

International Peer Review of the Supreme Audit Institution of India

Australia—Australian National Audit Office 

Canada—Office of the Auditor General of Canada 

Denmark—Rigsrevisionen 

The Netherlands—Algemene Rekenkamer 

United States of America—Government Accountability Office 



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EXECUTIVE SUMMARY AND RECOMMENDATIONS

EXECUTIVE SUMMARY

1. India has one of the largest public sectors in the world, within which there is a recognised need to strengthen performance, accountability for results and financial management systems. In this environment, the scale and complexity of the Supreme Audit Institution of India's (SAI India's) work are considerable. SAI India has around 43 500 staff, and its auditing covers multiple levels of government, all government sectors and many different types of organisations. There is also significant diversity in language, governance and development in the 28 states and seven union territories subject to audit by SAI India. This environment highlights the importance of SAI India's role in terms of improving public sector performance and accountability, and necessarily affects the audit approach it adopts.
2. At the request of the Comptroller and Auditor General of India (CAG), an international peer review team reviewed the performance audit function of SAI India. The objective of the peer review was to assess the extent to which the performance audit function of SAI India adheres to applicable standards of professional practice; and to identify opportunities for improvement. The peer review team was led by the Australian National Audit Office and included representatives from the supreme audit institutions of Canada, Denmark, The Netherlands and the United States of America.
3. The scope of the peer review focused on SAI India's Audit Quality Management Framework (AQMF) as it pertains to performance audit, reflecting the essential role of the AQMF in providing assurance to the CAG that his office is meeting applicable standards of professional practice. The period under review covered performance audit reports presented to the Parliament or a state legislature from April 2010 to March 2011. The peer review team examined 35 performance audits from this period. The review criteria were primarily based on the CAG's *Auditing Standards* and *Performance Auditing Guidelines*. The review also compared SAI India's performance audit practices with internationally accepted practices.
4. In the opinion of the peer review team, SAI India's AQMF is conceptually sound and provides the basis for its adherence to applicable standards of professional practice when undertaking performance audits. However, there is a need to strengthen the AQMF to increase the level of assurance provided to the CAG that these auditing requirements are consistently being met.
5. At an operational level, for the period under review, there was variability in SAI India's adherence to applicable standards of professional practice across the performance audit function. Individual audit guidelines, which outline the plan for each audit, were developed for all but one of the performance audits in the peer review sample. SAI India also interacted with the audited entities in accordance with accepted conventions, including seeking to conduct entry and exit conferences and providing a draft audit report to the audited entity for comment. Further, key audit approvals by senior SAI India management of audit guidelines, draft and final reports were generally well documented as part of their oversight of performance audits.

6. The principal area where SAI India could improve its adherence to auditing requirements is the application of reporting standards. Of particular note, the CAG's *Auditing Standards* require that audit reports are balanced, fair, persuasive, and satisfy the audit objectives. For the sample of 35 performance audit reports considered by the peer review, SAI India forthrightly presented a large number of important shortcomings in program administration and implementation. While the sample of performance audits also included a number of balanced reports on complex subject matter, of significance, there was scope for around half the reports reviewed to have been more balanced in content and tone. In large measure, this could be achieved by placing the audit findings in the appropriate perspective and reporting more fully against the audit objectives, as envisaged by the standards endorsed by the CAG. In this context, more regular inclusion of program outcomes and positive findings would contribute to the balanced presentation of audit reports. At the time of the peer review, SAI India was already pursuing more balanced audit reporting.

7. Two related areas for improvement in SAI India's application of auditing requirements concern the design of audits and audit evidence. In particular, the development of achievable audit objectives, appropriate audit criteria, and the test programs necessary to satisfy the audit objectives; and the extent and quality of evidence and documentation supporting performance audit findings and conclusions. As is the case for other supreme audit institutions, there is an ongoing need for SAI India to reinforce the application of relevant professional practices. This is particularly important given the scale and complexity of SAI India's performance audit work and the number of staff involved.

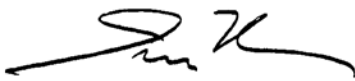
8. The peer review team also encourages SAI India to consider how to elicit responses from audited entities to all performance audit reports; and to more directly seek comments from third parties on relevant audit findings. Additional feedback from audited entities and third parties would further inform audit conclusions, and readers of SAI India's performance audit reports.

9. SAI India's performance audit function is continuing to evolve and at the time of our review SAI India was pursuing further initiatives designed to improve the function. Stakeholders consulted by the peer review team advised that the introduction of the *Performance Auditing Guidelines* in 2004 led to considerable improvements in audit practice and engagement with audited entities. Stakeholders also gave positive feedback on the usefulness of SAI India's performance audit reports, and the quality of recent reports. In addition, members of parliamentary committees mentioned the good relationships between their committee and SAI India, including the support provided to their committee by SAI India.

10. This report sets out the peer review team's key observations on SAI India's AQMF and performance audit function. The report includes recommendations designed to strengthen the AQMF, performance audit capability, adherence to auditing requirements, and the quality and impact of SAI India's performance audits. In addition, the report describes good practices adopted by SAI India that will be of interest to other audit offices in their pursuit of continuous improvement. These

practices include SAI India's long term strategic planning, its use of audit advisory boards, which include eminent individuals and highly qualified professionals from diverse fields, and its network of audit training facilities, including those used to host training programs attended by many international counterparts.

11. SAI India generally agreed with the recommendations made by the peer review team and has advised that it has initiated action on the majority of the recommendations. SAI India's formal response to the peer review report is at Appendix 2.

A handwritten signature in black ink, appearing to read 'Ian McPhee', with a long horizontal stroke extending to the right.

Ian McPhee

Auditor-General for Australia, on behalf of the peer review members.

10 October 2012

RECOMMENDATIONS

12. This table lists the recommendations of the peer review and SAI India's summary response. SAI India's detailed response to the recommendations is contained in full in the report.

| | |
|--|--|
| <p>Recommendation No.1 Paragraph 38</p> | <p>To strengthen quality management in the performance audit function, we recommend that SAI India review and update the Audit Quality Management Framework, and improve communication to its staff about the framework.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.2 Paragraph 44</p> | <p>To clarify and enhance performance audit direction and guidance, we recommend that SAI India review and update its <i>Auditing Standards</i> and <i>Performance Auditing Guidelines</i>, taking into account current performance audit practices, and relevant international standards and guidance.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.3 Paragraph 63</p> | <p>To strengthen performance audit capability, we recommend that SAI India build on the current performance audit training program by further developing performance audit skills of relevant staff, including through on-the-job training.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.4 Paragraph 74</p> | <p>To improve performance audit design and the basis for forming audit conclusions, we recommend that SAI India refine its approach to developing achievable audit objectives, appropriate audit criteria, and the test programs necessary to satisfy the audit objectives.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.5 Paragraph 79</p> | <p>To assist in managing the actual and potential conflicts of interest of its staff and contractors, we recommend that SAI India introduce a formal independence policy, which would require staff and contractors involved in performance audits to declare actual and potential conflicts of interest at the planning stage, and subsequently if they arise.</p> <p>SAI India's response: Agreed.</p> |

| | |
|--|--|
| <p>Recommendation No.6 Paragraph 84</p> | <p>To inform audit conclusions and focus attention on performance audit recommendations aimed at improving administration and program performance, we recommend that SAI India:</p> <ul style="list-style-type: none"> • review its approach to obtaining responses to audit reports from audited entities; and • request that audited entities respond directly to each recommendation made in draft audit reports, and publish the responses received in final audit reports. <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.7 Paragraph 89</p> | <p>To provide natural justice to third parties, and obtain and appropriately consider their perspectives when developing and finalising performance audit reports, we recommend that SAI India review its approach to consulting with third parties.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.8 Paragraph 96</p> | <p>To strengthen the evidence base supporting performance audit findings and conclusions, we recommend that SAI India reinforce validation techniques and documentation requirements for different types and sources of evidence.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.9 Paragraph 112</p> | <p>To strengthen application of reporting standards across performance audit reports, we recommend that SAI India develop and implement a strategy to improve reporting capability and reinforce the requirements of its standards.</p> <p>SAI India's response: Agreed.</p> |
| <p>Recommendation No.10 Paragraph 127</p> | <p>To increase assurance on compliance with applicable standards of professional practice and identify opportunities for improvement, we recommend that SAI India introduce:</p> <ul style="list-style-type: none"> • an annual quality assurance program covering a sample of performance audits completed during the year; and • a process to identify and disseminate lessons learnt for performance audits. <p>SAI India's response: Agreed.</p> |

**PEER REVIEW OPINION
AND FINDINGS**

THE SUPREME AUDIT INSTITUTION OF INDIA

13. The position of the CAG was established in 1950 as part of the Constitution of India. The CAG and the Indian Audit and Accounts Department (IAAD), which supports the CAG, comprise SAI India.¹ The CAG's powers and responsibilities are mainly derived from the Constitution and the *Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971* (the DPC Act). Under the provisions of the Constitution and the DPC Act, the audit mandate of the CAG includes the receipts and expenditure of the Government of India and state governments; the accounts of government companies and certain statutory corporations and bodies; and the accounts of autonomous bodies substantially financed from government funds. The DPC Act also requires that audit reports of the CAG relating to the Government of India and state governments are submitted to the President of India or the state governor to be presented to the Parliament or a state legislature. The Constitution of India provides for the independence of the CAG from the executive branch of the Government of India and state governments. In this context, the CAG is appointed by the President of India for a term of six years² and special procedures must be followed to remove the CAG from office.

14. In 2007, the then CAG issued the *Regulations on Audit and Accounts* (Regulations) under the DPC Act. These Regulations apply to the IAAD, government ministries and departments, and other bodies to which the CAG's audit mandate extends. The Regulations define the scope and extent of audit, types of audit undertaken, and guiding principles for the conduct of audits. SAI India undertakes three main types of audit: financial, compliance and performance audit.

15. SAI India defines performance audit as an independent assessment or examination of the extent to which an entity, program or organisation operates efficiently and effectively, with due regard to economy.³ These audits address broad ranging subject matter, from implementation of nationwide social development programs, to the performance of government companies and important state specific issues. Performance audit reports focus on administrative deficiencies and make recommendations for improvement. In 2010–11, SAI India presented 221 performance audits to Parliament or a state legislature. Prominent examples included the *Issue of Licenses and Allocation Spectrum by the Department of Telecommunications*, and the *Member of Parliament Local Area Development Scheme*.

16. SAI India audits are to be conducted in accordance with the Regulations, auditing standards and guidelines issued by the CAG. The 2002 *Auditing Standards* and 2004 *Performance Auditing Guidelines* outline important principles and procedures for

¹ SAI India has been in existence for over 150 years with its current constitutional status conferred when the Constitution of India was enacted in 1950.

² Or until he or she attains the age of 65 years, if this is earlier.

³ Comptroller and Auditor General of India, 2004, *Performance Auditing Guidelines*, p. 3.

auditors to follow. These Standards and Guidelines were based on international equivalents available at the time of their development.⁴

Managerial context

17. Within India, there are many challenges for governments that impact public administration and need to be taken into account by SAI India's audit function. A large number of Indian government projects are beset by substantial time and cost overruns, and poor outcomes. There is a recognised need to strengthen accountability for results and improve performance incentives within government. Further, the Indian civil service is hierarchical in nature and process driven, with the focus of governance more on inputs than outcomes.⁵ Government reviews have also noted shortcomings in financial management systems and the authority, independence, coverage, capability and impact of internal audit functions. The performance of audit committees in Government of India ministries and departments, where established, has also been reported as generally ineffective.⁶ This environment highlights the importance of SAI India's performance audits, and necessarily affects the approaches it adopts when undertaking these audits.

18. Several other features distinguish SAI India's working environment from that of many of its international peers:

- the extent and span of its audit work, which covers multiple levels of government and many different types of organisations across India;
- the size of SAI India, with approximately 43 500 staff, and a presence in 141 offices throughout India and in several overseas posts⁷; and
- significant diversity in language, governance and development in the different states in which it works.

19. To assist it to more effectively perform its audit work in this environment, in 2009 SAI India submitted proposed legislative changes to the DPC Act to the Government of India, which primarily aim to expand its audit mandate and enhance the powers to access information and records. The changes sought include:

- a clear audit mandate to follow the money where government funding is provided through channels such as non-government organisations and public-private partnerships⁸;

⁴ The *Auditing Standards* were based on auditing standards issued by the International Organization of Supreme Audit Institutions (INTOSAI) in 2001, (Comptroller and Auditor General of India, 2002, *Auditing Standards*, p. i). The *Performance Auditing Guidelines* were 'formulated keeping in mind international best practices, including those in the 5th ASOSAI [Asian Organization of Supreme Audit Institutions] research project and the exposure draft of INTOSAI implementation guidelines for performance audit', (Comptroller and Auditor General of India, 2004, *Performance Auditing Guidelines*, p. iii).

⁵ Government of India, Second Administrative Reforms Commission, November 2008, Tenth Report, *Refurbishment of Personnel Administration – Scaling New Heights*, pp. 1–3, 245–249 and 250–256.

⁶ Government of India, Second Administrative Reforms Commission, April 2009, Fourteenth Report, *Strengthening Financial Management Systems*, pp. 126–134.

⁷ Around 17 500 of SAI India's staff are primarily engaged in compiling the accounts of the state Governments, while around 26 000 are engaged in audit activities. In 2010 around 10 per cent of SAI India's audit time was devoted to performance audit.

- measures to penalise individuals who do not provide audit-related information and documents, allow inspections or comply with directions as required by the DPC Act within a reasonable timeframe; and
- measures to enforce the timely disclosure of audit reports by governments in Parliament or the state legislature.⁹

To date, the proposed amendments have not been adopted.

THE PEER REVIEW

20. Following a request by the CAG in August 2011, an international peer review team reviewed the performance audit function of SAI India. The peer review team was led by the Australian National Audit Office and included representatives from the supreme audit institutions of Canada, Denmark, The Netherlands and the United States of America.

21. The objective of the peer review was to assess the extent to which the performance audit function of SAI India adheres to applicable standards of professional practice; and to identify opportunities for improvement. A Memorandum of Understanding, between SAI India and the peer review members, set out the agreed terms and conditions of the peer review, including the objective.¹⁰

22. The period under review covered performance audit reports presented to the Parliament or a state legislature from April 2010 to March 2011. The review criteria were primarily based on the CAG's *Auditing Standards* and *Performance Auditing Guidelines*. As requested by the CAG, the review also compared SAI India's performance audit practices with internationally accepted practices.

23. The peer review methodology involved the examination of:

- SAI India's AQMF;
- SAI India's approach to strategic planning and human resources management as they pertain to performance audit;
- the CAG's *Auditing Standards* and *Performance Auditing Guidelines*;
- a sample of 35 performance audits (16 per cent) from the 221 performance audits presented to the Parliament or a state legislature during the review period; and
- international auditing standards, guidance and approaches, and the quality management frameworks of several supreme audit institutions.

⁸ In response to environmental factors, Indian governments have increasingly provided funding to non-government organisations and other autonomous bodies to deliver government programs and services. Indian governments are also making substantial investments in infrastructure development through public-private partnerships, joint ventures and other arrangements.

⁹ The current audit report tabling process requires SAI India to provide a signed copy of the final audit report to the President of India or state governor, who is to lay the report before the Parliament or a state legislature. However, a specific timeframe is not prescribed within which a government is to table an audit report.

¹⁰ The peer review objective, scope and approach are described in more detail in Appendix 1: About the Peer Review.

24. The peer review report outlines the peer review team’s key observations on SAI India’s AQMF and performance audit function. The structure of the peer review report is aligned to the five broad parameters of the AQMF. Within each AQMF parameter, the report focuses on key areas relevant to the performance audit function, as shown in the following table.

| AQMF Parameter | Areas Covered in this Report | |
|-----------------------------------|---|--|
| Leadership and Direction | <ul style="list-style-type: none"> Strategic direction and planning | <ul style="list-style-type: none"> Strategic audit planning |
| Human Resources Management | <ul style="list-style-type: none"> Resourcing and recruiting | <ul style="list-style-type: none"> Training and capacity building |
| Audit Management | <ul style="list-style-type: none"> Audit planning Audit interactions Audit evidence | <ul style="list-style-type: none"> Documentation Reporting Supervision and review |
| Clients and Stakeholder Relations | <ul style="list-style-type: none"> Feedback from clients and stakeholders Relationship between legislative committees and SAI India | <ul style="list-style-type: none"> Communicating audit messages |
| Continuous Improvement | <ul style="list-style-type: none"> Internal quality assurance review | <ul style="list-style-type: none"> Lessons learnt |

25. The report also includes recommendations to improve SAI India’s AQMF and performance audit function and other suggestions for SAI India to consider as it continues to evolve its approach to performance auditing. In addition, the report refers to good practices identified during the review, which may be of interest to other supreme audit institutions.

26. SAI India provided the peer review team with support, and access to audit documentation and teams, to allow the review to be completed in an efficient and timely manner. The peer review members wish to record our appreciation of the high level of support and cooperation provided by the CAG and his staff.

THE PEER REVIEW OPINION

27. In the opinion of the peer review team, SAI India’s AQMF is conceptually sound and provides a basis for its adherence to applicable standards of professional practice when undertaking performance audits. However, some important elements and key instruments employed under the AQMF need to be implemented, updated and/or strengthened to increase the level of assurance provided to the CAG that these auditing requirements are consistently being met. Primary areas for attention are:

- clarifying and updating the *Auditing Standards* and the *Performance Auditing Guidelines*; and
- introducing an annual quality assurance program for a sample of performance audits completed during the year.

28. At an operational level, for the period under review, there was variability in SAI India's adherence to applicable standards of professional practice across the performance audit function. Individual audit guidelines, which outline the plan for each audit, were developed for all but one of the performance audits in the peer review sample. SAI India also interacted with the audited entities in accordance with accepted conventions, including seeking to conduct entry and exit conferences and providing a draft audit report to the audited entity for comment. Further, key audit approvals by senior SAI India management of audit guidelines, draft and final reports were generally well documented as part of their oversight of performance audits.

29. The principal area where SAI India could improve its adherence to auditing requirements is the application of reporting standards. Of particular note, the CAG's *Auditing Standards* require that audit reports are balanced, fair, persuasive, and satisfy the audit objectives. For the sample of 35 performance audit reports considered by the peer review, SAI India forthrightly presented a large number of important shortcomings in program administration and implementation. While the sample of performance audits also included a number of balanced reports on complex subject matter, of significance, there was scope for around half the reports reviewed to have been more balanced in content and tone. In large measure, this could be achieved by placing the audit findings in the appropriate perspective and reporting more fully against the audit objectives, as envisaged by the standards endorsed by the CAG. In this context, more regular inclusion of program outcomes and positive findings would contribute to the balanced presentation of audit reports. At the time of the peer review, SAI India was already pursuing more balanced audit reporting.

30. Two related areas for improvement in SAI India's application of auditing requirements concern the design of audits and audit evidence. In particular, the development of achievable audit objectives, appropriate audit criteria, and the test programs necessary to satisfy the audit objectives; and the extent and quality of evidence and documentation supporting performance audit findings and conclusions. As is the case for other supreme audit institutions, there is an ongoing need for SAI India to reinforce the application of relevant professional practices. This is particularly important given the scale and complexity of SAI India's performance audit work and the number of staff involved.

31. SAI India could also build on its current performance audit training program to further develop the performance audit skills of relevant staff, and embed the improvements to the design and implementation of its AQMF outlined above.

KEY OBSERVATIONS ON THE AUDIT QUALITY MANAGEMENT FRAMEWORK

32. In 2009, the CAG approved SAI India's AQMF to provide assurance on quality in the audit function. The framework is based on the Asian Organization of Supreme Audit Institutions (ASOSAI) *Audit Quality Assurance Guideline*. The AQMF includes five broad parameters for quality management, 26 quality management elements and

the key instruments employed for each element. The AQMF parameters and elements are shown in the following table.

| Leadership and Direction | Human Resources Management | Audit Management | Clients and Stakeholder Relations | Continuous Improvement |
|--|--|--|--|---|
| <ol style="list-style-type: none"> 1. Tone at the top 2. Vision, mission, core values and auditing standards 3. Strategic direction and planning 4. Strategic audit planning 5. Portfolio and risk management | <ol style="list-style-type: none"> 1. Resourcing and recruitment 2. Training and capacity building 3. Performance management and appraisal 4. Personnel welfare and benefits | <ol style="list-style-type: none"> 1. Audit planning 2. Staffing for the audit 3. IT tools 4. Other tools and guidance 5. Conducting the audit 6. Consultation and advice 7. Supervision and review 8. Evidence 9. Documentation 10. Reporting and follow-up | <ol style="list-style-type: none"> 1. Communicating audit messages 2. Feedback from clients and stakeholders 3. Relationship between legislative committees and SAI India | <ol style="list-style-type: none"> 1. Internal audit 2. Internal quality assurance review 3. Peer review 4. Self-evaluation/ lessons learnt |

33. SAI India mapped the quality management elements to the key instruments it employs under each element, such as the *Auditing Standards* and the *Performance Auditing Guidelines*. At the time of its implementation, it was envisaged that the AQMF would be regularly updated, taking into account environmental and technological changes, as well as new audit methodologies and practices.

34. This section describes the peer review team’s observations on the design and maintenance of SAI India’s AQMF. We considered the suitability of the quality management parameters, elements and the underpinning key instruments. The peer review team also compared the AQMF with a selection of international quality management frameworks and guidance.

35. The five broad parameters cover the key aspects of quality management relevant to the delivery of performance audits: leadership and direction; human resource management; audit management; client and stakeholder relations; and continuous improvement. These parameters are very similar to those found in the international quality management frameworks and guidance. While the quality management elements are also similar to those used in quality management frameworks of other supreme audit institutions, our comparison found they could be used to give more prominence to the:

- independence, objectivity and integrity requirements for audit team members;
- relationships and interactions with audited entities; and
- security, confidentiality and access in relation to audit documentation.

36. We noted that, at the time of the review, two of the quality management elements had not been implemented. These are an internal quality assurance review program for audits, and the evaluation and dissemination of lessons learnt from audits. Strengthening the framework in these areas, as recommended by the review team in paragraph 127, would increase assurance that performance audits are conducted in accordance with applicable standards, policies and guidance, and support continuous improvement in the performance audit function. More generally, SAI India would benefit from a review of the AQMF taking into account current practices, with a view to updating the framework and addressing any other identified gaps. To maintain the AQMF there is also a need to periodically review and keep up-to-date each key instrument employed under the framework.

37. SAI India could consider how best to communicate the AQMF to senior managers and other staff to support its implementation. In this respect, explanatory material in the AQMF document is not well aligned with the framework itself. In particular, this material is presented in two sections¹¹ instead of the five parameters of the AQMF and does not cover the framework in its entirety. Clearly conveying to staff the importance of the elements of the AQMF as they relate to audit standards would also be useful. This is particularly important for such a large and geographically dispersed organisation.

Recommendation No.1

38. To strengthen quality management in the performance audit function, we recommend that SAI India review and update the Audit Quality Management Framework, and improve communication to its staff about the framework.

SAI India's response:

39. We appreciate the recommendation. The *Performance Auditing Guidelines* of SAI India were issued in 2004, whereas the Audit Quality Management Framework was approved in 2009.

40. A committee has been constituted for adoption of Quality Control Standards. It will review and update the Audit Quality Management Framework keeping in view the international best practices.

41. In view of the importance of Audit Quality Management Framework and dissemination of the same to staff, the Regional Training Institutes have already been advised to arrange training courses for the staff. In addition one Regional Training Institute has been designated as Knowledge Center for Audit Quality Management Framework.

42. Two of the essential key instruments used by SIA India to provide direction to auditors are auditing standards and guidance. These instruments should clearly set out how audit work is to be performed by staff. As mentioned in paragraph 16, SAI India *Auditing Standards* and *Performance Auditing Guidelines* were based on international

¹¹ The two sections are: 1. Audit Planning, Execution, Reporting and Follow-up; and 2. Continuous Improvement through Technical Inspection, Peer Review and Lessons Learnt Process.

equivalents available at the time of their development. From our review we noted that the *Auditing Standards* articulate a broad range of principles and practices to be followed. However, there is scope to improve their clarity, including by differentiating between mandatory requirements and matters of sound practice. There is also significant duplication in the *Auditing Standards*, presenting opportunities for streamlining the Standards. We concluded that the *Performance Auditing Guidelines* are comprehensive and offer practical guidance for auditors across the different aspects of a performance audit.

43. SAI India's *Auditing Standards* and *Performance Auditing Guidelines* have not been updated since they were issued in 2002 and 2004, respectively, and SAI India's performance audit processes have been refined since their introduction. While the principles and essential elements of the Standards and Guidelines generally remain the same, the environment and practices may change over time, and it is necessary to make adjustments as this occurs. In particular, it is good practice to establish arrangements to review auditing guidelines on a regular basis, drawing on the outcomes of quality assurance and lessons learnt for individual performance audits. In updating its Standards and Guidelines, SAI India could also consider revisions to the International Organization of Supreme Auditing Institutions (INTOSAI) professional standards.¹²

Recommendation No.2

44. To clarify and enhance performance audit direction and guidance, we recommend that SAI India review and update its *Auditing Standards* and *Performance Auditing Guidelines*, taking into account current performance audit practices, and relevant international standards and guidance.

SAI India's response:

45. Recommendation accepted. SAI India is conscious of requirement of regular updation of professional practices keeping in view the standards prescribed by the INTOSAI and the local context.

46. Auditing Standards of SAI India are based on ISSAIs (level 1, 2 and 3), the professional standards prescribed by the INTOSAI. Level 3 ISSAIs which form the basis of Auditing Standards of SAI India are under revision and the exercise is expected to be completed by 2013. SAI India is a member of the ISSAI harmonization project group and is committed to adapt the changes.

¹² INTOSAI has developed and endorsed an International Standards of Supreme Audit Institutions (ISSAIs) framework, which includes a comprehensive set of ISSAIs and guidance for good governance. In *the South African Declaration on the International Standards of Supreme Audit Institutions* INTOSAI encourages supreme audit institutions to implement the ISSAIs in accordance with their mandate and national legislation and regulations (refer to: <http://www.intosai.org/uploads/jhbaccordsen.pdf> for more information). The standards convey the generally recognised principles and shared professional experiences of the international community of supreme audit institutions. The standards are developed and maintained in accordance with the *Due Process for INTOSAI's Professional Standards* and issued after a decision of final endorsement by all supreme audit institutions at INTOSAI's congress (refer to: <http://www.issai.org/composite-405.htm> for more information). SAI India could also consider the Performance Audit Guidelines and Good Practice Guidance of the Performance Audit Subcommittee of the Professional Standards Committee of INTOSAI.

47. Performance auditing guidelines were issued in 2004 and are in sync with ISSAI 3000. SAI India is also a member of the Committee on Performance Auditing Standards.

48. We have already initiated the process for review and updation of *Performance Auditing Guidelines*. First draft of revised guidelines on performance auditing has been prepared. It is being peer reviewed within SAI India to ensure quality and consistency

KEY OBSERVATIONS ON THE PERFORMANCE AUDIT FUNCTION

LEADERSHIP AND DIRECTION

49. Strategic planning is used by organisations to evaluate the environment in which they operate, identify their goals and how these are to be achieved, and allocate responsibilities and resources accordingly. SAI India has two key organisation-wide strategic plans:

- the *Strategic Plan – 2020* outlines SAI India’s vision, mission and core values; emerging patterns of governance in India; organisational goals; and implementation arrangements; and
- the *Perspective Plan 2010–15* focuses on medium to long term challenges and goals, and allocates responsibilities and identifies timelines for completion of specific tasks.

Good practice: Long term strategic planning

The peer review team considered that SAI India’s long term strategic planning (out to 2020), which is focused on organisational goals, and strengthening audit capability and impact, is a good practice.

The *Strategic Plan – 2020* was the impetus for SAI India’s recent restructure to align with government sectors for Government of India audits. It is envisaged that the new structure will help to strengthen government sector knowledge and performance audit quality. In addition, SAI India’s strategic plans include a major increase in the proportion of audit time spent on performance audits (from around 10 per cent in 2010 to 50 per cent by 2020), to maximise the benefits to be gained from audits in terms of public accountability and improved efficiency and effectiveness of public administration. SAI India’s strategic plans also identify important changes to performance audit methodology, including more common use of a range of evidence gathering techniques¹³, and broad adoption of balanced reporting. SAI India’s organisation-wide strategic planning demonstrates a considered approach to improving its performance audit function.

50. A supreme audit institution’s strategic audit planning should outline, based on an assessment of risks and materiality, which areas are to be audited, the type of audit, and possible timing of audits. SAI India is currently preparing a five year *Strategic Audit Plan* which will identify broad focus areas and align with the

¹³ SAI India performance audits have historically relied on documentation from audited entities as the primary basis of audit findings.

Government of India Planning Commission's twelfth national five year plan.¹⁴ The completion of this plan will aid the development of audit plans at the office level and selection of performance audit topics.

51. SAI India's offices prepare annual audit plans, which are approved by senior management in New Delhi. Some offices also prepare strategic audit plans that detail key focus areas over a three to five year period. We reviewed a selection of different office plans and found some variability in their quality and content. The plans typically proposed audit activities for the period and attributed staff resources to these (across all types of audit). Activities were generally based on the profiles of audited entities, financial materiality and risks.¹⁵ Other matters discussed in some plans included the environment, government directions, the functioning of the relevant public accounts committee, the rationale for selecting performance audits, and human resource management issues.

52. We considered that there is an opportunity for SAI India to share examples of good office plans, and to use a more consistent format for office plans. For example, office plans could consistently emphasise the reasons for undertaking the selected performance audits during the planning timeframe, and the expected impact of the audits.

Good practice: Audit Advisory Boards

In relation to strategic and audit planning, the peer review team considered that SAI India's use of audit advisory boards, which include highly qualified individuals from outside SAI India, reflects SAI India's openness to external advice and is a good practice.

The CAG chairs the central Audit Advisory Board which includes eminent external individuals and highly qualified professionals from diverse fields. The board advises the CAG on matters relating to audit, including potential audit topics and focus areas. In July 2009, the CAG ordered the establishment of state audit advisory boards. The purpose of this initiative is to provide a forum in each state for professional discussion between senior managers and qualified professionals from various fields. There are now 24 state audit advisory boards in place, and most of these boards met once during 2011–12.

HUMAN RESOURCE MANAGEMENT

Resourcing and Recruitment

53. For any organisation, it is important to have sufficient capable staff to carry out tasks effectively. SAI India has around 43 500 staff working at headquarters in New Delhi, offices throughout India, and in several overseas posts. Staff are recruited into different organisational strata, undergo preparatory training and work across different audit types. Performance audit teams vary in size, ranging from extensive

¹⁴ The Planning Commission was set up by a Resolution of the Government of India in March 1950. It is responsible for making an assessment of all resources of the country, augmenting deficient resources, formulating plans for the most effective and balanced utilisation of resources and determining priorities. The Planning Commission's eleventh five year national plan spans 2007 to 2012.

¹⁵ SAI India is implementing an organisation-wide Audit Management System which will electronically capture data on audited entities, auditors and audit assignments, and replace a range of existing systems. The new system is designed to assist portfolio and risk management.

teams for all India audits that involve state government delivery of Government of India programs, through to small teams for many state specific audits.

54. SAI India works within the broader Indian civil service human resource and recruitment policies and systems. This brings some constraints, such as the inability to limit graduate intakes to only those from certain academic disciplines (for example, commerce, economics and political science), recruitment and promotion systems based more on length of service than merit, and the limitations in the movement of staff within the civil service. In addition, SAI India's current staffing level is well below its 'sanctioned strength' of approximately 68 000 staff. This situation was influenced by a government ban on direct recruitment between 2001 and 2008.

55. SAI India has identified improving human resource management as one of its six strategic goals. To achieve this goal, SAI India is reassessing all offices and plans to:

- commence a period of recruitment that will result in an additional 25 900 supervisory and subordinate level staff by the end of 2020;
- phase out recruitment at lower levels while increasing the calibre of recruits at higher levels; and
- provide incentives to staff for good performance.

56. The peer review team supports these plans, and also notes the need for a rigorous approach to training and developing the additional staff. Performance audit capacity in many states is currently below intended levels, with the strategic objective of increasing the proportion of staff time spent on performance audit adding to existing staffing challenges. The calibre of SAI India's recruits, its approach to developing their skills and proficiency, and also recognising good performance, are central to building the capability and output of the performance audit function in the coming years.

Training and Capacity Building

57. One of the AQMF's elements, Training and Capacity Building, states 'that audit teams designated to carry out the work have adequate technical training and proficiency'. Similarly, SAI India's *Auditing Standards* require that staff are properly trained and given opportunities to continue their professional development. Building the capacity of staff and ensuring that they have the necessary training and skills is an essential element in producing quality audit reports.

58. As previously mentioned, SAI India plans to substantially increase staff numbers and the proportion of time spent on performance audits. With a growing workforce and the increasing focus on performance audit, it is important that SAI India continue to strengthen its performance audit capability. Two approaches to achieving this objective are to ensure its staff are adequately trained and to engage external expertise when necessary.

59. Indian Audit and Accounts Service (IAAS) officers form the middle and top management of SAI India, and there are around 600 of these officers in total. When

commencing with SAI India,¹⁶ IAAS officers attend extensive training for around 18 months. This training is delivered in three phases and includes classroom based training at the National Academy of Audit and Accounts (NAAA) that focuses on the theoretical foundations of auditing and management (Phases I and III) and a three month on-the-job placement at a local office (Phase II). The training covers all types of audit; the performance audit portion is delivered over a period of six days and focuses on the *Performance Auditing Guidelines*. However, the training includes only limited opportunity to apply the theoretical knowledge and, consequently, at the end of the course IAAS officers are assigned to an office to manage audits with little practical performance auditing experience. The NAAA has received feedback from officers that they would like more practical application of the theory to supplement Phase II. The NAAA is responding to this feedback by exploring approaches to increasing IAAS officers' practical exposure to auditing, such as working in a local office on Saturdays to deliver an audit.

60. Performance audit training is also available to the large number of staff at other levels through a network of regional training facilities. The training is similar to that delivered to IAAS officers and focuses on the theory of performance audit, as contained in the *Auditing Standards* and the *Performance Auditing Guidelines*. We noted some variation in the content and length of performance audit training delivered by different training facilities. In 2010–11, 16 performance audit courses were delivered at nine facilities with 320 staff attending.

61. SAI India also undertook a program of training when it released the *Performance Auditing Guidelines* in 2004. The three day training course was delivered to all staff and included presentations on the *Auditing Standards*, *Performance Auditing Guidelines* and case studies from other supreme audit institutions. Staff can also attend other short term courses on specific topics. However, the majority of these topics are more relevant to financial and compliance audit.

62. Therefore, SAI India staff have access to a theory-based program of performance audit training that is based on the *Performance Audit Guidelines*. However, staff, including the IAAS officers who oversee performance audits, would benefit from the opportunity to further develop the skills relevant to performance audit, such as report writing, analytical methodologies and relationship management. Such development of skills could occur through guided practical application on-the-job and other tailored training.

Recommendation No.3

63. To strengthen performance audit capability, we recommend that SAI India build on the current performance audit training program by further developing performance audit skills of relevant staff, including through on-the-job training.

¹⁶ IAAS officers are generally directly recruited via Civil Service Examinations.

SAI India's response:

64. Recommendation is accepted. We are standardizing training modules for performance auditing. INTOSAI Development Initiative (IDI) trained master trainers of SAI India have been deputed to design course modules particularly for report writing and evidence gathering. In addition, officers of SAI India are also associated with the development of training modules for Performance Auditing by IDI. The same will be adapted as and when it becomes available.

65. Recently, we have introduced a scheme of continuing professional development for staff whereby they would get financial incentive on passing an examination which tests their knowledge of auditing methodologies and practical application thereof.

66. We will explore the possibility of introducing on the job training modules for IAAS officers as well as direct recruit Assistant Audit Officers.

Good practice: Network of training facilities

The peer review team considered that SAI India's network of training facilities at national, regional and office levels, which it uses to provide induction and refresher training for its staff, is a good practice.

National facilities include the NAAA and international training centres. SAI India has also established 10 Regional Training Institutes (RTIs) and two Regional Training Centres (RTCs). In this context, SAI India provides training for international participants belonging to other supreme audit institutions. International facilities include the International Centre for Information Systems and Audit and the International Centre for Environment Audit and Sustainable Development.¹⁷

67. In its *Perspective Plan 2010–15*, SAI India recognises the value of using consultants to build capacity in new and emerging areas of audit. Along these lines, we suggest that SAI India explore opportunities to more widely use external expertise in its performance audit function to inform managerial approaches to issues, particularly where technical assistance is not available in-house. To date, SAI India has drawn on external expertise on a very limited number of occasions to assist with performance audits, reflecting a cautious approach to sharing confidential audit information with individuals from outside SAI India and the potential for conflicts of interest to arise (see also Recommendation 5).¹⁸ Nonetheless, expertise, such as persons or groups providing legal, scientific or forensic technical assistance to inform the management of the program can at times strengthen the audit methodology and report, while building the capacity of the audit team by imparting additional subject matter knowledge.

AUDIT MANAGEMENT

Audit Planning

68. Sound audit planning is an essential element of an efficient and effective performance audit. SAI India's *Auditing Standards* require that an audit is planned in a

¹⁷ SAI India has conducted international training since 1979, and has provided more than 100 international training programs to over 3000 attendees.

¹⁸ SAI India advised of eight cases since 2008, in which it drew on external expertise for its performance audits.

manner that ensures that it is of high quality and carried out in an economic, efficient, effective and timely manner.¹⁹ Generally, audit planning involves:

- identifying important aspects of the audited entity's operating environment;
- developing a sound understanding of the subject of the audit and the audited entity;
- specifying the audit objectives, criteria and the test program necessary to satisfy the objectives;
- determining the most efficient and effective audit approach; and
- preparing a budget and schedule for the audit and identifying staff requirements.²⁰

69. The output of SAI India's individual performance audit planning process is the detailed audit guidelines for the audit. SAI India's *Performance Auditing Guidelines* outline the required contents of the individual audit guidelines, including the audit scope, objective(s), criteria, methodology and test programs, evidence to be gathered, the timeframe of field audit, supervision and control systems, and the report structure. Individual audit guidelines serve as planning documentation and, particularly in the case where the audit is to be conducted by many audit parties, identify the specific audit tasks to be undertaken by those parties.

70. Audit guidelines were developed for 34 of the 35 audits in the peer review sample, providing a reasonable basis for the conduct of the performance audits. In the majority of cases, the audit guidelines were detailed, including information on the audited entity's environment, audit materiality and risks, and describing the audit scope, objectives and methodology.

71. However, we noted that there was variability in the manner and extent to which the audit guidelines covered all the elements required by the *Auditing Standards* and the *Performance Auditing Guidelines*. In around one-third of the sample of audits there were a large number of audit objectives, or the objectives were expressed in broad terms, making them difficult to achieve. We also noted subsequent refinement or narrowing of objectives during the audit process for more than a quarter of the audits reviewed. In this respect, SAI India advised that the difficult environment it operates within presents challenges for gathering the information needed to fulfil the audit objectives, and in such circumstances it may be necessary to refine an audit's objectives as the audit progresses.²¹

72. In addition, we noted that the audit guidelines did not always clearly specify appropriate audit criteria or the test program necessary to satisfy the audit objectives. Audit criteria were regularly described in terms of the source of the criteria (for example, legislation and relevant government directives) or very broadly (for example, feasibility and sustainability of the program), rather than as clearly expressed normative statements of expected performance against which the subject of the audit

¹⁹ Comptroller and Auditor General of India, 2002, *Auditing Standards*, Chapter III, paragraph 4.1.

²⁰ Comptroller and Auditor General of India, 2002, *Auditing Standards*, Chapter III, paragraphs 4.2.2 and 4.3.

²¹ The review and approval of key audit parameters, including audit objectives, is discussed in paragraph 115.

could readily be assessed.²² For several audits in the sample, detailed test programs were not included in the guidelines, and in some other audits, the test programs described in the guidelines did not fully address the operation of key controls or deliverables to inform the assessment against the audit objectives. In addition, for some audits the test programs focused on compliance and did not fully address the scope of the audit objectives.

73. Based on our review, we are of the opinion that SAI India could give greater attention to more clearly defining and better aligning audit objectives, criteria and test programs. This would help to focus audit efforts on achievable objectives and material matters earlier, providing for a more efficient and effective audit approach. It would also provide a sound basis for forming audit conclusions and support balanced reporting of results, based on an overall assessment against the audit objectives and criteria.

Recommendation No.4

74. To improve performance audit design and the basis for forming audit conclusions, we recommend that SAI India refine its approach to developing achievable audit objectives, appropriate audit criteria, and the test programs necessary to satisfy the audit objectives.

SAI India's response:

75. Recommendation is accepted. As part of continuous improvement, we have already initiated the process of review and updating the *Performance Auditing Guidelines*. As part of this exercise, we also intend to refine our approach to developing achievable audit objectives, appropriate audit criteria, and the test programs necessary to satisfy the audit objectives. As already mentioned above, the first draft of revised guidelines on performance auditing has been prepared. It is being peer reviewed within SAI India to ensure quality and consistency with relevant international standards and guidance.

76. Generally, the audit guidelines included a schedule setting out milestones for the audit, with the last milestone being the date the draft audit report was to be submitted to SAI India's headquarters in New Delhi for review. The guidelines did not include the expected audit completion date; the broad timeframe for completion of audits was instead understood as part of office planning. That is, office planning targeted audit topics and reports for presentation at particular sessions of the Parliament or state legislature. Furthermore, SAI India budgets at the office level; for each office, a specified number of hours are dedicated to performance audits in a particular year. As such, the individual audit guidelines reviewed did not include audit budgets. Developing a full schedule and budget for individual performance audits would assist SAI India to monitor subsequent audit timing and costs, to identify good practices and areas where efficiencies may be made. For many of the audit guidelines reviewed, we also noted there was scope for SAI India to more clearly

²² We noted that the multiple objectives of many audits were often similar in nature to criteria.

identify audit staffing requirements and the audit team, taking into account the subject matter and audit risks.

77. To improve consistency in the development and contents of audit guidelines, and focus planning on key matters, SAI India could consider using a template for the individual audit guidelines. Such a template could be based on the planning requirements detailed in the *Auditing Standards* and *Performance Auditing Guidelines*.

78. As part of planning, SAI India could also consider formalising its approach to managing the actual or potential conflicts of interest of its staff and contractors. SAI India currently uses an informal approach for managing conflicts of interest, which largely relies on information held about staff members and each supervisor's knowledge of the interests and activities of their staff. A formal independence policy would require staff and contractors involved in performance audits to declare actual and/or potential conflicts at the audit planning stage, and subsequently if any actual or potential conflicts arise.

Recommendation No.5

79. To assist in managing the actual and potential conflicts of interest of its staff and contractors, we recommend that SAI India introduce a formal independence policy, which would require staff and contractors involved in performance audits to declare actual and potential conflicts of interest at the planning stage, and subsequently if they arise.

SAI India's response:

80. Recommendation is accepted. SAI India is committed to independence and objectivity. Code of Ethics has been notified. It provides for a formal declaration by all the members of the audit team before commencement of audit assignment. The formal declaration, inter-alia, includes a clause that the member of the audit team does not have any personal or professional interest in the audited entity. It also provides for a formal declaration on similar lines by the outside agencies/ personnel who are involved in performance auditing.

Audit Interactions

81. The Regulations issued by the CAG require an entry conference with the audited entity to discuss the audit scope, objectives, methodology, timeframe and the information required by the audit team; and an exit conference to allow the audited entity to offer their observations and comments as part of finalising the draft audit report. Additionally, the Regulations provide for the furnishing of written replies by audited entities to draft audit reports.

82. For the audits reviewed, SAI India interacted with the audited entities in accordance with accepted conventions. This included seeking to conduct entry and exit conferences, and providing a draft audit report to the audited entity for comment. In a few instances, SAI India was hindered by a lack of cooperation and/or responsiveness from the audited entity in gathering information and records. As previously mentioned, some of the proposed changes to the DPC Act are directed towards

improving the timeliness in which audited entities provide information and records to SAI India. In addition, for approximately one-quarter of the audit sample, the audited entity did not provide a response to the draft report, and for three other audits we noted responses were received well after the requested response date. The Regulations state that the audited entity shall furnish a reply to the draft performance audit report within the specified timeframe. From our examination of the audit sample, the lack of responsiveness of audited entities in commenting on draft audit reports is a significant issue for SAI India to address, as responses inform audit conclusions and are directly relevant to readers of SAI India's performance audit reports.

83. In addition, for the majority of the audits reviewed, it was not clear whether the audited entity had agreed with the recommendations. As a result, the reader was unsure about the actions (if any) entities were taking in response to the proposed recommendations. When seeking a response to draft audit reports from the audited entity, many supreme audit institutions specifically request a response to each recommendation, including whether the audited entity agrees with the recommendation and, if so, the action to be taken in response to the recommendation. The responses received are then published alongside the relevant recommendation in the audit report. Adopting this approach assists in making recommendations a focal point of discussions between the auditor and the audited entity about improvements in administration, and also for subsequent follow-up of audit reports.

Recommendation No.6

84. To inform audit conclusions and focus attention on performance audit recommendations aimed at improving administration and program performance, we recommend that SAI India:

- review its approach to obtaining responses to audit reports from audited entities; and
- request that audited entities respond directly to each recommendation made in draft audit reports, and publish the responses received in final audit reports.

SAI India's response:

85. Recommendation is accepted. However, the efficacy and real impact of the recommendation would depend upon the cooperation from the audited entity. This would also require improved relational strategies. A beginning has been made with Seminars being organized for the Senior functionaries. We propose to follow up by organizing more courses for stakeholders to sensitize them about role and orientation of audit and responsibilities of the stakeholders.

86. We are examining the possibility of requesting the audited entities to respond directly to each recommendation made in draft audit reports and publish the responses received in final audit reports. We have followed this practice in some recent reports.

87. Another important aspect of audit interactions is consulting with ‘third parties’ involved in the delivery of government programs and services.²³ While third parties are generally not audited entities, their activities affect program and service delivery, and audit reports often include commentary about their responsibilities and performance. Consulting with third parties during the course of an audit can bring important perspective to the audit, and provide additional information about the audited entity and/or program administration. Also, as critical audit findings can have lasting impacts on the reputation and financial position of third parties, it is important to provide them with an opportunity to respond to any of these findings prior to the finalisation of an audit report, and its public release. Such an approach affords third parties ‘natural justice’ and gives due consideration of their feedback. To facilitate this process, many supreme audit institutions send relevant extracts of draft audit reports to third parties for their comment. Changes may also be made to the final audit report, to reflect the third party’s response.

88. For the audit sample, there was little evidence of consultation with any third parties mentioned in reports, either directly, or through the audited entity. In this regard, SAI India advised that it expects audited entities to interact with third parties when there are audit findings critical of a third party. However, there is a risk that audited entities may not do so, including because consultation may not be in their interest. Given the importance of natural justice in providing a ‘fair hearing’ and the benefits of greater perspective, there would be merit in SAI India reconsidering its approach to third party consultation, particularly where there are critical audit findings about a third party.²⁴

Recommendation No.7

89. To provide natural justice to third parties, and obtain and appropriately consider their perspectives when developing and finalising performance audit reports, we recommend that SAI India review its approach to consulting with third parties.

SAI India’s response:

90. While we appreciate the spirit of the recommendation, we would need to examine it in consultation with our stakeholders given the present state of accountability of the audited entities and governance.

Audit Evidence

91. Audit evidence is information collected and used to support audit findings. The quality of a performance audit report rests on the evidence obtained in the course of the audit. Chapter III of SAI India’s *Auditing Standards* outlines the requirements regarding evidence, and states that competent, relevant and reasonable evidence

²³ Two common examples of third parties are contractors who provide goods and services, either to government, or on its behalf; and commercial entities that partner with government for certain ventures.

²⁴ As part of any review, SAI India could also consider issuing performance audit guidance on circumstances when it may be appropriate to name third parties in audit reports, and when third parties may be referred to but not named. The centrality and materiality of audit findings about third parties are important considerations in deciding whether to name them in audit reports.

should be obtained to support the auditor's judgment and conclusions regarding the organisation, program, activity or function under audit.

92. As indicated earlier, SAI India is operating in a challenging environment. The maturity and capability of audited entities varies considerably, entity information systems may be poor, evidence may be physically inaccessible because of regional unrest, and audited entities may not be responsive to access and data requests. As a result, SAI India's auditors may have difficulties obtaining or verifying evidence.

93. The peer review team examined the audit evidence and documentation to support three key issues from 34 of the 35 audits in the review sample.²⁵ When examining the competence, relevance and reasonableness of the evidence, we considered whether the:

- audit report included information, findings and conclusions that were supported by competent and relevant evidence;
- evidence was persuasive, reliable and corroborated where appropriate; and
- validity of data was tested and verified.

94. We found that for around half of the 34 audits reviewed, the evidence supporting the findings and conclusions was competent, relevant and reasonable. For the remainder of the audits, we found some shortcomings with at least one of the three issues examined in detail. In particular, in around one quarter of the reports, the evidence supporting some specific audit findings was not documented, or the evidence was not accurately represented in the audit report. The importance of having appropriate audit evidence is an issue which is commonly raised by peer review and other quality assurance mechanisms within the profession.

95. We noted for a number of the issues, audit teams did not independently validate certain representations and data provided by the audited entity, which were central to the audit findings. While independent validation of information may not always be feasible, particularly within the environment SAI India operates, it is important to convey the source of the information used and any caveats on the reliability of the information, as part of audit reports.²⁶ We also noted that a range of 'audit observations' or draft findings were considered to be confirmed if they were not disputed by the audited entity. In this regard, we found that SAI India gave audited entities ample opportunity to respond to audit findings, and on many occasions the entities did not respond.

Recommendation No.8

96. To strengthen the evidence base supporting performance audit findings and conclusions, we recommend that SAI India reinforce validation techniques and documentation requirements for different types and sources of evidence.

²⁵ For one of the 35 audits, most key evidentiary documents were in Hindi, and the peer review team was unable to examine the audit evidence and documentation.

²⁶ An assessment of the reliability of information may also lead to a decision not to use the information.

SAI India's response:

97. Recommendation is accepted. *Performance Auditing Guidelines* and Audit Quality Management Framework provide detailed guidelines regarding validation and documentation of evidence. Comptroller & Auditor General of India in June 2012 has reiterated the importance of continuous improvement in planning and great rigour in execution. He has directed that the staff doing the performance audit should be provided with clear and well defined guidelines for doing this work. There should not be gaps in documentation, insufficiency of acceptable audit evidence and lack of objective analysis in the development of audit conclusions.

98. A training module being designed for evidence gathering and analysis would address these issues as well and facilitate dissemination of these requirements to the audit staff across the country.

99. SAI India's performance audit review process emphasises the importance of checking the evidentiary basis of audit facts. This includes a requirement that, with each draft audit report, documentation supporting all audit findings be submitted to headquarters for examination. We found that all the audits in our sample were reviewed at more than one stage during the draft and final report process. However, the quality of those reviews varied—from a check of the facts to an in-depth review of the evidence, report structure, logic and conclusions. The findings of the peer review suggest that there would be merit in SAI India reviewing the effectiveness of its current approach to checking the evidence used to support its audit findings and conclusions. Some supreme audit institutions adopt a risk-based approach to evidence review as part of their quality management systems, and undertake quality assurance reviews of completed audits, which examine the evidentiary basis of selected findings.

100. SAI India primarily relied on documents requested from the audited entity and some physical evidence (such as photographs), to illustrate findings in performance audit reports. As previously discussed, SAI India's strategic directions for performance audit include making more common use of a range of evidence gathering techniques. The peer review team encourages SAI India to further expand the types of evidence upon which it relies, and the methodologies applied to gather and analyse that evidence. For example, greater use of oral evidence collected via interviews with audited entities and relevant stakeholders would build the evidence base, and add more depth and context to audit findings and conclusions.

Documentation

101. SAI India's *Auditing Standards* require that auditors adequately document all evidence, including the basis and extent of the planning, work performed and the findings of the audit, such that the documented evidence supports all conclusions, recommendations and opinions.²⁷ We found that in the majority of audits reviewed, the working papers adequately documented evidence, findings and conclusions. However, in the minority of cases, the organisation and contents of

²⁷ Comptroller and Auditor General of India, 2002, *Auditing Standards*, Chapter III, paragraphs 8.2.4 and 8.2.6; Comptroller and Auditor General of India, 2004, *Performance Auditing Guidelines 2004*, pp. 78–80.

working papers made it difficult for an experienced auditor to follow the audit trail from the audit plan, through the evidence collected, to the findings and conclusions contained in the report.²⁸ Areas of documentation that could be improved include evidencing all reported findings and documenting: data analysis²⁹; variations to key audit parameters; and all management reviews of draft and final reports, and the changes made in response.

Reporting

102. Chapter IV of SAI India's *Auditing Standards* states that the auditor should prepare a written report setting out the audit observations and conclusions in an appropriate form. The Standards require that the report should be easy to understand, free from ambiguity, supported by sufficient, competent and relevant audit evidence, and be independent, objective, fair, complete, accurate, constructive and concise.

103. The peer review team examined aspects of reporting for each of the 35 audits in the review sample. We considered whether:

- reports contained all the elements required by the *Auditing Standards* (such as the audit objectives, scope and methodology);
- reports were concise, complete, accurate, objective, balanced, convincing, clear, constructive and independent;
- reports achieved their respective objectives;
- the conclusions and recommendations flowed logically from the evidence and findings, and the recommendations were practical and value adding; and
- the audited entity provided comments about the findings and recommendations.

104. The audits we reviewed included a brief executive summary or highlights section; an explanation of the government program and its administration; the audit approach; and findings, conclusions and recommendations. A large majority of the reports contained the central elements required by SAI India's *Auditing Standards*. While most of the reports were concise, there remained scope to improve the readability of reports, including through more consistent use of structure and style, avoidance of excessive detail, presentation of sufficient context and greater clarity in language. In pursuing improvements in its reporting approach, there is merit in SAI India reflecting on the most appropriate structure for its performance audit reports. A template could be used to apply a consistent structure, including an executive summary that concludes against the audit objectives.

105. The major focus of the performance audit reports was shortcomings in the audited entity's program administration and implementation, including not meeting or complying with stipulated requirements. Calculations of foregone government

²⁸ SAI India's *Auditing Standards* and the *Performance Auditing Guidelines* require that the working papers are sufficiently complete and detailed to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's findings and conclusions. See for example: Comptroller and Auditor General of India, 2002, *Auditing Standards*, Chapter III, paragraph 8.2.4.

²⁹ In two of the 35 audits reviewed, some analysis of data was not documented to provide a full audit trail.

revenue, unspent funding and irregularities in the use of funding, as a result of less than effective administration, were a prominent feature of the reports. In adopting this emphasis, the reports drew attention to many important issues for administrators, governments, legislatures and the public. Consistent with the reporting approach, stakeholders consulted by the peer review team noted that the key role of the CAG is to identify discrepancies and improve accountability.

106. In relation to objectivity and balance in reporting, Chapter IV of SAI India's *Auditing Standards* states that the presentation throughout the report should be balanced in content and tone. The audit report should be fair, not be misleading, and place the audit results in proper perspective. For SAI India, this means presenting the audit results impartially, in an appropriate context, and guarding against the tendency to exaggerate or over-emphasise deficient performance. In describing shortcomings in performance, the auditor should present the explanation of the audited entity and minor instances of deviation should not be used to reach broad conclusions. The tone of reports should encourage decision-makers to act on the auditor's findings and recommendations. Findings should be presented clearly and forthrightly, and the use of language that generates defensiveness and opposition should be avoided.

107. In reviewing the sample of audits, the peer review team noted there were often considerable deficiencies in program administration and implementation for SAI India to report. Nonetheless, for around half of the sample of 35 audits reviewed, we concluded that the audit report could have been more balanced in tone and content. A common issue was that the focus on shortcomings meant that there was limited reporting of any program outcomes and positive findings. In addition, the proportionality of negative findings was often not clear leaving the interpretation to the reader; and on some occasions, SAI India could have more clearly linked audit findings with the broader program-level impacts of those findings. To achieve a better balance, reports could more fully explore and present the challenges faced by audited entities; and include further diagnosis and explanation of any underlying causes of systemic weaknesses in administration and performance.

108. We found that a majority of the reports in the peer review sample did not comprehensively address the reported audit objectives. Reports tended to focus on shortcomings, with report conclusions generally listing the key deficiencies identified, rather than providing a balanced assessment of program administration and performance. In addition, for just under half of the sample of 35 audits reviewed, the recommendations could have been improved, particularly where these restated administrative or program requirements that were not met, rather than also addressing the underlying causes of identified deficiencies.

109. SAI India requested responses from audited entities to audit findings and draft audit reports for all of the reports in the audit sample. There was variability in the extent and timing of responses received. These responses were generally included in the audit reports within relevant sections of the report. In finalising audit reports, SAI India often added a rejoinder, and we noted a tendency for some rejoinders to dispute or dismiss entity comments without further exploring relevant issues raised by

the entity. The rejoinders could deal with the concerns raised by the audited entity in a more comprehensive manner.

110. Since 2008, the CAG has emphasised to his staff the need to institute more balanced reporting. The need is also recognised in SAI India's long term strategic plan. Consistent with these directions, SAI India provided the peer review team with details of a range of positive comments and good practices included in performance audit reports in the past few years. A consistent and high level of reinforcement will be required to achieve broad adherence to reporting standards across the performance audit function, particularly given the scale and complexity of SAI India's performance audit work and the number of staff involved. Ensuring this message is embedded in training for staff at all levels and development of better practice case studies would also assist to convey the CAG's expectations for performance audit reporting.

111. While the peer review sample included a number of balanced performance audit reports on complex subject matter; there is also significant variability in report quality and balance across the performance audit function. As indicated in paragraph 73, the key point is to pursue more systematic and balanced performance audit assessments, using well-designed audit objectives, criteria and test programs. This will better enable reporting of informed judgements about the overall quality of administration and program performance. In continuing to adjust its reporting approach, it is important that SAI India maintains the positive features of its current approach, including its forthright presentation of key audit findings for stakeholders.

Recommendation No.9

112. To strengthen application of reporting standards across performance audit reports, we recommend that SAI India develop and implement a strategy to improve reporting capability and reinforce the requirements of its standards.

SAI India's response:

113. We accept the recommendation. Reporting requirements for performance auditing would be addressed in the updation of *Performance Auditing Guidelines*. In addition, we are developing specific training module on report writing.

Supervision and review

114. Chapter III of SAI India's *Auditing Standards* requires the work of audit staff to be properly supervised and reviewed during the audit. The *Performance Auditing Guidelines* also note that a sound system of supervision and review contributes to good quality audits. The key elements of SAI India's approach to audit supervision and review are: oversight of each audit by a senior IAAD officer; the review and approval of individual audit guidelines, draft and final audit reports at appropriate levels (including by headquarters); and mid-term reviews and workshops with senior management.

115. Generally, for the audits we reviewed, key approvals were well documented and mid-term reviews were held with senior management. However, as previously indicated, we noted that some variations to key audit parameters (for example, the

audit objectives) and to the report content were not sufficiently justified and documented. For example, in several audits the audit objectives expressed in the individual audit guidelines differed to those included in the final report. In these cases, the reason for the changes was not usually documented or approved by senior management. Under the *Auditing Standards*, the audit plan and action steps in the plan should be followed unless a variation is authorised.³⁰

116. SAI India's draft and final performance audit reports were reviewed by senior management at offices and headquarters, although the level of review varied. For some audits the review focused on fact checking using key documents underpinning audit findings. For other audits in the sample, feedback from headquarters was comprehensive and resulted in significant improvements to the final report.

117. When submitting draft reports to headquarters, the relevant office also provides an assurance memoranda. This memoranda should assert that various audit management and quality aspects have been met, including that the audit has been conducted in accordance with the *Auditing Standards*. However, the peer review found some variability in the scope and level of assurance provided, and the stage of the audit process at which the memoranda was submitted to headquarters. Developing and mandating the use of a quality assurance memoranda template would increase assurance that each stage of the audit has been conducted in accordance with the *Auditing Standards* and relevant auditing guidance. This includes that the evidence obtained is competent, relevant and reasonable, and that the audit documentation and report have been appropriately reviewed by senior managers. Such a template could also be used as a checklist to guide the review by headquarters staff of different aspects of audit reports, thereby improving the consistency and quality of central review processes.

CLIENT AND STAKEHOLDER RELATIONS

118. The primary clients of the CAG are the Parliament, state legislatures and the public. For the Parliament and each state legislature there is a Public Accounts Committee (PAC) and a Committee on Public Undertakings (COPU) which examine SAI India audit reports.³¹ Other key stakeholders of the CAG include government departments and ministries, and organisations and individuals with specific interests in the subject matter of SAI India performance audits.

119. During the peer review, we met with a range of SAI India's stakeholders, including PAC and COPU members, and senior government officials. They advised that SAI India's performance audits provide valuable information, often not otherwise available, on the performance and on-the-ground impact of government programs and funding. Stakeholders also provided positive feedback on the quality of recent performance audit reports. Further, PAC and COPU members mentioned the good

³⁰ Comptroller and Auditor General of India, 2002, *Auditing Standards*, Chapter III, paragraph 5.2.2(c).

³¹ The PACs examines the appropriation accounts of government bodies and the reports of the CAG, while COPUs focus specifically on government commercial operations and examine the CAG's audit reports that relate to government commercial operations.

relationships between their committee and SAI India, including the support provided to the committee by SAI India. Finally, stakeholders commented on the importance of proposed changes to the DPC Act to provide for the CAG to audit public-private partnerships and 'follow the money', in accordance with trends in allocation of government funding.

120. As part of the follow-up of audit reports by PACs and COPUs, senior managers from SAI India testify at committee hearings on the reports. Audited entities are also required to prepare an Action Taken Note³² in response to audit reports, and SAI India staff vet these notes prior to their submission to the committees.

121. The timeliness and effectiveness of PAC and COPU follow-up of performance audit reports differ. The committees for the Indian Parliament and certain states meet on a regular basis, and inquire into recent performance audit reports. However, we understand other state committees meet infrequently, are many years behind in their examinations of performance audit reports, and/or examine few performance audit findings. In addition, many audited entities do not prepare Action Taken Notes in a timely manner, and may only choose to do so when a committee examination is imminent. In recognition of the importance of the oversight role of PACs and COPUs, the CAG has advocated for regular committee meetings, contemporary consideration of audit reports and the timely submission of Action Taken Notes.³³

122. The delay in parliamentary committees reviewing audit findings highlights the importance of SAI India pursuing a range of audit follow-up mechanisms to drive accountability. Many of the administrative shortcomings identified in the performance audit reports we reviewed were longstanding, and some had been raised in earlier audits of the same program. From our review, we considered that there is scope for SAI India to give more attention to recommendations and key findings from previous related audits, actions taken by audited entities in response, and any ongoing administrative shortcomings, as part of subsequent audits of the same program.

123. SAI India undertakes a range of actions to communicate audit messages to its clients after audit reports are presented to Parliament and a state legislature. A media conference is held to discuss each audit report, the reports are made available on the SAI India website in multiple languages, and SIA India has introduced small booklets to communicate audit messages for significant social sector performance audits.

³² An Action Taken Note outlines the action taken by the audited entity in response to an audit report.

³³ To promote the effectiveness of legislatures in ensuring good governance, the CAG held a national seminar in July 2010 on the 'legislative-audit interface', which was attended by chairpersons of the India Parliament and state legislature PACs and COPUs, speakers of legislative assemblies and senior officers of the Government of India. Following the seminar, SAI India developed and made available an introductory guide for newly inducted members of the committees, to support the effective operation of the committees.

Good practice: Alternate report presentation

The peer review team considered that SAI India's use of small colour booklets to communicate performance audit messages to clients is a good practice.

These booklets are developed for significant social sector performance audits and include a summary of key findings and conclusions, accompanied by colour photos and an electronic copy of the report on a CD-ROM. The booklets are an innovative way to reach out to a broader audience and draw attention to important community issues.

CONTINUOUS IMPROVEMENT

124. A well-functioning organisation seeks to continuously improve its processes, products and outcomes. This requires regular reflection on existing strategies and practices, and a culture committed to implementing improvements. During the review, we noted SAI India uses several mechanisms to improve its performance audit function:

- long and medium term strategic plans identify organisational and methodological changes necessary to improve performance audits;
- SAI India conducts internal peer reviews of offices which examine the functioning of the office as a whole. Thirty-one offices were peer reviewed during 2011–12; and
- during the past decade, SAI India has been the subject of two external reviews. In January 2003, the National Audit Office of the United Kingdom completed a report aimed at strengthening the strategic planning and capacity of SAI India in relation to audit work.³⁴ This international peer review focuses on the performance audit function and provides another example of SAI India seeking to benefit from external perspectives.

125. As previously discussed, the AQMF envisaged an internal quality assurance review mechanism to provide feedback on individual audits, and this mechanism has not been implemented to date. Many supreme audit institutions establish an annual quality assurance program as a key element of their overall quality control and assurance framework. Such a program is separate from, and not a substitute for, the quality control that is exercised during the course of an audit.³⁵ The principal objective of a quality assurance program is to periodically provide the head of the supreme audit institution with reasonable assurance that the policies and procedures relating to the system of quality control are relevant and adequate, and are operating effectively. A vital part of a quality assurance program is to assess whether audits are conducted in accordance with relevant legislation, auditing standards and policies. In addition, feedback from quality assurance reviews, including good practices, assists audit teams to continuously improve and can inform learning and development programs. To these ends, an SAI India quality assurance program could be conducted annually and

³⁴ National Audit Office of the United Kingdom, January 2003, *IDF Grant TF050110—For the Modernisation and Capacity Building of the Office of the Comptroller and Auditor General of India*.

³⁵ SAI India focuses on quality control mechanisms—primarily the review and clearance of audit plans and reports by SAI India headquarters (including checking of documentation underpinning audit findings).

involve examination of a sample of completed performance audits, by an independent group not directly involved in the performance audits.

126. The other element of the AQMF that is yet to be implemented is a formal process to identify and disseminate lessons learnt from individual audits. In implementing such a process, it is essential that a constructive approach is adopted, with the focus being on good practices, how to improve, and lessons applicable more broadly to all performance audits. Again, these lessons could be incorporated into learning and development programs where appropriate.

Recommendation No.10

127. To increase assurance on compliance with applicable standards of professional practice and identify opportunities for improvement, we recommend that SAI India introduce:

- an annual quality assurance program covering a sample of performance audits completed during the year; and
- a process to identify and disseminate lessons learnt for performance audits.

SAI India's response:

128. SAI India is conscious of the need for internal quality assurance review program for audits, and the evaluation and dissemination of lessons learnt from audits as part of strategy for continuous improvement. We have already put in place a system of annual quality assurance program covering a sample of performance audits completed during the year. The selected reports will be peer reviewed by select officers of SAI India shortly to identify and disseminate lessons learnt from performance audits.

APPENDICES

APPENDIX 1: ABOUT THE PEER REVIEW

129. At the request of the CAG, an international peer review team reviewed the performance audit function of SAI India. The peer review team was led by the Australian National Audit Office and included representatives from the supreme audit institutions of Canada, Denmark, The Netherlands and the United States of America.

130. The objective of the peer review was to assess the extent to which the performance audit function of SAI India adheres to applicable standards of professional practice; and to identify opportunities for improvement. A Memorandum of Understanding, between SAI India and the peer review members, set out the agreed terms and conditions of the peer review, including the objective. The scope of the peer review focused on SAI India's AQMF as it pertains to performance audit, reflecting the essential role of the AQMF in providing assurance to the CAG that his office is meeting applicable standards of professional practice. The period under review covered performance audit reports of the CAG presented to the Parliament or a state legislature from April 2010 to March 2011.

131. SAI India's performance audit function was evaluated against criteria based on the following key legislative authorities and professional standards:

- *Constitution of India;*
- *Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971;*
- *Regulations on Audit and Accounts 2007;*
- *Auditing Standards, 2nd Edition, 2002;*
- *Performance Auditing Guidelines 2004;*
- *Audit Quality Management Framework 2009;* and
- other relevant guidance.

132. The peer review methodology involved examination of:

- SAI India's AQMF;
- SAI India's approach to strategic planning and human resources management as they pertain to performance audit;
- the CAG's *Auditing Standards* and *Performance Auditing Guidelines*;
- a sample of 35 performance audits (16 per cent) from the population of 221 performance audits presented during the review period;³⁶ and
- international auditing standards, guidance and approaches, and the quality management frameworks of several supreme audit institutions.

³⁶ The judgmental sample was selected with regard to the number of Union and state reports presented to Parliament or a state legislature, to achieve broad representation in terms of states and proportional coverage by category of audit (civil, commercial, railways etc.).

133. The peer review team also consulted with a selection of SAI India’s key stakeholders, visited two states, Uttarakhand and Karnataka, and visited the National Academy of Audit and Accounts in Shimla.

134. The peer review team included senior auditors from the supreme auditing institutions of Australia, Canada, Denmark, The Netherlands, and the United States of America.

| Peer Review Team | |
|--|-----------------|
| Australian National Audit Office | |
| Barbara Cass | Deborah Jackson |
| Stuart Turnbull | Jane Whyte |
| Brendan Mason | |
| Office of the Auditor General of Canada | |
| Eric Hellsten | Patricia Bégin |
| Rigsrevisionen (National Audit Office of Denmark) | |
| Inge Laustsen | Lena Küppers |
| Algemene Rekenkamer (The Netherlands Court of Audit) | |
| Thomas Meijer | Erik Israël |
| Government Accountability Office (United States of America) | |
| Diana Pietrowiak | Cynthia Jackson |

APPENDIX 2: SAI INDIA'S RESPONSE TO THE PEER REVIEW REPORT

LETTER FROM COMPTROLLER AND AUDITOR GENERAL OF INDIA

Vinod Rai



भारत के नियंत्रक - महालेखापरीक्षक
COMPTROLLER & AUDITOR GENERAL OF INDIA

No. 155-CAG/Peer Review/DG (Trg.)
Dated: 1.10.2012

Dear Mr. McPhee,

I take this opportunity to thank you for carrying out the peer review of performance audit function of the Supreme Audit Institution of India. I would like to convey my appreciation for the effort put in by the Australian National Audit Office and the other Supreme Audit Institutions of Canada, Denmark, The Netherlands and The United States of America.

We have gone through the draft peer review report. We generally agree with the recommendations made by the peer review team. You would be happy to know that we have already initiated action on majority of the recommendations. As desired, I am enclosing the response to the draft peer review report for inclusion in the report as well as response to the recommendations.

I would like to thank you and the other peer review partners for the valuable suggestions.

Best regards

Yours sincerely,

(Vinod Rai)

Mr. Ian McPhee,
Auditor General,
Australian National Audit Office,
GPO Box 707,
Canberra ACT 2601
Australia.

RESPONSE TO THE DRAFT PEER REVIEW REPORT

Executive Summary

There are no specific comments to the Executive Summary. The issues mentioned in the Executive Summary have been covered in our detailed response to the key observations.

Recommendations

We have given our detailed response to recommendations in a separate annexure.

The Supreme Audit Institution of India

No Comments.

Managerial Context

No Comments.

The Peer Review

No Comments.

Peer Review Opinion

There are no specific comments to the Peer Review Opinion. The issues mentioned in the Peer Review Opinion have been covered in our detailed response to the key observations.

Key observations on the Audit Quality Management Framework

Audit Quality Management Framework (AQMF) was introduced in June 2009 as an umbrella framework. It mapped various existing key instruments to be employed (KIEs) for audit quality assurance viz. the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971, Auditing Standards and Manuals and Guidelines with the main Audit Quality Management Elements (QMEs). The draft report suggests that "While the quality management elements are also similar to those used in quality management frameworks of other supreme audit institutions, our comparison found they could be used to give more prominence to the:

- Independence, objectivity and integrity requirements for audit team members;
- Relationships and interactions with audited entities; and
- Security, confidentiality and access in relation to audit documentation."

It may be mentioned that independence, objectivity and integrity requirements for audit team members are already covered in *Auditing Standards* of SAI India. As far as relationships and interactions with audited entities are concerned, the Audit Execution as discussed in AQMF provides for regular interaction with audited entity particularly at Entry and Exit Conferences. Further Para 9 of the draft report also noted that, Stakeholders consulted by the peer review team advised that the introduction of the *Performance Auditing Guidelines* in 2004 led to considerable improvements in audit practice and engagement with audited entities. We have also issued instructions regarding security, confidentiality and access in relation to audit documentation.

SAI India is committed to strengthening quality management in the performance audit function. As part of our strategy for continuous improvement we review the AQMF and update it periodically taking into account best international practices. Peer Review Team had noted that out of 26 QMEs, two have not been operationalised. SAI India is conscious of the need for internal quality assurance review program for audits, and the evaluation and dissemination of lessons learnt from audits as part of strategy for continuous improvement. We have already put in place a system of annual quality assurance program covering a sample of performance audits completed during the year. This will be carried out by select officers of SAI India shortly to identify and disseminate lessons learnt from performance audits. Our training institutes regularly organize courses on AQMF to facilitate communication about framework to the staff. Recently we have designated one Regional Training Institute as the Knowledge Centre for AQMF.

Auditing Standards 2002 are based on ISSAI Standards level 1, 2 and 3. Level 3 ISSAIs are under revision. SAI India is a member of the ISSAI Harmonization Project Group. This exercise is expected to be complete by 2013. SAI India is committed to adapt the changes. *Performance Auditing Guidelines* were issued in 2004 and are in sync with ISSAI 3000. SAI India is also a member of the Committee on Performance Auditing Standards.

Key observations on the Performance Audit function

Leadership and Direction

Every field office prepares annual audit plan and submits to Headquarters for approval. All audit plans clearly spell out the audit activities for the year based on profiles of audited entities and resources available. Our audit plans invariably provide a justification for undertaking selected performance audits during the planning timeframe. Exceptions have to be made when a performance audit is conducted on request of Government. We can certainly identify best practices among our field offices in this respect and replicate it across the country as part of continuous improvement.

Human Resource Management

Towards continuous strengthening of performance audit capability of SAI India, Peer Review Team has suggested: (a) to ensure that staff are adequately trained and (b) to engage external expertise where necessary. It has also identified network of training facilities as a good practice. All our training institutions conduct at least one course on performance audit every year. We have already designated one training institute as Knowledge Centre for performance auditing. We are also strengthening in house training programs to ensure that staffs are adequately trained.

SAI India engages external experts in a limited number of cases. This is largely in view of potential danger of conflict of interest. Moreover, building domain knowledge has been one of the major thrust areas of SAI India. It is for this reason that our offices are organized on sectoral basis which has enabled our staff, who are engaged in auditing a particular area or sector, to develop expertise even in complex technical areas. This

attribute of our set-up has also been duly recognized by our audited entities. For this reason, the requirement and scope for hiring outside experts is very limited.

Audit Management

Audit Planning

We conduct performance audits only after preparing detailed guidelines. This has also been confirmed by the peer review team. However, it may be mentioned that even in the single exception mentioned in the report, the performance audit was conducted following the generic guidelines and detailed issue analysis was carried out. Planning for individual performance audits involves defining audit objectives, determining audit criteria, specifying methodology, sample size, types of evidence and source of evidence. Draft report refers to variability in the manner and extent to which the audit guidelines covered all the elements required by the *Performance Auditing Guidelines*. INTOSAI guidelines refer to performance auditing as an investigatory work that requires flexibility, imagination and analytical skills. It advocates that practices must be built on learning from experiences.

We do agree that audit objectives should be specific and predetermined. However, this presupposes complete information about the audited entity as well as cooperation from them from very beginning. As already explained, SAI India operates in an environment characterized by large size, regional variations in terms of levels of governance. The audited entity is largely disengaged at the preliminary study stage. Thus, due to imperfections in the information, many times it becomes imperative to revisit the objectives.

Determining audit criteria is the second most crucial step after the setting up of the audit objectives in the performance audit planning process. INTOSAI guidelines prescribe that audit criteria are standards used to determine whether a program meets or exceeds expectations. They can be obtained from different sources. Finally, every criterion is elaborated in the form of a question. These questions are factual in character and intended to describe or measure the practical situation to be audited. In every performance audit conducted by SAI India, this exercise is carried out. INTOSAI guidelines also acknowledge that sometimes audit criteria are easy to define, for example when the goals set by the legislature or the executive branches are clear, precise and relevant. However, this is often not the case. The goals may be vague, conflicting or non-existent. INTOSAI guidelines further state that it is sometimes advisable to avoid setting precise and detailed audit criteria in the design phase since the knowledge is limited. This is the case in India.

The *Performance Auditing Guidelines* of SAI India acknowledge that it will not be possible to anticipate all contingencies. For example, the precise nature of the data held or the likely difficulty of access may not be known. Therefore, there is a need to retain flexibility to allow for the introduction of new evidence/criteria and the exclusion of outdated or irrelevant evidence/criteria. The guidelines thus provide us the framework for deviations from the ideal situation. SAI India is largely auditing the entities which are not auditable in the strict sense of the term as they are characterized by opaque

processes of decision making, inadequate documentation and low levels of financial management maturity. We are exercising the choice of auditing under suboptimal conditions and informing our stakeholders about the state of affairs in the audited entities. In the process, we are perhaps making some minor procedural omissions but preparing reports that are conveying strong messages as acknowledged by the peer review report.

Performance audits conducted by the field offices are part of their annual plan. Monetary budgeting is therefore done for the audit products for the office as a whole. For individual audits, physical budgeting is done in terms of number of mandays set aside for that audit. Multiplication of this human resource deployment with the manday rate would give indication of financial budget for that assignment. Many a times we also receive requests from the Government for specific performance audits. This necessitates prioritization. However, for efficiency gains we could consider this suggestion of developing a full time schedule and budget for individual performance audits. Suggestion for using a template for the individual audit guidelines is welcome as it would facilitate uniformity.

Audit Interactions

As already pointed out in the Report by the Peer Review Team, lack of responsiveness of audited entities in commenting on draft audit reports is a major constraint faced by SAI India. The suggestion regarding seeking specific response to recommendations is welcome. In fact we have followed this practice in some of our recent reports. Regarding interaction with the third party, it may be stated that Audit Regulation 169 stipulates that information from third party is to be obtained by the audited entity and provided to audit. Thus audit is not expected to interact with the third party. As a convention we normally do not interact with the third parties. SAI India's jurisdiction is limited to government entities. With increasing privatization and outsourcing, role of third parties is expanding. The third party is in a contractual relationship with the audited entity. As auditor we are commenting on due diligence or lack of it on part of the audited entity and not the third party. Thus we do not interact with the third party in normal course. A potential danger of direct interaction with the third party is that the audited entity may not feel responsive enough and may leave it to the SAI and third party to sort out issues. There is also a potential moral hazard if the auditor interacts with the audited entity directly.

Audit Evidence

The draft report refers to shortcomings in evidence in about half the reports. We noted that in about a quarter of the reports these shortcomings were minor errors (for example typographical errors or other insignificant non material errors), data validation issues and documentation issues. We would like to mention that only material issues are normally reported. Other minor aberrations are brought to the notice of management for corrective action and do not form part of the report. As far as gaps in documentation are concerned they are also addressed in paragraph 101 of the report. We have already clarified that independent validation of information may not be feasible, particularly in the environment in which SAI India operates. In most cases

we rely on information and data supplied to us by the audited entities, who are the owners and custodians of such information and data. While we do verify this data for internal consistency within the organization (from the point of collection to the point of consolidation) as a part of standard audit practice, to independently validate it – for example the area of land under cultivation of a particular crop - is neither feasible nor in our view is it called for, unless there is strong basis for us to believe that the data collection process is compromised or there is a deliberate attempt to present misleading data.

The draft report creates an impression that there are problems with all the issues examined by the peer review team. However, we feel that even within the selected issues the Peer Reviewers found only one or two segments/figures within the section examined in detail, which were not properly evidenced. In respect of nine PAs specifically highlighted we feel that in case of three PAs there are interpretation issues.

We would like to mention that SAI India does not carry out physical verification. As mentioned above, the information provided by the audited entity regarding physical parameters is accepted. We do carry out joint physical inspection in certain cases, but it is not mandatory. In a vast country it may not always be possible. We generally treat audit findings as confirmed if they are not disputed by the audited entity. It may be mentioned that audited entity is given a number of opportunities to convey their view point or contest the observations. While forwarding the draft report, it is invariably mentioned that facts and figures may be confirmed within a specified period. The peer review team has noted that audited entity does not respond in all the cases. Thus, we have no choice but to treat the observations as confirmed if not disputed by the audited entity. Incidentally, the audited entity is also aware of this practice and interpretation. Suggestion regarding risk based approach to evidence review as part of quality management system would be examined.

Documentation

There are detailed guidelines regarding documentation in *Performance Auditing Guidelines* as well as AQMF. These are invariably followed. Draft report has referred to minor aberrations. The instructions would be reiterated for strict compliance. Training module on evidence gathering, which is under preparation, will also address the issue.

Reporting

As per our *Auditing Standards*, all efforts are made to present a balanced report. As far as limited reporting of any positive findings and program achievements is concerned, it may be stated that even our stakeholders recognize that the key role of the CAG is to identify shortcomings and improve accountability. SAI India is conscious of the need for balanced reporting. The message has been reiterated by the CAG himself to all the field offices in June 2012. This message regarding balanced reporting will get further embedded in the training module on Report Writing. We would explore the possibility of making the reports more reader friendly and will design a template for uniform and consistent structure of the report. The draft report also highlights that in about half the reports, recommendations could have been improved. Audit recommendations have to

be drafted very carefully within the policy framework as they have serious implications including financial. Since our reports comment about shortcomings in implementation of schemes etc. recommendations would revolve around the administrative or program requirements as a natural corollary.

Supervision and review

We have a very well designed system of reviews and approvals at headquarters. All changes in the performance audits are approved by the Senior Officers at headquarters. The level of review conducted by Senior Officers is same. Feedback from Headquarters would result in significant improvements in final report only when there is scope for same. Suggestion regarding developing and mandating the use of a quality assurance memoranda template is welcome. We would review the existing template to make it consistent with revised *Performance Auditing Guidelines* as well as address the concerns of the issue raised by the Peer Review Team.

Client and Stakeholders Relations

Draft report has suggested that SAI India may give more attention to recommendations and key findings from previous related audits, actions taken by audited entities in response, and any ongoing administrative shortcomings, as part of subsequent audits of the same program. While we welcome the suggestion, it may be mentioned that we are already following this practice. We can make this practice more structured.

Continuous Improvement

SAI India is conscious of the need for internal quality assurance review program for audits, and the evaluation and dissemination of lessons learnt from audits as part of strategy for continuous improvement. We have already put in place a system of annual quality assurance program covering a sample of performance audits completed during the year. The selected reports will be peer reviewed by select officers of SAI India shortly to identify and disseminate lessons learnt from performance audits.