesh.

## **Following files, registers and documents are of interest to audit:**

- (i) Pre-shipment inspection agencies' certificates;
- (ii) valuation and certification files;
- (iii) Bond registers and bond documents;
- (iv) Register of customs duties receipts/ print outs of receipts;
- (v) Register of Penalties;
- (vi) Register of Seizures, Attachments and Forfeitures;
- (vii) Register of unclaimed goods;
- (viii) Importer/Exporters' ledgers;
- (ix) Chalans of revenue paid;
- (x) Duty Drawback/exemption papers;
- (xi) Letters of Credit;

**The above documents are the primary information on the subject matter for the purpose of compliance audit.**

### **Audit checks for Customs**

10.23 The following are the important compliance audit checks of Customs assessments

- (i) All required documents and certificates were and are available at the time of assessment and clearance of imported goods;
- (ii) Assessments were carried out following the laid down procedures;
- (iii) Goods declared in the manifests, invoices and insurance documents match;
- (iv) Value of goods as evident from manifests, invoices and insurance (and other subsidiary documents) matches;

- (v) While calculating duties on ad valorem basis, all components like freight, insurance are included;
- (vi) The goods have been classified correctly for the purpose of imposition of tariffs;
- (vii) Concessions, if granted, are in accordance with the relevant rules and supported by proper orders issued by the competent authority with special attention to individual discretionary concessions by NBR;
- (viii) The VAT/BIN Registrations of the importer match with other documents;
- (ix) Bonded warehouse facilities have been used as admissible; Each case where goods are lying in the bonded warehouse for unusually long time should be examined in audit;
- (x) Each case of re-export, re-import and transit goods should be examined in audit.

## Excise Duty

10.24 Excise Duty is an indirect tax mainly on domestic production. However, in Bangladesh, such excise duties are levied on some services as well. The main authorities governing excise duties are:

- (i) Excise and Salt Act 1944, as amended from time to time;
- (ii) Excise SROs and General Orders

**10.25 The various registers and documents which are of interest to audit are:**

- (i) Application forms for trade license in excisable goods;
- (ii) Register of excisable goods;
- (iii) Register regarding payment of duty;
- (iv) AR forms for movement of goods;
- (v) Warehouse/Store room register.

10.26 The following audit checks of assessments are suggested:

- (i) All necessary documents including declarations are available and was available at the time of clearance of goods at the factory gate;
- (ii) The excise officer has verified the correctness of the declarations and other forms;
- (iii) Necessary post clearance audit has been performed.

## Value Added Tax

10.27 VAT (Value Added Tax) is an indirect tax charged on consumption. The main authorities governing VAT are:

- (i) Value Added Tax Act 1991;
  - (ii) Value Added Tax and Supplementary Duty Act 2012;
  - (iii) Development Surcharge and Levy (Imposition and Collection) Act 2015;
  - (iv) Amendment of VAT Rules, 1991;
  - (v) Value Added Tax and Supplementary Duty Rules 2016;
  - (vi) Value Added Tax Rules 1991;
  - (vii) VAT SROs and GOs
-

- 10.28 Even though VAT is a tax on consumption, it is an indirect tax and is levied on traders. The essence of VAT tax administration in Bangladesh is enlistment/registration. Enlistment is to be done by traders and entities as specified in rules and orders. VAT is calculated on the basis of actual sales price. Some of the important features of VAT, which are of interest to audit are:
- (i) Enlistment and Registration can be done paperless without submitting any documents;
  - (ii) Input Tax benefits are available;
  - (iii) To avail of input tax, document required are (a) Purchase contract or (b) Form VAT 6.3 for local purchase or (c) Bill of Entry for import purchase;
  - (iv) Accrual basis accounting will be maintained;
  - (v) Accounting for the purpose of VAT will follow commercial accounts system;
  - (vi) A trader can use the VAT for a maximum of 45 days for use in his business;
  - (vii) Periodic payment of VAT can be done on submission of VAT chalan;
  - (viii) Payment of VAT can be done either manually or on-line;
  - (ix) VAT Return will be the only document based on which tax will be assessed;
  - (x) VAT Return will be treated as claim for refund, if refund is due;
  - (xi) Refund will be paid within three months from the submission of the return;
  - (xii) Claim for refund will be treated as approved if claim is pending for more than 3 months;
  - (xiii) Appeal can be preferred on line and appeals will also be disposed of online.
- 10.29 Compliance audit of VAT will, inter-alia, be audit of VAT returns with supporting documents and assessments. While classification of goods is one of the most important audit checks, the following general audit checks are recommended:
- (i) Are all returns received? The checks will involve comparing the enlisted/registered traders with the number of returns received in the Commissionerate.
  - (ii) Are advance tax deposited by the traders commensurate with the amount of VAT declared in the return?
  - (iii) Are assessments carried out regularly and in time?
  - (iv) Are the returns accompanied by the required documents?
  - (v) Are the supporting documents complete and valid?
  - (vi) The taxes paid according to the return are in consonance with the supporting documents. This will involve arithmetic check, checks of classification and rates of taxes and of input costs exemptions;
  - (vii) Are the refunds claimed correct and if the assessment could not be done within 3 months, has the refunds been paid correctly? Checks of greater number of such cases are desirable.
  - (viii) Are the cross checking done by the assessing officer? Audit should also do independent cross checking {Cross checking in audit means that a claim by a seller is cross checked with the claim of the buyer. If Y claims that he bought goods from X and paid VAT and claims input tax, does the return of X show the sale and receipt of VAT}
- 10.30 It is to be noted that Tax audit involves continuous updation of knowledge on the part of auditors, as fresh rulings, judgements and other guidance are issued very frequently. An auditor needs to be absolutely current in his knowledge.

## Audit of Non-Tax Revenue

- 10.31 Traditionally tax revenues have been the main source of revenue of the governments. Audit of non-tax revenues has thus been of less importance than audit of tax revenues. However, as economies expand and governments are hard pressed to resort to newer avenues to bolster resources, non-tax receipts are often seen as important source of revenue.
- 10.32 Broadly, non-tax revenues can be classified into three categories. These categories are:
- (a) Revenue earned by allowing private persons to exploit resources which are intrinsically sovereign assets. Radio waves, mining licenses, exploitation of natural resources are examples of such resources.
  - (b) Governments in order to augment revenues, sells assets which are owned by it. Shares in government companies, land owned by government organisations, government buildings are examples of such assets.
  - (c) Government recovers fees for services rendered by it. Such fees can be semi-permanent in nature as in case of fees for educational institutions, or temporary as in case of entry fees for exhibitions and fairs.
- 10.33 While the first two categories of revenue can be substantial, the third category of revenues is often of less importance and does not fully recover the cost of services provided. However, the third category can be regular and semi-permanent, the first two categories are case specific and more complex.
- 10.34 Compliance audit of first two categories should keep the following characteristics in view, while planning and executing the audit:
- (a) Activities relating to these are within an overall framework of laid down policies. Such policies may be laid down through an act or a pronouncement by the government. Audit of such cases must therefore use the policy framework as one of the criteria.
  - (b) Resource raising activities can take the form of public private partnership which is essentially contractual arrangement.
  - (c) Valuations, future revenue projections, discount rates, assumptions relating to rate of returns play a very important role and can influence the arrangements significantly. It may be difficult to establish clear benchmarks to evaluate the valuations.
  - (d) Innovative price discovery methods can be used. Reverse auction, Swiss challenge method etc. are examples of such innovations. In many cases, it is almost impossible to have realistic price discovery through traditional methods.
  - (e) Many elements of sound procurement system are, nevertheless applicable.
  - (f) Consultants outside government play significant roles. Such consultants provide financial, legal and other services. Little independent evaluation of the advices are done of such advices. OCAG can be the only agency to evaluate the processes independently. Services of such consultants are in turn subject to procurement procedures.
  - (g) It is often difficult to arrive at any conclusion with the audit certitude expected of OCAG. Impartial application of professional judgment and transparent reporting are important.
  - (h) Complex financial instruments and concepts play important roles. The audit engagement teams from OCAG should be fully conversant with these instruments and concepts.

10.35 The following are the compliance audit checks for such non-tax revenue arrangements:

- (i) What is the source of revenue?
- (ii) What are the arrangements for collection of revenue?
- (iii) Are the arrangements continuous or one time?
- (iv) Is the revenue for sale of assets or provision of services?
- (v) What is the overall policy framework for raising revenue?
- (vi) Is asset valuation involved?
  - (vii) In case asset valuation is involved, what are the asset valuation methodologies adopted?
- (viii) Are these valuation methodologies realistic done by competent persons?
- (ix) Is public private partnership involved?
- (x) Is monetisation of assets involved?
- (xi) Has any public asset been allowed to be exploited for non-public purpose and if so, consideration for the same?
- (xii) Does the arrangement has the approval of the competent authority?
- (xiii) Has the competent authority used any discretionary powers and if so, is he within his competence to do so?
- (xiv) Is calculation of Future Value and Net Present Value involved and if so, are the assumptions including discount rates realistic?
- (xv) What are the value discovery processes adopted?
- (xvi) Are the value discovery processes commensurate with the asset?
- (xvii) Has any asset been transferred which was outside the ambit of valuation?
- (xviii) Are the arrangements in the interest of government?
- (xix) Are there loopholes in contractual arrangements?
- (xx) Are contractual arrangements in the interest of government revenues?
- (xxi) Are there any post contractual concessions agreed to which vitiate the procurement process.

## **Chapter 11: Audit of Stores and Stocks**

- 11.1 Audit of Stores and Stocks, particularly of purchase of stores will be conducted in accordance with the mandate of CAG under Article 128(1) of the Constitution and Section 5(1) of CAG (Additional Functions) Act, 1974. This audit primarily will be compliance audit. However, to assess the effectiveness of procurement procedures and other related matters pertaining to stores and stocks, performance audit of selected areas can also be undertaken. This chapter deals with compliance audit of stores and stocks.
- 11.2 Audit of stores and stocks has four key areas. These are (i) audit of purchase of stores (ii) audit of custody and issue of stores (i.e. aspects of storekeeping) (iii) audit of stores management (iv) audit of stores records.

### **Audit of purchase of stores**

- 11.3 Audit of purchase of stores will be audited in accordance with the guidelines relating to audit of procurement described elsewhere in this guidelines. Broadly, however, the following points need to be kept in mind while auditing purchase of stores:
- (i) All purchases are properly sanctioned in writing either on file or by separate specific or general order;
  - (ii) All purchases have been carried out in accordance with the rules and regulations;
  - (iii) Quantities purchased have been calculated on realistic basis and taking into account the requirements in a reasonable time span;
  - (iv) Adequate storage facilities are available for quantities purchased;
  - (v) Funds for the purchase are available and payments have been made after supply or proof of despatch; necessary safeguards have been taken when payments have been made in advance;
  - (vi) The rates paid are reasonable and in the auditor's professional judgement, corresponds with the market rates;
  - (vii) Purchases have not been split up to remain within the delegated powers;

### **Audit of custody and issue of stores**

- 11.4 The following audit checks are recommended while auditing custody and issue of stores;
- (i) A particular official has been made responsible in the organisation for the custody of stores;
  - (ii) Physical verification of stores is carried out as per procedures and regularly;
  - (iii) Discrepancies, if any, between the book balances and physical balances have been reconciled;
  - (iv) Stores like stone chips etc. have been measured rationally and reasonably;
  - (v) Clear responsibilities have been established to safeguard stores at site;
  - (vi) Efforts have been made to transfer surplus stores to other sister offices/departments;
  - (vii) Stores have been issued against proper indents;



- (viii) If there is system of priced ledgers, the value of stores have been correctly recorded;
- (ix) Normally in government “First in First Out” methodology is adopted; exceptions to these need to be examined; in case the policy is “Last in First out” or any other method, the rationale of the same should be examined.

### ***Audit of stores management***

11.5 Audit of stores management may overlap with other key areas. However, the distinguishing audit checks relating to audit of stores management are provided below:

- (i) Stores procured involve capital blocked and long period of stores remaining locked up leads to wastage of valuable resources;
- (ii) Sound stores management should lay down parameters like stores to be held, authorised balance level triggering further procurement and issue of stores only against requirement;
- (iii) Audit of write off of stores will form important step in audit of stores and stocks. Writing off and disposal of unusable stocks indicate poor planning resulting in unnecessary procurement. Irrespective of value earned in disposal of old and obsolete stocks, it indicates poor planning; the fundamental principle at work is that government and government agencies procure stores for their own use and not for sale;

### ***Audit of stores records***

11.6 Audit of records of stores will remain an important part of audit of stores and stocks. The following audit checks are recommended:

- (i) Proper records are kept relating to stores. These will include stores registers, goods received sheets, bin cards, indent register, master list of stores including priced ledger nomenclature of stores;
- (ii) Proper system exists to maintain the documents and periodical verifications are carried out of the records;
- (iii) Documents like bin cards are maintained on chronological basis based on receipts and issues;
- (iv) Indents are kept on chronological basis;
- (iv) Issue registers are kept up to date and periodically verified.

## Chapter 12: Risk Assessment

- 12.1 Audit risk is the risk that the auditors might provide a report that is inappropriate in the circumstances of audit. In case of compliance audit, it would mean that the auditor provides findings, conclusions and recommendations that are incorrect in the circumstances of the subject matter of audit. In very simple terms, this means that the auditor provides a wrong report. In case of compliance audit, it means that the auditor provides findings and conclusions which are incorrect in as much as the auditor may have failed to detect a deviation or non-compliance or have reported a deviation or non-compliance where it was actually not a deviation or non-compliance. Such wrong report may emanate from inadequate risk analysis and resultantly, of adopting inadequate and incorrect audit procedures. Incorrect audit procedures will in case of compliance audit include selecting wrong criterion or failure to select an authority which is applicable to the transactions of the entity.
- 12.2 Audit risk is essentially a combination of three components. These are: Inherent Risks, Control Risks and Detection Risks. Inherent risk and Control risk pertain to the audited entities. These are entity's risk. Detection risk falls within the domain of the auditors.

### Non-conforming engagement

- 12.3 If any audit engagement is performed without assessing the audit risks, the engagement will not be considered as conforming to Government Auditing Standards of Bangladesh, regardless of the amount of analytical procedures and substantive tests.

### Inherent Risk

- 12.4 Inherent risk is a risk that something might go wrong because of reasons of the nature of the organization or the activities of the organization and not due to any specific control failure. Typically, for example, the inherent risk of a bank will be more than that of a upazilla health complex.

### Control Risk

- 12.5 Control risk is a risk that something might go wrong because of lack of internal control or an incident of control failure. Typically, for example, cash embezzlement may take place if cash books are not maintained properly and cash verification is not carried out regularly.

### Relationship between Inherent Risk and Control Risk.

- 12.6 It is desirable that higher the Inherent risk, Control risk should be lower. In other words, if the Inherent risk is perceived high, there should be more control measures in the organisation so that the overall risk comes down. This will lead to low Control risks. However, Inherent Risks and Control Risks being entity risks and beyond the control of the auditors, the latter should use detection risk to minimize audit risk.

### **Relationship with Audit risk.**

12.7 There is a direct relationship between audit risk, inherent risk and control risk. If inherent risk is high, the audit risk will be high. Similarly, if the control risk is high, audit risk will be high.

So  $AR \uparrow$  when  $CR \uparrow$  or  $IR \uparrow$  or  $IR \uparrow$  If the inherent risk is high or the control risk is high, then the chances of auditor not being able to detect a misstatement or deviation or deficiency goes up. This increases the audit risk.

### **How to bring down the audit risk**

12.8 One way to bring down the audit risk (i.e. to minimize chances of not detecting a misstatement or deviation or deficiency) to increase scope and volume of audit test. This minimizes the detection risk.

### **Detection risk**

12.9 Detection risk is the risk of auditor failing to detect a misstatement, deviation or deficiency. It follows that if the audit testing is increased in scope and volume, chances of failing to detect a misstatement or deviation or deficiency would go down.

So  $DR \downarrow$  when Audit testing  $\uparrow$

### ***Relationship with Audit risk.***

Audit risk has a direct relationship with the Detection risk.

So  $AR \downarrow$  when  $DR \downarrow$

12.10 If the inherent risk and control risk is high, then a low detection risk can bring down the audit risk. In layman's language this would mean that if the inherent risk and control risk are perceived high, then the scope and volume of audit testing should be increased to reduce detection risk which will reduce audit risk.

12.11 OCA's risk assessment would follow the above framework.

### ***Role of professional judgement and professional Scepticism.***

12.12 Officers and staff will apply professional Scepticism to qualitatively and quantitatively assess the risks. Application of professional Scepticism would mean that no audited entity would be considered as completely free from inherent risks and control risks. Professional judgement would mean that collectively the audit engagement team will assess the risks and allot quantitative values to each of these risks.

### **Assessment of Risks**

12.13 Risks can be assessed both quantitatively and qualitatively.

### **Norm of Qualitative assessment**

12.14 There would be three levels namely High, Medium and Low. OCAG will keep the acceptable level of audit risk as "LOW". However, the Director General may decide in case of a particular entity or cluster.

12.15 To keep the audit risk level at "LOW", at least two levels of risks should be low and the third one at medium. Audit risk cannot be low if detection risk is high. The best scenario would be to have inherent risk and detection risk at low level and control risk at not more than medium level.

### ***Norm of Quantitative assessment***

12.16 Quantitative value for risk assessment will be on a scale of 0 to 1.

### **Acceptable low level of Audit risk**

12.17 Acceptable low level of audit risk should not be more than 0.02. However, the Director General may decide in case of a particular entity or cluster.

### **Inherent Risk and Control Risk assessment**

12.18 The following factors are suggested for the purpose of Inherent and Control Risk assessment:

		If answer is Yes, the Inherent Risk/ Control Risk score on a scale of 0-5
1	Budgetary Central Organisation?	1
2	Extra-budgetary Organization?	2
3	Autonomous body funded by Government in the current year?	2
4	Is it a Statutory Corporation?	3
5	Is it a Company?	3
6	Is it fully owned by Government?	2
7	Is it a listed company?	3
8	Is there a failure to comply with BSEC compliance conditions?	3
9	Is there a failure to comply with Corporate Governance Code?	3
10	Is it a unlisted financial sector company (like NBFC)?	2
11	Is it a listed financial sector company?	4
12	Is it a Board managed company?	1
13	Does it not have a Board?	3
14	Is it a loss making company for the past three years?	3
15	Is it a profit making company for the past three years?	2

16	Is the accumulated loss more than the equity?	4
17	Is the accumulated profit more than the equity?	1
18	Is the debt equity ratio more than 1:2	1
19	Is the debt more than the equity?	4
	<b>For Non Companies</b>	
20	Is the number of transactions more than 100 per month?	3
21	Is the expenditure or receipts very high?	5
22	Does the entity deal with more than 10 account heads	1
23	Does the entity deal with more than 20 account heads	2
24	Does the entity deal with more than 30 account heads	3
25	Does the entity deal with procurement of goods?	5
26	Does the entity deal with procurement of services?	5
27	Does the entity have public financial dealings?	3
28	Is the cash management of the entity outside TSA?	3
	<b>For all entities</b>	
29	Has the entity come under adverse media publicity in recent past?	4
30	Does the entity has foreign dealings?	4
31	Is the entity under pressure to perform? ( Stiff targets)	3
32	Has the entity any person of political significance in its decision making bodies?	4
33	Is the entity headed by a full time official during last one year continuously?	1
34	Has the entity been involved in any financial scandal in recent past?	5
35	Has the OCAg received any whistle blower information?	4
36	Does the entity deal with emergency relief/ aid ?	4
37	Is the entity funded by Foreign Aid?	4
38	Is the entity highly pyramidal?	3
39	Does the entity follow Government Rules or has laid down financial rules?	1
40	Does the entity has a predominance of contract and temporary employees?	3
41	Does the entity has too many court cases against it?	4
42	Has the entity been established recently?	2

43	Does the entity function in market environment?	4
44	Does the entity's activities depend on seasonal fluctuations?	3
45	Is the entity involved in service delivery?	4

### ***Control Risks***

46	Does the entity have a separate Finance Branch?	2
47	Does the entity have a separate Internal Audit Branch?	2
48	Does the entity have a Finance Manual ?	1
49	Is the entity current in its Financial Statements?	1
50	Does the entity have internal control policies?	1
51	Does the entity conduct Control Risk Self-Assessment (CRSA)periodically?	1
52	Does the entity have a Code of Ethics?	1
53	Is the entity covered by Government vigilance Organization?	1
54	Is it a Board Managed entity?	1
55	Does the entity have an Audit Committee?	1
56	Are segregation of duties documented in the business processes?	1
57	Is the Head of the entity adequately concerned with internal controls?	1
58	Is there Parliamentary financial control over the entity?	1

### ***Detection Risks***

12.19 While considering Detection risks, the following risks to the quality of the audit should be kept in mind and mitigating measures should be taken. The risks and illustrative mitigating measures are indicated below:

	<b>Risks</b>	<b>Mitigating measures</b>
(i)	The audited entity can be very specialized scientific or technical organisation and auditors may not have adequate knowledge of the subject matter and subject matter	External experts should be involved with the audit engagement team.

	information.	
(ii)	The audited entity might have failed to cooperate fully with the audit engagement team in the past.	Matter may be taken up at the highest level and issues must be sorted out before undertaking the audit. It would be worthwhile to commit the working arrangements in writing.
(iii)	The information on the subject matter may be maintained on a digital platform and to conduct audit the engagement team would require IT experts.	The risk should be mitigated by involving IT experts in the audit engagement team. It would also be necessary to work out suitable arrangements with the audited entity in order to gain suitable access to the systems and databases to facilitate the audit. Audit should have only "Read Only access" to the systems and databases. Audit engagement team should also develop suitable protocol for data authentication so that audit evidence can be authenticated by the audited entity.
(iv)	The financial statements are in arrears.	Perform Intense audit procedure.
(v)	The information required to audit the line items, balances and assertions are dispersed over a large number of locations.	<p>The audit engagement team must collect a comprehensive list of such locations and ascertain the volumes and value of transactions. Any of the following two strategies can be used either individually or collectively:</p> <p>(a) Choose transactions on a sample basis and audit these irrespective of the locations;</p> <p>(b) Choose samples of locations and perform intense audit of the locations.</p>

## The Detection risk matrix

12.20 Logically, if 100% checks are done, then the Audit risk becomes zero. Similarly, if no test is done, then the audit risk remains entirely factored upon inherent risk and control risk. The audit engagement team should determine the extent of audit checks keeping this in view.

## *Audit Risk Assessment Tool for Compliance Audit*

Form No 3/CA/OCAG Bangladesh

1	Name of the Entity				
2.	Category of the Entity (Category I/II/III/IV)				
3.	Brief Understanding of the Entity highlighting nature of operations, financial aspects and financial reporting framework				
4.	Indicate clearly basis of accounts (In case of hybrid basis, indicate clearly the transactions on cash basis and transactions on accrual basis)				
5.	Indicate documents consulted and procedures performed to obtain the understanding				
6	Indicate Inherent Risk Score with Inherent Risk Assessment Document Number:				
7.	Indicate Control Risk Score with Control Risk Assessment Document Number:				
8	Detection Risk level				
9	Overall Audit Risk Level				
10	Indicate Documents consulted and procedures performed to assess control Risks				
11	Indicate audit areas and their risk level		Audit Area	Risk Assessment	Basis



12.	Participants in the Risk Assessment meetings				
13.	This Document		Prepared By		Date
			Approved By		Date
14	Comments of the Approver				

### ***Special considerations for risk assessment in compliance audit***

12.21 The strategy for effective compliance audit should be to select important areas of audit and concentrate on these rather than trying to seek assurance in all areas. Pay and allowances, for example can be considered a low risk area unless there are cases of bulk pay fixation due to pay revisions or any other reason. It is essential for the audit engagement team to understand the system and the control risks mitigation mechanism. For example, if the pay bills are prepared

fresh every month by hand, the risk will be much more than computerized pay bill preparation.

12.22 Typically, government bills for non-cheque drawing offices pass through an independent organization. This is to be considered as an effective control risk mitigation measure as all bills are checked by an independent authority.

### ***Cluster risk assessment***

12.23 OCAG is required to carry out compliance audit of a large number of entities every year. Many of these entities are similar in nature in their activities and expenditure pattern and some of them are quite small in volume of transactions. Carrying out risk assessment of each and every such entity can be infructuous. It will thus be practical to form clusters of such entities for the purpose of risk assessment, which can be carried out every year at the beginning. For example, all Primary Health Centres of a particular type can be considered as a cluster and a risk assessment may be carried out every year before the audit season .

### ***Additional factors for risk assessment***

12.24 For compliance audit, the following additional factors may be considered while carrying out risk assessment:

- (1) Routine and Non-routine activities: A typical district social welfare office is an example of an entity with routine activities. The activities (suggestive) considered as non-routine can be:
  - (i) Local procurement;
  - (ii) Managing stores but not procuring them;
  - (ii) Seasonal spurts in activities and expenditure (election office in an election year);
  - (iv) Procurement including procurement of perishable goods;
- (2) Financial dealings with public: Distribution of financial assistance, distribution of relief etc.

- (3) Non-financial dealings with public but responsible for distribution of materials like seeds, fertilizers, blankets and relief materials etc.
- (4) Entities without much activity like a statistics gathering office in a far flung area.
- (5) Dealing with loose cash receipts like entry fees in zoos, parks;
- (6) Extremely small office but with cash dealings;

# Chapter 13: Materiality

- 13.1 Materiality in the context of audit means that any misstatement or omission or deviation is of such magnitude that it could reasonably be expected to influence the intended users of the audit report in case of compliance audit.
- 13.2 The auditor's determination of materiality is a matter of professional judgement. However, this professional judgement is not ad hoc and is informed by the circumstances of the audited entity and the auditor's risk assessment.
- 13.3 Materiality is relevant both in planning and performance of the audit engagement. The overall materiality is normally set at the planning stage or even at the audit strategy stage.
- 13.4 It is important to keep in mind that materiality establishes an amount below which, the deviations, omissions or non-compliance might be considered as immaterial to affect the judgement of the state of compliance of the entity with the authorities. However, that is a general statement. The circumstances related to some of the misstatements might lead the auditor to evaluate them as material even if the amount is below the level of materiality.
- 13.5 It should also be borne in mind that in compliance audit particularly in the context of public sector audit, the financial amount may not be the sole criterion to form a judgement regarding materiality with relation to non-compliance. There can be situations in which the monetary implication may be negligible but the nature of non-compliance is such that it needs to be brought to the notice of the legislature and the general public through audit report.

## *Link between Risk assessment and Materiality*

- 13.6 There is close link between Audit risks and Materiality. Essentially, the auditor's judgement about materiality provide a basis for:
- (a) Determining the nature, timing and extent of risk assessment procedure;
  - (b) Identifying and assessing the risks of deviations; and
  - (c) Determining the nature, timing and extent of audit procedures.

## *Three types of Materiality*

- 13.7 The auditor needs to determine three types of materiality. These are:
- (a) Overall materiality;
  - (b) Performance materiality; and
  - (c) Trivial materiality or clearly trivial materiality.
- 13.8 **Overall materiality** is the materiality level which is set by the auditor for the audited entity as a whole. One can say that it is set at the macro level, more to assist in planning and determination of performance materiality rather than determining the audit procedures.

- 13.9 **Performance materiality** is the materiality level set by the auditor below the level of overall materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected deviations, omissions and non-compliance exceeds overall materiality. To put it simply, the performance materiality can be termed as the working materiality which assists the auditor to plan the audit procedures in respect of the class of transactions and audit areas.
- 13.10 The performance materiality must therefore be less than the overall materiality but it should not be computed mechanically. The following factors should enable decisions relating to performance materiality in respect of line items, account balances, class of transactions and disclosures:
- (a) Professional judgement;
  - (b) Overall Risk assessment;
  - (c) Understanding of the entity;
  - (d) Results of previous audits;
  - (e) Importance of each item in the overall context;
  - (f) Expectation of misstatements in the current period.
- 13.11 **Trivial materiality or clearly trivial materiality** are such deviations which are smaller in magnitude or of a nature that is considered inconsequential. The inconsequentiality of the deviations will be judged by the criteria of size, nature or circumstances.

### ***Key steps to Determine overall materiality***

- 13.12 The key steps to determine overall materiality are the following:

Appropriate benchmark

Determining a percentage of the benchmark

Explain the choice and the percentage i.e. explain professional judgement.

### **Appropriate Benchmarks in respect of entities not having commercial operations**

- 13.13 The main objective of such entities is public service delivery. It is therefore recommended that the appropriate benchmark for such entities will be the expenditure incurred in the financial year.

### **Appropriate Benchmarks in respect of entities having commercial operations**

- 13.14 Entities having commercial operations primarily work for revenue/profit. ISA 320 gives a number of examples of benchmarks that can be used. These include:
- profit before tax or normalised (or adjusted) profit before tax
  - total income or total expenses
  - gross profit
  - total equity
  - net assets.

It is recommended that the total income from operations and financial activities may be treated as the benchmark to determine overall materiality.

### ***Determining a percentage of the benchmark***

13.15 It is recommended that a range of 1-2% of the recommended benchmark should be considered as the appropriate level of overall materiality. It should rarely exceed 5% of the benchmark. However, while choosing the percentage, it should be kept in mind that it is auditor's professional judgement that should determine the percentage. The above percentage should be taken as indicative and not prescriptive.

### ***Revision as the Audit Progresses***

13.16 Materiality including performance materiality and clearly trivial materiality can be revised as a result of change in circumstances that occurred during the audit, new information, a change in the auditor's understanding of the entity or any new fact coming into notice requiring change in the scope of audit.

### **Action on deviations, omissions and non-compliance identified during the audit**

13.17 The following steps would be taken by the audit engagement teams in respect of identified deviations, omissions and non-compliance.

- (i) The audit engagement team shall accumulate such incidents identified during the audit except those which are considered as clearly trivial;
- (ii) The team will consider whether the overall audit strategy and audit plan need to be revised if:
  - (a) The nature of identified incidents and the circumstances of their occurrence indicate that other deviations etc. may exist which, when added to the identified deviations, could be material; or
  - (b) The aggregate of the money value of all deviations, omissions and non-compliance identified during the audit approaches materiality;
- (iii) The audit engagement team will evaluate all the deviations, omissions and non-compliance to identify serious irregularities with or without financial implications and will seek comments from the entity on such irregularities.
- (iv) The final decision to include the findings in the audit report will depend on three factors namely, nature of the irregularity, materiality and the replies given by the entity.

### ***Materiality and Fraud***

13.18 If the audit engagement teams come across any evidence of suspected fraud, embezzlement of cash and other assets or any such serious misdemeanor, they would be treated without consideration of materiality. Such findings, irrespective of the money value, will be treated as serious and action as deemed necessary will be taken by the team without consideration of materiality.

## ***Documentation***

13.19 The audit engagement team will include in the audit documentation:

- (a) A list of all deviations, omissions and non-compliance identified during the audit engagement;
- (b) The amount below which the deviations would be considered as trivial;
- (c) The conclusion with adequate justification as to whether the deviations are material, individually or in aggregate.

## Chapter 14: Audit Evidence

- 14.1 Audit Evidence is all the information that an audit engagement team gathers by performing audit procedures and other sources both inside and outside of the entity, that assist it to arrive at conclusions. Audit evidence is gathered primarily during the performance of the audit. There can be situations and circumstances in which the absence of information (for example, management's refusal to provide a requested information or failure of the entity to provide replies to audit queries and memos) can be used by the auditor and hence constitutes audit evidence.
- 14.2 Audit evidence in its totality needs to be sufficient and appropriate. The audit engagement team is thus required to plan and perform the audit in such a manner that it can obtain appropriate evidence which are sufficient to support the conclusions.
- 14.3 Sufficiency is the measure of quantity of audit evidence. It directly relates to risk assessment and the auditor's response to the risks assessed. As the risks increase, the need for quantum of evidence also increases. Sufficiency of evidence also relate to the totality of the evidence. For example, sanction of an expenditure is not sufficient evidence that the expenditure has indeed occurred. Similarly, a document showing an intended journey like a tour programme is not sufficient evidence that a tour has indeed been undertaken. It is to be kept in mind that quantity alone cannot compensate for the poor quality of evidence.
- 14.4 Appropriateness of audit evidence refers to the quality of the evidence. It relates to relevance and reliability in providing support for the conclusions on the basis of which the opinion will be provided. As quality of evidence increases, the need for additional corroborative evidence decreases. While the relevance of the evidence is related to the objective of the audit procedures, reliability refers to the nature and source of the information. For example, an independent confirmation from recipient is more reliable than the record of the department regarding a payment.
- 14.5 In case of compliance audit, evidence needs to be always evaluated against the authorities. Evidence in these circumstances, often constitutes details of a single transaction or a class of transactions. Sufficiency and appropriateness of evidence should not be confused with the inadequacy of authorities or incorrect interpretation of such authorities. As regards the details of transactions in case of compliance audit, two elements of such details must be kept in mind. The first are the facts concerning the transaction. The second is the interpretation of those facts. Normally there should not be any divergent views about the facts. That a purchase order was placed on a supplier is a fact. That a tender was called and there was only one response is a fact. Whether there were adequate efforts to discover the lowest price can be a matter of opinion based on interpretation by audit of the circumstances of the facts. A distinction needs to be made between the two.

- 14.6 The facts should not be based on hearsay or indirect or unverified set of information. Evidence based on documents averring the transaction is the best in case of compliance audit. Thus a voucher of a payment is the best evidence that the payment has been made, not a sanction order for the payment or an entry in the account books.
- 14.7 Opinions and surmises are not direct evidence of an event happening or the nature of the event. For instance, a Secretary of a Ministry observing on a file that “the situation is bad” is not an evidence that the situation is indeed bad. At best it is the evidence of the fact that the Secretary thought that the situation was bad.
- 14.8 Inaccurate or incomplete information affect the relevance and reliability of audit evidence.
- 14.9 The following key principles should be kept in mind by the audit engagement teams while considering the relevance and reliability of the audit evidence:
- (a) Evidence obtained directly by the auditors from original documents are more reliable than those obtained indirectly.
  - (b) Evidence gathered from originals are more reliable than from photocopies, or documents that have been filmed, digitised, or converted into electronic forms; The auditor is not an expert on document authentication and hence professional scepticism should be exercised while evaluating the authenticity of any document.
  - (c) Newspaper and magazine reports, unconfirmed data and reports, unverified complaints, anonymous complaints, photographs- digital or otherwise and similar documents are unreliable evidence for the purpose of audit.
  - (d) Unscientific and unauthorised surveys, responses from randomly selected beneficiaries, contradictory responses etc. are both irrelevant and unreliable.
  - (e) When information on the same subject is collected from different sources, consistency of the information is the key criterion of reliability of audit evidence.
  - (f) Corroboration of information is a key criterion in assessing the reliability of the evidence. Corroboration from a party independent of the entity (for example, banks) is thus a major source of assurance for the auditor regarding the reliability of the evidence.
  - (g) The evaluation of the relevance and reliability of audit evidence gathered during an audit engagement is a matter of auditor’s professional judgement and is the sole responsibility of the auditor.

### ***Audit Procedures to obtain audit evidence***

14.10 Broadly, the audit procedures to obtain sufficient and appropriate audit evidence are:

- (a) Risk assessment Procedures;
- (b) Test of Controls;
- (c) Substantive procedures.

14.11 The methods of these procedures are:



## ***Inspection***

- 14.12 Inspection involves examining records and documents, whether internal or external in paper or electronic format or physical examination of an asset. Inspection is probably the most important way for compliance audit. However, it should be borne in mind that such inspection without a definite objective can turn out to be a search in darkness. Audit engagement teams should avoid trying to carry out a blind inspection without any audit strategy and audit planning.

## ***Observation***

- 14.13 Observation involves looking at a process or procedure being performed by others such as cash verification by entity's personnel or checking physical verification of inventories.

## ***External Confirmation***

- 14.14 An external confirmation, widely practiced in case of bank balances, and balances where third parties are involved, is audit evidence as a direct written response to the auditor from a third party. The confirmation can be in paper form or in electronic form. In case of financial audit, external confirmation of balances may constitute a very important part of audit procedures. In case of compliance audit, such verification may cover a large number of areas, namely whether benefits have reached the stated beneficiaries, or whether a payment claimed to have been made has indeed been made to the claimant.
- 14.15 External confirmation in compliance audit may also be an effective procedure to detect evidence of fraud and embezzlement particularly in case of disbursements. The audit engagement team must seek precise information from the third party including mode of payment, dates and other details. Electronic transfer itself is not a guarantee that the money is reaching the claimant.

## ***Recalculation***

- 14.16 Recalculation involves checking the mathematical accuracy of documents and records.

## ***Re-performance***

- 14.17 Re-performance- often used as part of test of controls- involves auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

## ***Analytical Procedures***

- 14.18 Analytical procedures consist of evaluations of information-financial or non-financial, through analysis of plausible relationships among both financial and non-financial data. Trend analysis is a good example of analytical procedure. Such procedures involve identifying notable fluctuations and relationships among the datasets or that differ from expected values by a significant amount. Normally payroll expense in an entity in every month is expected to be similar with very little fluctuations. The auditor while comparing the payroll expenses might expect a 5% variation from month to month. Any variation beyond that needs auditor's examination.

## ***Inquiry***

- 14.19 Inquiry consists of seeking information of knowledgeable persons within the entity or outside the entity. Inquiry should be used throughout the audit but only in addition of other audit procedures. Inquiries may range from formal written queries to informal interviews and oral inquiries.
- 14.20 The auditor must apply professional judgement and professional scepticism to evaluate evidence emanating from inquiries-particularly oral informal inquiries.

## ***Selecting Items for Testing to Obtain Audit Evidence***

- 14.21 An effective test provides appropriate audit evidence to an extent that, taken with other audit evidence obtained, will be sufficient for the auditor's purpose. While selecting items for testing or while selecting the population from which the sample is to be chosen, it is necessary to keep in mind the issues of relevance and reliability of the evidence. In fact, the auditor must determine the relevance and more importantly the reliability of the information even before deciding on the testing. The means available to the auditor for selecting items for testing are:

- (a) Selecting all items;
- (b) Selecting specific items;
- (c) Audit sampling.

The application of the selecting methods will depend on the practicality and efficiency of the method as also the circumstances.

In audit reports for public sector auditing, it may not always be possible to arrive at conclusion on estimations based on statistical sampling.

## ***Selecting All Items***

- 14.22 Selecting all items may be necessary when it is most appropriate to examine the entire population of items. Such selection will be more common for test of details. 100% examination may be appropriate when:
- (a) The populations consist of small number of large value items;
  - (b) The risks are so significant that 100% items need to be tested;
  - (c) When such testing is done using IT and is thus cost effective.

In case of compliance audit, it may be worthwhile to carry out intensive checks in a few areas rather than doing a cursory check in a large number of areas. Risk assessment will provide a very useful tool in this respect.

## ***Selecting Specific Items***

14.23 The judgemental selection of selecting is subject to non-sampling risks. However, this can be resorted to in the following circumstances:

- (a) High Value or Key Items: It may be decided to select specific items within a population because they are of high value or exhibit some other characteristics which are significant from the auditor's point of view. Such items can be particularly risk prone, unusual or of particular professional interest to the auditor.
- (b) All items over a certain value: It may be decided to select all items whose value exceed a certain amount. This may also help to verify a large proportion of the total amount of a class of transactions or account balance.
- (c) Items to obtain information: It may be decided to examine items to obtain information about such matters to ascertain the nature of the entity or to understand the nature of the transactions.

## ***Audit Sampling***

14.24 Audit sampling is used to provide a reasonable basis to draw conclusions about the population from which the sample is selected. While drawing conclusions, factors like sampling methodologies, sampling risks, anomaly etc. should be kept in mind. The following two terms need particular explanation:

- (a) Tolerable misstatements: A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatements of the population. Tolerable misstatements, thus are the application of performance materiality to sampling procedures. Tolerable misstatements should be the same amount of performance materiality or preferably an amount lower than the performance materiality.
- (b) Tolerable rate of deviation: Mainly applied for testing of controls, tolerable rate of deviation from the control procedure is set in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

(Example: Signing of cheques by at least two signatories is a critical control measure. The audit team might expect a ZERO rate of deviation to this. Even if one cheque in a sample selected following statistical sampling procedure is found to be lacking two signatures, the auditor may have to reassess the control risks and expand detailed testing.)

## ***Special Considerations:***

### **Inventory**

14.25 Inventory is often material to the financial statements, especially in case of entities with commercial activities. But it is of equal importance for compliance audit. While in financial audit, an auditor is more concerned with the depiction of balances and absence of misstatements, in compliance audit, the auditor should be more concerned with the system of inventory procurement and recording. It is also important for the audit engagement team to obtain sufficient and appropriate audit evidence regarding the existence and condition of the inventory. The following audit procedures may be used by the team:

- (a) Attendance at the physical inventory counting: often impracticable as the inventories are recorded on a particular date and there can be many entities using the same balance sheet date. OCAg will find it impossible to attend the inventory counting on the last date of the financial period which is the balance sheet date.
- (b) Evaluation of management's instructions and procedures: these instructions and procedures will reveal the soundness of these instructions and procedures, on one hand and on the other, the actual performance of the management in following these. Auditors should pay particular attention to slow moving, obsolete and damaged items and ensure that these items have not been included in the list of good inventory.
- (c) Record of physical inventory counting: examination of records relating to actual counting of physical inventories should be examined. Such physical verification must be as close to the Balance Sheet date as possible. The audit team must specially examine the movement of inventories since physical verification in order to arrive at the account balance on the Balance Sheet date.
- (d) Inspect the Inventory: the audit team may inspect the inventory on a select date. However, in respect of the sample items, the audit team may arrive at the balance independently and physically verify that the balance tallies with the inventories available physically.

### ***Fixed Assets and Plant and Machinery***

14.26 Usage of plant and machineries will form one of the important areas of compliance audit.

### ***External Confirmations***

14.27 The following audit procedures will be performed to obtain external confirmation requests:

- (a) Determine the information to be confirmed or requested;
- (b) Determine the appropriate confirming party;
- (c) Draft the confirmation requests which should include request for return information, where applicable and a time limit;
- (d) Send the requests including follow up requests.

14.28 Confirmations can be positive or negative. The audit team should suitably evaluate the nature of confirmations and apply professional judgement to determine whether the confirmations received can be treated as sufficient and appropriate evidence.

### ***Documentation***

14.29 With regard to documentation, the duties of the audit engagement teams will be:

- (a) To record truthfully all evidence that have been obtained as a result of application of audit procedures applied both for test of controls and substantive procedures;
- (b) To document comprehensively the process of evaluation of the audit evidence obtained and record application of professional judgement.
- (c) To recommend conclusions supported by audit evidence.

## Chapter 15: Audit Documentation

- 15.1 Audit Documentation is the record of all the audit processes and procedures performed, audit evidence obtained and conclusions reached. Audit Documentation often is referred to as audit working papers or work-papers. In simple terms, Audit Documentation includes all records from beginning to end of an audit engagement. Such documentation may include one or more Audit Files or Audit Folders.
- 15.2 Audit documentation is important for the following reasons:
- (1) It is a record that should support the findings and conclusion of the audit engagement team;
  - (2) It serves at a later date, as a source of information regarding all that has gone into the audit engagement and as a reference for subsequent discussions at the Public Accounts Committee;
  - (3) It is a record of auditor's compliance with the standards and other materials;
  - (4) It enables effective direction, supervision and review;
  - (5) It enables independent assessment of the audit engagement at a future date and facilitates quality assurance of the audit engagement.
- 15.3 Audit Documentation should be prepared in such a manner that it should be sufficient to enable an experienced auditor who is not at all associated with the particular audit engagement, to understand:
- (a) The nature, timing and extent of the audit procedures performed to comply with the auditing standards and applicable legal and regulatory frameworks;
  - (b) The results of the audit procedures and the audit evidence obtained; and
  - (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

### ***What should Audit Documentation include:***

- 15.4 Audit documentation in the form of audit files can be generally divided into two categories namely permanent file and current file. Permanent files typically contain information (information of continuing importance) that can be useful to the auditor for several assignments at the audit entity, whereas current files usually contain the supporting documentation (information relevant to a single period) for a specific audit.
- a) A permanent file should at least contain information on the following:
- (i) The legal and organizational framework of the audited entity,
  - (ii) A description of internal control system of the entity,
  - (iii) Extracts or copies of essential legal papers, agreements (e.g., loan agreements), and minutes that may be important and relevant for audit.
  - (iv) Notes regarding significant accounting policies being followed by the entity.

Permanent file is an important reference for getting a preliminary understanding of audit. Therefore, the file should be reviewed at least annually to ensure that outdated material is removed and that relevant documents from the most recent audit are included. Pertinent audit documentation should be retained in line with the document retention regulations. Permanent audit files should be retained and filed by the audit team responsible for auditing the entity concerned.

- b) A current file must contain the information following:
  - (i) Audit Strategy and Audit Planning Documentation including revisions;
  - (ii) Risk Assessment documentation;
  - (iii) Any other record relating to audit strategy and audit planning;
  - (iv) Audit procedures planned and performed;
  - (v) Correspondence with the entity relating to the audit engagement including *ALL* audit queries and audit memos and replies received thereto;
  - (vi) Audit evidence collected during the audit engagement;
  - (vii) Letters of confirmations and representations;
  - (viii) Analyses of audit evidence and replies of the entities;
  - (ix) Checklists filled in where checklists are prescribed;
  - (x) List of records demanded by the audit engagement team but not provided by the entity and the decision of the audit engagement team on this;
  - (xi) Records of collective professional judgement applied;
  - (xii) Significant matters arising out of the audit engagement;
  - (xiii) The conclusions arrived at by the audit engagement team and the basis thereof;
  - (xiv) Draft audit inspection report;
  - (xv) Final inspection report.

15.5 The following guidelines should be kept in mind by the audit engagement team with regard to Audit Documentation:

- (a) The assembly of the final Audit Documentation file will be the responsibility of the Team Leader of the audit engagement team;
- (b) No audit query or audit memo or any other correspondence with the audited entity will be left out of the Audit Documentation;
- (c) Audit Documentation will include the responses of the entity and comments of the audit engagement team on such responses;
- (d) The audit engagement team shall make a separate list of such communications with the audited entities to which no responses have been received;
- (e) The Audit Documentation will be reviewed by the concerned Director General and his remarks including NIL remarks shall be part of the Audit Documentation.
- (f) After reviewing the Documentation by the Director General, the draft AIR shall be authorised to be issued to the audited entity or the management or to those charged with the governance of the entity, as the case may be.

## Chapter 16: Communication and Reporting

### *Introductory*

- 16.1 It is in the treatment of results of audit that the auditorial function demands the highest qualities of understanding, balanced judgement and sense of proportion: and it is to enable him to deal with results adequately that the auditor has been accorded a high degree of independence and prestige. An auditor must develop an instinct for assessing the importance of an individual irregularity.
- 16.2 It should be remembered that, while financial and other rules must be observed, mere rigid and literal enforcement of such rules and orders may degenerate into wholly unintelligible audit. As a general rule, undue insistence on trivial errors and technical irregularities should be avoided, and more time and attention devoted to the investigation of really important and substantial irregularities with the object not only securing rectification of the particular irregularity but also of ensuring regularity and propriety in similar cases for the future. At the same time failure to appreciate the significance of what appears to be trifling irregularity may lead to failure to discover an important fraud or defalcation. Again, notice may be taken of the cumulative effect of numerous petty errors or irregularities as indicating carelessness and inefficiency in the maintenance of accounts or in financial administration generally.
- 16.3 All observations and queries must be conveyed in courteous and impersonal terms, and must be legible and intelligible. It is of the utmost importance that any statement of criticism or irregularity in an audit report should be accurate, fair, moderately worded and dispassionate.
- 16.4 For Category I entities, reports of individual cases of serious financial irregularities (SFIs) should in first instance, be addressed to the Principal Accounting Officer. Moreover, all observations including non-SFIs should be addressed to the heads of apex agencies<sup>13</sup> concerned so that, responsible authorities communicate their responses with necessary documents and explanations to the auditor in time.

For Category II, III, and IV entities, all observations should be addressed to the heads of apex agencies with a copy to the Secretary of concerned ministry / division, but their responses on SFIs should be routed through the Secretary of concerned Ministry / Division.

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<sup>13</sup> Generally, heads of apex agencies mean heads of the departments / directorates.

## ***Audit Queries***

- 16.5 An audit query is defined as a communication with an audited entity in which the audit engagement team requisitions records, documents, information, confirmation to further proceed with the audit engagement. It is usual that the audit engagement team would require considerable information from the audited entity to begin with its work and as the engagement moves on, such queries will only rise.
- 16.6 While requisitioning records, documents etc. the audit engagement team should be precise in their requisition. In case it has an 'order' and wants to examine the background papers of which the team does not possess any precise information, the phrase "papers leading to the issue of order No" may be used. On the whole, the audit engagement team should avoid leading a fishing expedition while seeking records and documents.
- 16.7 The audit engagement team may have a meeting and in case it is required, more than one meeting to form an idea about the records before formally requisitioning them. Such meetings avoid infructuous work.
- 16.8 The following should be kept in mind while issuing audit queries:
- (1) All audit queries should be numbered, dated and signed by the team leader who should pay attention to the preciseness of the requisition, the relevance and other factors of the contents;
  - (2) The audit engagement team may be required to examine registers. The names of the registers and the period of such registers should be mentioned.
  - (3) Books like cash book may be required by the entity on a day to day basis. It is recommended that suitable convenience should be worked out so that it does not disrupt the working of the entity. Such registers should not be kept in the custody of the audit team for a long time.
  - (4) Adequate time should be allowed to the entity for providing the records. Often this is extra work and no additional staff is available for this additional work. To the extent possible, requisition of routine documents should be intimated to the audited entity even before the commencement of the audit engagement.
  - (5) All audit queries should be in courteous language. No unrealistic deadline should be given for submission of records.

## ***Audit memos***

- 16.9 Audit observations are such communications through which the audit team communicates its findings and preliminary conclusions for seeking comments of the audited entity. The primary standard of such communication would be that it should be such that the reader should be able to understand the context, be aware of the authorities, comprehend the transactions and understand



the audit engagement team's point of view about non-compliance. The audit memo containing the observation should be comprehensive and to the point, precisely bringing out the context, the authorities, the transaction and the aspect of non-compliance.

### ***Model Audit observation***

16.10 OCAG shall issue a separate instruction regarding the format of audit observation memos. The audit observation memos shall include the following elements and shall be communicated as audit memos mentioned above (although not necessarily in this order):

- (i) Title;
- (ii) Context or Condition;
- (iii) Criteria and authority;
- (iv) Cause;
- (v) Consequence of such transaction; and
- (vi) Conclusion and recommendations.

### ***Principal-Auditor Vs Sub-Auditor***

16.11 Normally, each audit directorate is responsible for audit of specific Grant(s) or Appropriation(s) or Entity(ies). If an audit directorate conducts audit on a part of a grant/ appropriation / entity which is under audit jurisdiction of another directorate then the latter will be known as principal auditor and the former will be considered as sub-auditor. In this case the findings of the sub auditor will considered to be included in the audit report prepared by the principal auditor. A&R wing of OCAG shall issue a separate instruction for detail procedure for this operation.

### ***Audit Inspection Report***

16.12 Audit inspection report is the first report that is issued to the entity on completion of the audit engagement. This is not a report under Article 132 of the Constitution nor the audit inspection report is approved by the CAG at this stage. It is therefore important to remember that this cannot be termed as CAG's report, even though it is issued by OCAG.

16.13 The audit inspection report highlights cases of deviations and non-compliance to provide an opportunity to the audit entity to respond to such observations and bring on record new facts to explain the transactions. This also gives the entity an opportunity to take remedial measures in the interim and inform audit about such measures. The audit inspection report is therefore to be considered as yet another stage of communication between the audit and the audited entity.

16.14 Audit inspection reports (AIRs) will be issued by the concerned directorate and not by the audit engagement team. The directorate shall follow the Audit Calendar to ensure that audit inspection reports are issued during the stipulated time period in accordance with the calendar. It will review the evidence obtained by the audit engagement team from the audit documentation file submitted by the team and edit and evaluate the draft inspection report submitted by the team before issuing it to the entity. The concept of materiality and importance of the issue raised will be considered by the directorate before reaching a

decision about inclusion of an observation in the inspection report.

- 16.15 While reviewing the draft audit inspection report, the directorate shall combine the audit observations of same nature under the same apex unit to which the AIR is issued. Each of these observations which are combined together shall have sufficient and appropriate audit evidence.
- 16.16 The final AIR which is issued to the apex unit or entity is a refined version of the draft AIR. It shall be the duty of the directorate to ensure all quality control procedures as stipulated by the OCAG in accordance with the Quality Control System (QCS) before finalizing the draft AIR.
- 16.17 The audit inspection report will be divided in two parts, Part – I & Part – II. Part – II is further divided into two sub – parts: Part – II (A), Part – II (B). If required Part – II (C) may be added in the AIR. The structure with descriptions of the parts are as follows:

## ***Part I***

16.18 This part should contain the following information:

- (i) Name of the entity;
- (ii) Duration of audit from. (dd/mm/yyyy) to(dd/mm/yyyy);
- (iii) Period covered by audit from (mm/yy) to (mm/yy);
- (iv) Short introduction of the entity;
- (v) Scope of audit;
- (vi) Authorities used as criteria in audit;
- (vii) Standards according to which the audit was conducted;
- (viii) Names of the members of the audit engagement team including that of the team leader;
- ((ix) Location of audit including branches of the entity visited by the audit party;
- (x) Field trip undertaken by the audit team to obtain understanding of the entity;
- (xi) List of records, documents and information sought by the audit party;
- (xii) List of records, documents and information provided by the entity;
- (xiii) List of records, documents and information **not** provided by the entity;
- (xiv) Number of meetings with officials of entity with dates and time;
- (xv) Total number of audit queries issued to the entity by the audit engagement team during the course of audit;
- (xvi) Number of audit queries replied to;
- (xvii) Total number of audit observations issued to the entity by the audit engagement team during the course of audit;
- (xviii) Number of audit observations replied to;
- (xix) Number of audit observations that have not been included in the draft inspection report submitted by the audit engagement team;
- (xx) Any finding or observation that was not raised during the course of audit but included in this report due to new facts coming to the notice of the audit team/OCAG. (Yes/No with Paragraph No);
- (xxi) A general request should be issued to respond in writing to the observations in Part II of the audit inspection report.

## **Part II A**

- (i) Part II A should contain such observations which have the potential of being considered for inclusion in the audit report to be submitted under Article 132 of the Constitution.
- (ii) Each observation will be drafted in the format of the audit observations mentioned earlier. These should be detailed and should contain all relevant information and the exact nature of deviation/ non-compliance as well as the impact of such deviation or non-compliance. Pecuniary loss can be just one of the considerations. Other issues like potential loss of reputation, risk of accidents, damage to environment, impairment of asset, lack of controls, suspected fraud, should also be highlighted, should they pass the test of materiality.
- (iii) While pointing out risks of future happenings, the engagement team and the inspection report must provide cogent, objective and verifiable evidence to support the contention of audit. It is essential that professional judgement is applied in an unbiased manner.

## **Part II B**

- (i) Part II B should contain such observations involving deviations or non-compliance but do not have the potential of inclusion in the audit report under Article 132 of the Constitution.

## **Part II C**

- (i) Part II C should contain all other observations relating to the performance of audit procedures and findings. Such findings can be positive or negative. In case of positive and affirmative findings, additional care should be taken to describe the audit scope, the records verified and the limited nature of assurance. Observation included in Part II C should be such that no separate pursuance will be necessary.

## ***Internal Action in OCAg***

### **Part II – A**

- (i) For Category – I entities, SFIs will be issued to the Principal Accounting Officer with a copy to the Head of the Department. For other categories SFIs will be issued to the head of apex agencies or those responsible for governance with a copy to Secretary of concerned ministry / division, and the responses to SFIs should be routed through the Secretary of concerned ministry / division;
- (ii) A separate register called SFI Register should be maintained in all directorates for each sector. All observations featured in Part II – A should be entered in this register individually with all details;
- (iii) Replies to the audit observations will be considered in the relevant audit documentation file and results will be noted in the Register;
- (iv) All observations in the SFI Register must be reviewed in every quarter (a) to ascertain that replies have been received (b) to ascertain that the replies have been considered (c) to decide on continuation of the observation in the Register in view of the replies;
- (v) An observation, when included in the audit report or when relegated to Part II – B will be removed from the Register;
- (vi) For SFIs which are not included in the audit report, if possible, additional information or evidence are collected in the following years and will be considered to be included in the audit report;
- (vii) No observation will be retained in the Register beyond three calendar years even if it is not considered for inclusion in the audit report. The year in which the AIR is issued will be counted as the first year. At the end of third year the SFIs which are not included in the audit report shall be relegated to Part II-B and shall be included in the non-SFI Register. A list of SFIs which are removed from Part II – A to Part II – B shall be sent to the Principal Accounting Officer (for Category I entities) and to the head of apex agencies (for Categories II, III, IV entities).

## ***Part II – B***

- (i) For Category – I entities, non-SFIs will be issued to the Head of the Department. For other categories non-SFIs will be issued to the head of apex agencies or those responsible for governance;
- (ii) A separate register called non-SFI Register should be maintained in all directorates for each sector. All observations featured in Part II – B and those relegated from Part II – A should be entered in this register individually with all details;
- (iii) Replies to the audit observations will be considered in the relevant audit documentation file and results will be noted in the Register;
- (iv) In any extremely rare case if additional information or evidence is collected, a Part II – B observation may have potentiality to be included in the audit report. Part II – B observations, which individually may be below the materiality level but together with similar observation in other units within same apex agency may have potentiality to be included in the audit report. Such observations will be included in the SFI register.
- (v) An observation, when included in the SFI register or in the audit report will be removed from the Register;
- (vi) All observations in the non-SFI Register must be reviewed in every year (a) to ascertain that replies have been received (b) to ascertain that the replies have been considered (c) to decide on continuation of the observation in the Register in view of the replies;
- (vii) The unsettled observations except those relating to withdrawal in excess of entitlement, direct loss of revenue, and misappropriation due to fraud, embezzlement, defalcation will be pursued for three years. The audit directorates on review shall strive to remove such non-SFIs from the non-SFI Register within this period. The year in which the AIR is issued will be counted as the first year. At the end of third year a list of non-SFIs which will not be pursued further will be sent:
  - (a) to the head of the departments for Category I entities with an advice to take necessary actions;
  - (b) to the head of apex agencies for Category II, III & IV entities with an advice to take necessary actions.

## ***Audit Report Format***

- 16.19 OCAG shall issue a separate instruction regarding the format of compliance audit report. The audit report shall include the following elements (although not necessarily in this order):
- (i) title;
  - (ii) identification of auditing standards;
  - (iii) executive summary (as appropriate);
  - (iv) description of subject matter and the scope (extent and limits of the audit);
  - (v) audit criteria;
  - (vi) explanation and reasoning for method used;
  - (vii) findings;
  - (viii) conclusion(s) based on answers to specific audit questions or opinion;
  - (ix) replies from the audited entity (as appropriate);
  - (x) recommendations (as appropriate).