

**Effectiveness of the Public Audit System in India  
Reforming the Institution of the Comptroller and Auditor General (CAG)**

[being an edited version of the consultation paper of the National Commission to Review the Working of the Constitution entitled - Efficacy of Public Audit System in India: C & AG - Reforming the Institution released for public debate and eliciting public response]

***Readers are requested to send their comments and responses  
to the NCRWC at the following address:***

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**Important !**

[For any doubts or clarifications please check with the original consultation paper. Complete versions of the consultation paper and questionnaire are available on the [NCRWC website](#)]

<b>Guidelines for Using this Document</b>	
<b>1.</b>	This document summarises the ideas and questions contained in the consultation papers along with additional background information.
<b>2.</b>	For the sake of ensuring continuity, the order of topics and questions has been changed from the original.
<b>3.</b>	Every sub-section and corresponding question has an identification number in the original paper. We have used the same numbers for easy reference. Questions marked '■' against them are additional queries raised by the paper in the same context.
<b>4.</b>	While sending your responses to the Commission please quote the sub-section and the question numbers. This will make it easy for Commission Staff to categorise them. You need not quote the entire question.
<b>5.</b>	The NCRWC website has a user-friendly facility for making online submissions. Apart from 'yes/no' answers responses up to 50 words may also be submitted online. In order to log in you must have an email address as this will be used as your log-in identification. (however this facility is not available for making submissions relating to the consultation paper entitled- ' <a href="#">Pace of Socio-economic Change under the Constitution</a> ').

## Background to the Constitution Review

The National Commission to Review the Working of the Constitution (NCRWC) was set up in February 2000 by the National Democratic Alliance government thereby fulfilling its electoral promise to review the Constitution. The government initially wanted to find a way of amending the Constitution to ensure political stability and avoid frequent elections to the Lok Sabha. But the mandate of the NCRWC was a wide one and included development and human rights related topics and other important constitutional issues. The necessity of reviewing the Constitution was discussed several times in Parliament. The NDA and its allies favoured the review but the Opposition saw no special need and repeatedly wanted the government to spell out what needed reviewing. However, in the end it was not by a resolution of Parliament that the NCRWC was set up but by an executive order of the Ministry of Law Justice and Company Affairs. Perhaps the NDA feared that it might not be able to get parliamentary approval for reviewing the Constitution as it lacked a majority in the Rajya Sabha. The arbitrary manner of appointing the NCRWC and the lack of any effort at evolving a political consensus have resulted in the major opposition parties staying away from the review process.

The NDA government assured Parliament repeatedly that it would not touch the basic structure of the Constitution. Before accepting its Chairmanship, Justice M.N. Venkatachaliah - former Chief Justice of the Supreme Court - also insisted that reviewing the basic structure of the Constitution should not be included in the mandate of the NCRWC. As a result of these developments the idea of changing over from the parliamentary form of government to a presidential form - similar to that which exists in the USA will not be considered. This debate has come up from time to time and would have required a major overhauling of constitutional arrangements.

Since January 2001, the NCRWC has released 14 consultation papers on subjects such as electoral reforms; reviewing the working of the political party system; making the public audit mechanism more effective; setting up a judicial services commission to ensure independence and merit in the appointment of judges; codifying laws regarding the State's tortious liabilities so that citizens can get compensation for wrong-doing or neglect by officers acting under the state's authority; allowing for the prosecution of MLAs and MPs for corrupt activities - especially in the legislatures; enlarging the fundamental rights chapter of the Constitution to include more rights for citizens such as the right to education; reviewing centre-state relations especially with regard to imposition of President's rule under Article 356 and reviewing the institution of the Governor; setting up a mechanism for ratifying international and other treaties signed by the government which does not exist at present; effectuating fundamental duties etc.

**The ideas contained in these papers are not the Commission's own views.** Instead various options for reform have been put forward for public discussion. The Commission wants people to debate these ideas and give their opinion on the suggested options for reform. These suggestions will be taken into consideration when the NCRWC compiles its final report to the government.

## **Effectiveness of the Public Audit System in India**

### **Reforming the Institution of the Comptroller and Auditor General of India**

#### **Why does the government need money?**

Every government needs resources to perform its functions effectively. The government employs several lakhs of citizens at the central, state and municipal level to carry out day-to-day administration. All of them must be paid salaries and if eligible, pension benefits after retirement. Apart from people, running an effective administration also requires several resources like office buildings, furniture, stationery, uniforms, transport vehicles, fuel and communications machinery like telephones, telegraph, computers etc. The government has to spend money in order to acquire all these materials. Money is also required to buy arms and ammunition to defend the country from external threats. Lakhs of soldiers and officers of the defence forces must be paid salaries and allowances.

In keeping with the constitutional mandate to secure socio-economic justice for all citizens the government is also responsible for people's welfare. Welfare schemes cannot be implemented without spending money. Roads have to be built and maintained, water and electricity must be supplied, buses and trains must be operated and hospitals and schools must be run for the benefit of the people. The government also owns or controls industries, mining operations, national parks, reserve forests, revenue land and other assets whose functioning, upkeep and supervision require money. Then the government provides subsidies on fertilizers, electricity and water supply, fuels like kerosene, cooking gas (LPG), petrol and diesel, food grains and other items supplied through ration shops in order to make these commodities available to a majority of people at prices lower than market rates. All these activities require investment of funds in a big way.

#### **Where does the money come from?**

##### **Taxes:**

In order to meet this expenditure which runs into several thousand crores of rupees, the Constitution authorises the government to collect taxes from the people. Taxes are levied on commodities of daily use like food grains, vegetables, clothes, medicines and practically every item sold within the country as well as those exported to foreign countries. Though the individual may pay only a few paise or rupees as tax while buying an item from a shop, the total amount of tax collected from buyers all over the country is a huge figure. During the financial year 2000-2001, the central government estimated a collection of Rs. 1,20,462 crores from excise and customs duties alone. Another important source of revenue for the government is income tax paid by individuals (i.e., those who earn more than Rs. 50,000 per year<sup>1</sup>) and corporate tax paid by private and public sector companies and enterprises. During the same financial year, the central government estimated collections of Rs. 3,5271 crores by way of income tax and Rs. 3,8721 crores through corporate taxation.<sup>2</sup>

##### **Public Borrowing:**

India is a country with many needs but limited resources. Despite the huge amount of money collected by way of taxes, the government requires more and more funds to meet its expenditure each year. So the government takes loans from banks, borrows from public and foreign sources in order to finance development and welfare schemes for the people. As of March 31, 2001 the central government's borrowings amounted to Rs. 11,32,230.49 crores. This figure includes money borrowed from the Reserve Bank, short-term borrowings from other banks and international financial institutions like the International Monetary Fund, the World Bank, and the International Fund for Agricultural Development. This figure also includes money that the government owes those people who had invested in Small Savings Schemes, Provident Funds and securities sold by the Industrial

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<sup>1</sup> Unlike during the British rule, farmers do not have to pay income tax in independent India if agriculture is their only source of income.

<sup>2</sup> These budget figures are available on the [Government of India \(GOI\)](http://www.goi.gov.in) website.

Development Bank of India, Unit Trust of India and other nationalised banks.<sup>3</sup> As these funds will have to be returned to the investors along with the promised sum of interest at a fixed point of time in the future, they become liabilities of the government.

### States' Finances:

State governments also collect taxes- for example profession tax (doctors, lawyers, teachers, journalists etc. are required to pay every month a certain amount as tax depending upon the existing laws in each state), mining, sales of commodities entering their jurisdiction, electricity consumption, motor vehicles, entertainment (such as movies and betting at horse races) and duties on stamp paper used for legalising any transaction (i.e., sale or rental of land, residential or commercial buildings etc.). The state governments also resort to borrowing from the Reserve Bank and other financial institutions in order to meet their rising expenditure.

### The Budget:

The Constitution clearly spells out the sources from which the central and state governments may collect taxes.<sup>4</sup> All tax proposals of the central government must be approved by Parliament. Similarly at the state level, proposals to raise taxes must be approved by the concerned legislature. During the last week of February every year, the Finance Minister presents a budget which contains estimates of tax and non-tax revenues<sup>5</sup> collected and expenditure incurred by the central government during the current financial year. It also contains a ministry wise and department wise estimate of the expenditure likely to be incurred during the coming financial year and the amount of money that is likely to be collected in the form of taxes. The Finance Minister may propose to collect new taxes; or raise the rates of the existing taxes; or reduce the existing rates; or do away with a tax entirely in his budget. In the states, finance ministers follow the same process, though the timing of the presentation may vary. The Finance Minister consults captains of industries, trade unions and consumer forums and other economic interest groups before formulating the annual budget. But the actual proposals for raising or reducing taxes are kept secret until they are presented to Parliament. If traders had advance knowledge of a new tax that the government was likely to levy on a particular commodity they would buy it in large quantities at cheaper rates, hoard it until the budget presentation and sell it at prices inclusive of the new taxes. As the new tax was not applicable at the time of buying the commodity, the traders would be under no obligation to pay the tax. Instead, by including it in the price of the commodity the traders would make a huge profit causing losses to both the government and citizens. Therefore utmost secrecy is maintained in order to prevent such unscrupulous traders and businessmen from profiting at the citizens' expense. The process of preparation and presentation of budgets at the state level is generally similar though the timing may vary in some cases.

Parliament and state legislatures discuss budgets at length. Each ministry/department's demands for funds are taken up for debate separately and the concerned minister defends the estimated requirement. This provides people's representatives an opportunity to critically examine the working of the government in detail. Often Opposition members come to the house armed with data to take the

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<sup>3</sup> See [GOI](http://goi.gov.in) website.

<sup>4</sup> The tax related provisions of the Constitution are given in Part XII- Articles 264- 279. Some taxes are-

- i) levied by the central government but collected and taken over by the states (Article 268). Eg. Stamp and excise duties on medicines and toiletries like soap, shampoos toothpastes etc.
- ii) levied and collected by the central government but handed over to the states (Article 269). Eg. Duties on property inheritance, estate duty (not applicable to agricultural property in both cases), taxes on railway fares and freights, sale of newspapers and stamp duties on transactions in stocks and shares.
- iii) Levied and collected by the central government but shared between the states and the centre (Article 270). Eg. Income tax.

<sup>5</sup> Non-tax revenue includes payment received in the form of-}

- i) interest from loans given to state governments and others;
- ii) dividends on shares owned by the government in public and private enterprises and
- iii) money received from the rental or sale of property owned by the government.

government to task for its poor performance. Sometimes the Chairperson of the house also expresses his/her concern if a Minister's response to the Opposition's criticism is not satisfactory. This system ensures financial accountability of the government.

Ultimately Parliament and the state legislatures must pass the respective budgets by a majority. If a government fails to get its budget passed it implies that people's representatives do not have enough confidence in the policies of the ruling party or alliance. Therefore the ruling party or alliance will have to resign and make way for a new government, in keeping with parliamentary convention. In other words budgets must be passed by people's representatives every year if the government has to function smoothly.

The central government may resort to printing of currency notes in order to make up for the gap between income and expenditure.<sup>6</sup> State governments cannot resort to this trick as they do not have the constitutional authority to print currency notes. They have to depend upon grants and loans from the central government or borrow from banks to meet their excess expenditure.

### The Finance Commission<sup>7</sup>

Every five years the President of India appoints a Finance Commission to determine the manner in which money collected through various taxes will be shared between the central and state governments. As of now the financial position of the central government is much better than that of the states. Generally states have faced the problems of falling tax collections, shortfalls in income, over-dependence on central grants and loans and massive overdrawing from the Reserve bank of India. State governments have always been demanding a greater share in the tax revenues collected by the central government.

### Norms of Public Spending

In a democratic system public funds ultimately belong to the people. Therefore the government must be held accountable for the manner in which it spends their money. The government must spend public funds **efficiently** *i.e.*, the outcome of the expenditure should clearly show that the money was well spent. Public funds should be spent **economically** *i.e.*, the government should spend less but show more good results avoiding wastage. Public money should be spent **effectively** *i.e.*, the gap between the original goals and the actual results should be as narrow as possible. Finally in a democratic set up there should be an **auditing mechanism** for determining whether the government has followed these norms while spending public money.

### Auditing Government Finances- the Comptroller and Auditor General

In India the Comptroller and Auditor General (CAG) audits the government's financial performance.<sup>8</sup> He is responsible for investigating whether the central and state governments have followed the norms of public spending mentioned above.<sup>9</sup> Every year he submits to the President a detailed report relating to the central government's accounts, spending of public money and the performance of public sector undertakings. This report is then presented to Parliament which is expected to debate over it and hold the government to task for any lapses or wrong doings. Similarly, the CAG submits reports on the accounts, spending decisions and performance of companies of the state governments

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<sup>6</sup> According to many economists this practice of printing currency notes to make up for the gap in income and expenditure is a bad way of managing finances. It results in an artificial increase in the supply of money and causes inflation - a situation where there is too much money but few commodities for people to buy. Unless commodities are produced and supplied to the market in large quantities quickly prices will go up. This happens because people who have more money will be willing to pay a higher price in order to buy the same commodity. The poor who have very little money will be the worst affected (according to one estimate about 30-35 crore Indians live below the poverty line as they earn less than Rs. 3,500 per year.)

<sup>7</sup> Articles 280-281. As of the present the guidelines for tax sharing between the centre and the states are based upon the recommendations made by the Eleventh Finance Commission chaired by Prof. A.M. Khusro.

<sup>8</sup> At the time of writing, the Comptroller and Auditor General of India was Sri. V.K. Shunglu.

<sup>9</sup> The Comptroller and Auditor General Act, 1971 passed by Parliament lays down the powers and functions, manner of appointment and removal of the CAG in detail. CAG reports are available on their [website](#).

to the respective Governors which are then tabled in the respective legislatures for debate. Though the budget session provides an opportunity for the Opposition to critically examine the working of the government the budget does not contain all data about its financial activities. The CAG's report however is more detailed and points out where the government has failed to perform and for what reasons.

**The reports of the CAG contain objections and remarks over errors committed by government authorities while spending money during a given financial year. Non-spending, under-spending, overspending and misspending of allocated funds are all pointed out in clear terms in the report.**

### **Parliament, Legislatures and CAG Reports**

When presented to Parliament, the audit report of the CAG relating to the central government is automatically transferred to two Committees. The Public Accounts Committee (PAC) scrutinises those sections of the report dealing with the accounts of the various ministries, departments and offices of the central government such as the Railways, Defence, Post and Telegraph, Agriculture, and Social Empowerment. The sections dealing with central public sector undertakings (PSUs) are scrutinised by the Committee on Public Undertakings (COPU). Air India, Bharat Aluminium Company Limited, Central Warehousing Corporation, Food Corporation of India, Housing and Development Corporation LTD, Neyveli Lignite Corporation and Rural Electrification Corporation of India are some of the PSUs whose functioning has been examined by the COPU in recent years.<sup>10</sup>

The PAC consists of 15 members of the Lok Sabha and 7 members of the Rajya Sabha elected every year.<sup>11</sup> The Speaker of the Lok Sabha appoints its Chairman from among its members. The Chairman is usually a member of one of the opposition parties. A minister in the government cannot become a member of the PAC. If a member of the PAC is made a minister he must resign from the committee. The COPU is constituted in the same way.<sup>12</sup> The PAC and COPU are reconstituted every year.<sup>13</sup>

The CAG sits in the meetings of these committees as a 'friend philosopher and guide' of its members. Representatives from the ministries and departments appear before the PAC when matters relating to them are taken up. They are required to answer questions raised by committee members on the basis of the report of the CAG. The PAC may constitute sub-committees to conduct an in-depth study of the specific departments or projects if necessary. The COPU selects PSUs from time to time for a detailed study of their functioning. The concerned Ministries responsible for the PSUs are asked to furnish all details. The COPU often visits the selected PSUs and examines their working on the spot. Both committees submit reports on their findings to Parliament. The concerned ministries are required to file action taken reports on the points raised in these reports. At the state level, the system of legislative scrutiny of government spending and accounts is fairly similar to this process.

The paper states that despite providing constitutional authority to the CAG and setting up an elaborate machinery for auditing public accounts there are several weaknesses in the system.

### **Power to Take Legal Action against Erring Officials**

During the last fifty years, the CAG has pointed out in every audit report several hundreds of irregularities in the decisions made by government officials while spending public funds. For example, money set aside for one purpose - say constructing a well - was actually spent on something else - say for repairing a road. This is an irregularity. Again if the decision taken by an officer caused huge losses for the PSU it becomes an irregularity. If the tax collection target - of say the Excise department - has not been reached during a financial year there is a shortfall in the revenue estimate

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<sup>10</sup> For a detailed list of public undertakings scrutinised by the [COPU](#) please visit the website.

<sup>11</sup> For more details about the working of the [PAC](#) visit the website.

<sup>12</sup> For more details about the working of the [COPU](#) visit the website.

<sup>13</sup> At present the PAC and COPU are constituted under Rule 308 (1) and Rule 312A of the Rules of Procedure and Conduct of Business of the Lok Sabha.



that was made in the budget earlier. The expenditure decisions of the government are adversely affected as adequate money is not available. This is an irregularity and the causes for the shortfall must be investigated.

### **CAG Report on Emergency Defence Purchases for Operation Vijay (Kargil)**

The consultation paper briefly mentions the fodder scandal in Bihar as an example of irregularities in government spending. More recently the CAG has detected several irregularities in the manner in which urgent supplies of ammunition and defence equipment were purchased in connection with the Indo-Pak clash in Kargil (also known as Operation Vijay). It would be worthwhile to take a look at this report in order to understand the nature of irregularities that occur when the government fails to observe norms of public spending.<sup>14</sup>

After receiving a written request from the Ministry of Defence, the CAG investigated alleged financial irregularities involving the acquisition of emergency supplies for Operation Vijay.<sup>15</sup> The entire investigation seems to have taken more than one year to be completed. The emergency defence purchases - most of which were paid for in foreign currency - costed the nation a sum of Rs. 2175.50 crores. The CAG examined documents belonging to more than 99% of the purchase contracts (worth Rs. 2163.09 crores) and found several irregularities. Though the equipment purchased in such a hurry was meant to be used in Operation Vijay, the CAG found that less than 1% of the supplies was actually received before the clashes ended in Kargil. Contracts for 75% of the emergency supplies were concluded after the conflict had come to a halt. Among these purchases was Rs. 91.86 crores worth of ammunition whose shelf life had expired and could not have been used effectively even if they had been deployed in Kargil.<sup>16</sup> Further, according to the report, supplies worth Rs. 342.37 crores did not meet the qualitative requirements of the army. For example two European firms supplied 4138 pairs of multipurpose boots at a cost of Rs. 2.22 crores. Of these, 83% were of sizes 5 and 6, which were too small to be worn by grown-ups and the rest, size 12, which are abnormally large. The report unveils several cases where special gloves, woollen socks, automatic grenade launchers, disposable flame throwers, fuses for 155 mm howitzers, rubber tyres apart from the now famous aluminium caskets (which were to be used as coffins for soldiers killed in action) were procured despite their not meeting quality standards as determined by the Indian army's Director General, Quality Assurance.

In another instance, 26,000 rounds of ammunition, for T-72 tanks, were purchased from an Israeli firm as 'a one time measure for meeting the requirements in the prevailing situation.'<sup>17</sup> According to the CAG report, this contract was concluded even though the same version of ammunition was already being produced by the Ordnance Factory within India.<sup>18</sup> This import of ammunition was finally approved by the Defence Minister in June 1999. The report states that the government urgently concluded this contract worth Rs. 119.55 crores even though T-72 tanks could not have been used in the mountainous terrain of Kargil. The actual delivery of the first consignment took place only in December 1999, five months after the end of hostilities. The CAG report mentions several such irregularities involving procurement of defence supplies at very high costs, non-adherence to quality specifications set by the appropriate authorities, undue delay in supply of materials and lack of foresight on the part of the officials while concluding contracts with the suppliers.<sup>19</sup>

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<sup>14</sup> Report of the CAG on the Union Government (Defence Services) Review of Procurement for OP Vijay (Army) 7A of 2001. The entire report is available on the CAG website- [http://www.cagindia.org/reports/defence/2001\\_book3/index.htm](http://www.cagindia.org/reports/defence/2001_book3/index.htm) The NCRWC's consultation paper was released much before the CAG's report on Kargil procurement. We have referred to this report in some detail as it has generated heated debate in Parliament and the media.

<sup>15</sup> A news article published in an English fortnightly magazine (Sukumar Muralidharan, 'Deals Under Scrutiny', Frontline, Volume 17 - Issue 04, Feb. 19 - Mar. 03, 2000), as far back as in March 2000, also reports that the Ministry of Defence had actually made such a request. This news article is also available on <http://www.flonnet.com/fl1704/17040230.htm>.

<sup>16</sup> See pages 7-8 of the report. The shelf life of some of the ammunition had expired more than decade ago.

<sup>17</sup> See page 7 of the report.

<sup>18</sup> The Russian firm which had supplied the T-72 tanks also offered to supply ammunition which in any case had been tested and used earlier. But their tender was rejected on procedural grounds according to the paper.

<sup>19</sup> The report also cites replies received from the Ministry of Defence and Army authorities with respect to the objections raised by the CAG's office. The report of the CAG therefore appears to be based on written documents acquired from government files rather than mere hearsay as alleged by some political leaders.



These findings assume great significance in the light of the fact that the Ministry of Defence, despite the emergency, had not relaxed procedures prescribed by the PAC in 1992, which were meant to ensure that technically optimum equipment was purchased at optimum value for money.<sup>20</sup>

**Although various government officials commit such irregularities while spending public money the CAG does not have the power to summon them and seek explanations for their decisions. Similarly, the CAG does not have the power to make the erring official pay for the loss caused by mispending of funds or for committing fraud while handling funds.** In countries like Germany, Japan, China, France and New Zealand auditing officers have powers to summon erring officials and make them pay from their own pockets for losses caused by them to the state. In some serious cases the erring official is imprisoned after instituting criminal proceedings against him in a court of law.

**Question # 4:** Do you think senior officers of the Audit Department should be given powers to summon erring officials and order them to pay for losses caused by their negligence, fraud or neglect? If not, should they have powers to recommend initiation of disciplinary action against such erring officials to their department heads?

### **Appointment and Status of the CAG**

The President appoints the CAG for a period of six years. As the Constitution requires the President to act upon the advice of the Prime Minister and his council of ministers<sup>21</sup> all Presidential appointments have to be approved by the central government. In effect this means that the political party or alliance which is in power will appoint an individual as CAG only if he or she is to its liking. This raises doubts over the impartiality of the office of the CAG. But the power to remove the CAG does not belong to the President or the central government. He can be removed from office for proven misbehaviour or incapacity only if Parliament resolves to do so by a majority decision.<sup>22</sup> This procedure for removal ensures some amount of independence to the office of the CAG as the government would not be able to appoint and remove CAGs at will.

As the head of the Indian Audits and Accounts Department, the CAG is assisted by about 6000 employees working in more than 90 offices spread across all states. Of late, the post of CAG is being filled by officers belonging to the I.A.S who do not have the same expertise as officials working in the Audit Department itself. This affects the work of the Audit Department.

The paper notes that in Commonwealth countries like the United Kingdom (UK) and Australia, the job of public auditing is classified as belonging to the legislative branch of the state. This has been done so because all authority to collect taxes and regulate expenditure lies with their respective Parliaments. Therefore the CAG in these countries is an independent officer of Parliament. Similarly in the USA, the General Accounting Office is recognized as an agency of the legislative branch and enjoys a special relationship with the US Congress.<sup>23</sup>

**Question # 1:** Do you think the CAG should be appointed by a committee consisting of the Prime Minister, Finance Minister, Leader of the Opposition in the Lok Sabha and the Chairman of the PAC of Parliament?

■ Should the term of the CAG be reduced to five years like that of the Lok Sabha and the Vidhan Sabhas?

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<sup>20</sup> According to the report relaxations were made only in procedural details regarding payment for supplies in order to ensure quicker acquisition- see page 1 of the report.

<sup>21</sup> Article 74 requires that the President shall exercise his powers and functions in accordance with the aid and advice of the Prime Minister and the council of ministers.

<sup>22</sup> See Articles 148-152 for provisions relating to CAG. The process of removal is similar to that of the impeachment of judges of the High Court and Supreme Court provided in Article 124 (4). The CAG may be removed from office by an order of the President of India if Parliament passes a resolution by a majority vote. But it must be supported by a two-thirds majority in both the Lok Sabha and the Rajya Sabha.

<sup>23</sup> The House of Representatives and the Senate are collectively known as the Congress in the US.

■ Do you think only a person who has extensive knowledge and experience in public auditing and accounting should be appointed for the post of CAG?

**Question # 9:** What kind of a relationship do you suggest the CAG should have with Parliament? Do you think the CAG should be made an independent officer of Parliament following the example of the UK and Australia?

### **Strengthening the Auditing Mechanism in the States**

Under the Constitution every State has its own Governor, Chief Minister, High Court and legislature. But there is only one CAG for the whole of India who audits accounts of both the centre and the states. Accountant Generals in the states do not derive their power from constitutional provisions like the CAG. They are subordinated to the CAG without much independent authority. Their reports must go to the CAG for final approval. The paper notes that the CAG personally approves about 20 audit reports for the central government and about 75 reports for the state governments. There is too much concentration of authority in the hands of the CAG. There is a lot of delay due to the heavy workload and it is difficult to detect irregularities committed by state level officials in time. Furthermore the Audit department is criticised for its practice of raising petty objections and adoption of a negative approach in its work. It does not provide solutions to the problems faced by the administration. The CAG does not have the necessary expertise to audit the accounts of scientific and technical departments such as the departments of Science and Technology, Atomic Energy, Space Applications etc or review the economic policies of the governments.

Countries like the USA, Germany, Canada, Australia with populations or territories of large size have a federal structure where the powers and positions of the central and provincial governments are clearly defined. They have separate Auditor Generals for the provinces who have more powers to deal with irregularities. Audit Commissions or Boards consisting of all senior officials of the Audit Department are responsible for finalising audit reports in many of these countries. Members of these boards enjoy independence and a status similar to that of judges of the higher judiciary.

**Question # 2:** Do you think the Accountant Generals should have a constitutional status like the Governor or a Judge of the High Court and more autonomy for auditing accounts at the State level?

■ If your answer is yes do you think Accountant Generals should be appointed by the President of India upon the recommendations of a committee chaired by the CAG?

■ What kind of a relationship should the Accountant Generals have with the CAG?

**Question # 3:** Do you think the office of the CAG should be restructured and made broad based by creating an Audit Commission with Deputy CAGs being appointed as its members for taking collective decisions regarding all audit and accounts policy matters? Should they be given the status of a judge of the High court?

### **Auditing Accounts of Panchayati Raj Institutions**

With the passing of the 73rd and 74th Constitution amendments Panchayati Raj system was formally extended to all parts of India with the exception of the areas covered by the Sixth Schedule.<sup>24</sup> Under the new system governments directly distribute funds to District Rural Development Agencies (DRDA) which have been set up for carrying out developmental works at the level of Zilla Parishads (ZPs).<sup>25</sup> The paper notes that every year about Rs.10,000 crores are spent on poverty alleviation programmes through the DRDA and ZPs but their accounts are not audited by the CAG. Instead Chartered Accountants are hired to audit accounts of DRDAs and ZPs. They do not get adequate information

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<sup>24</sup> The Sixth Schedule gives details of the separate local administrative arrangements that have been made for tribal areas in the states of Assam, Meghalaya, Tripura and Mizoram.

<sup>25</sup> Article 243J introduced by the 73rd Constitution Amendment empowers the state governments to determine the manner in which accounts of Panchayats will be maintained and audited.

about the money received and the manner in which it was spent by these institutions. Therefore their audit reports do not provide a detailed picture of the financial performance of Panchayati Raj institutions.

**Question # 7:** Do you think Parliament should make a law clearly laying down auditing and accounting arrangements for Panchayats and Municipalities? Do you think the CAG should have the authority to lay down auditing and accounting standards for Panchayats and Municipalities from time to time?

### **Auditing Accounts of NGOs and other Similar bodies**

Similarly thousands of NGOs, autonomous bodies and other institutions receive public funds and grants from governments for carrying out developmental activities. The Ministries of Health, Environment, Child Welfare and Social Empowerment, Rural Development etc. fund the activities of several NGOs, voluntary organisations and community based organisations. The CAG does not have access to their accounts and records of transaction. As a result activities of various agencies financed by a large chunk of public funds are not available for scrutiny under the public audit system. So far such organisations have audited their accounts through private Chartered Accountants.<sup>26</sup>

**Question # 6:** Do you think that suitable Constitutional provisions should be made to empower the CAG to audit the accounts of all bodies receiving public funds? Should any stipulation that exempts some organisations from the jurisdiction of the CAG be declared ultra vires (i.e., declared illegal or unconstitutional)?

### **Auditing the Accounts of Public Corporations in the Banking and Financial Sector**

The government has set up various financial corporations in the public sector such as Industrial Development Bank of India, Industrial Finance Corporation of India, Life Insurance Corporation of India and several banks have been nationalised till date. These corporations need money for performing their functions. So they collect funds from the people through public sale of shares or from nationalised banks and financial institutions which also use public money for buying these shares.<sup>27</sup> The paper notes that most of these corporations have been kept outside the jurisdiction of the CAG although they make use of public funds. The specific law through which these corporations were set up determines their auditing arrangements. This was done because it was felt that these corporations would not be able to function as effectively as their counterparts in the private sector if they were subjected to government audit. Several decisions have to be taken on a commercial basis and book accounts cannot be maintained in the same manner as government departments do. Furthermore, transactions of these corporations extend beyond the one-year time limit that determines the work of government ministries and departments. Yet during the 1950s the CAG prevailed upon the government to have their accounts audited by the CAG on a supplementary basis. Subsequently, in the 1970s an Audit Board was set up to provide commercial auditing for these corporations.<sup>28</sup>

The paper notes that the very face of these corporations is changing due to the economic reform policies of the government. The government is increasingly withdrawing from these corporations by selling away a large portion of its shares.<sup>29</sup> If the government's ownership of shares falls below the 50% mark the corporation can no longer be called a public sector corporation. But the government would continue to hold some percentage of the shares which implies that public funds are still being

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<sup>26</sup> Such organisations are normally registered under the Societies Registration Act XXI of 1860 which requires that their accounts be audited every year by a professional Chartered Accountant

<sup>27</sup> The investors receive a share in the profits if the corporation itself earn profits.

<sup>28</sup> This was done upon the recommendations of the Administrative Reforms Committee set up under the Chairmanship of Sri Morarji Desai in 1966. The recommendations were implemented during the Janata Party regime when Sri Morarji Desai became Prime Minister.

<sup>29</sup> This process is known as disinvestment. Earlier the government controlled more than 50% of the share capital in these corporations. When the government brings down its portion of equity to less than 50% by selling away its shares in the stock market it loses control over the corporation. As all major decisions in these corporations are taken on the basis of a majority vote of shareholders, the government loses its exclusive edge when it disinvests below 50%. The current Union Minister-in-charge of Disinvestment Policy is Sri Arun Shourie.

used in the corporations. **If these corporations are kept out of the jurisdiction of the CAG then the government does not have to be accountable to Parliament or the legislature (in the case of states) for the amount of public funds invested in them. This goes against the principle of financial accountability.**

The paper points out the objection voiced by the managers of these corporations against bringing these corporations within the jurisdiction of the CAG. They argue that this will negatively affect their ability to take risks. They believe it is necessary to provide them a level playing field as they have to compete with other private companies for business in the current era of globalisation. Therefore they have demanded autonomy from the public audit mechanism. But the paper notes that large public corporations and nationalised banks fall within the jurisdiction of the state audit in countries like France and Italy.

**Question # 5:** As compared to private corporations in the era of globalisation do you think public corporations are at a disadvantage due to the public audit system? What audit arrangement do you suggest for corporations (managed wholly or partially using public funds) to ensure they are accountable to the public keeping in mind that their commercial autonomy and freedom are not adversely affected?

### **Strengthening the PAC and COPU mechanisms**

The paper states that the PACs and the COPUs at the state levels have not been very effective. For example, if the state government spends more money than what has been allotted in the budget for a specific item, such excess expenditure must be approved and regularised by the legislature.<sup>30</sup> The PACs are required to examine the explanation given by the government for such extra expenditure and present a report to the legislature recommending regularisation. This process is necessary as all expenditure of the government must have the sanction of the legislature. The paper notes that PACs have not been able to perform even this job in many states. As of 1999 a total of Rs. 9,4314 crores of excess expenditure had not been regularised in states like Assam, Bihar, Jammu and Kashmir, Uttar Pradesh and many others. This implies that in several states huge amounts of public funds are spent outside budgetary control. Such delay provides ample scope for misappropriation of funds. In the absence of a mechanism for the timely detection of irregularities in public spending, guilty officials will go unpunished. This situation has arisen because there is no time limit fixed for making such regularisation.

At the central level, the Parliamentary PAC and COPU have not been able to examine all audit reports submitted by the CAG. The paper states that during 1997-98 out of 16 reports containing 1209 paras submitted by the CAG, the PAC selected 76 paras for review but was able to discuss only 16 of them. In other words these committees are able to examine only a tiny fraction of the contents of the CAG's many volumed reports. **This defeats the very purpose of making the government accountable to Parliament.** The paper states that the situation is no different in the states.

Lack of continuity in the committees is one of the reasons which the paper has identified for this piling up of a backlog of reports. As said above fresh elections to the PACs and COPUs must be held every year. The paper believes that for these committees to function effectively their life should be extended to a maximum period of five years subject to dissolution if the Lok Sabha or the legislative assemblies are reconstituted after elections. One third of the members of these committees could retire every year. This will help members develop specialisation in their work and the committees could function more effectively.

**Question # 8:** Do you think PACs and COPUs should be constituted for five years with one third of its members retiring every year to ensure continuity? Do you think a time limit of 18 months should be

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<sup>30</sup> This provision has been made to allow the government to meet any expenditure arising out of an emergency or some unforeseen circumstance which could not have been imagined at the time of preparing the budget. Article 204 (b) requires that the government present to the legislature the estimated excess amount and the reason why such extra expenditure had become necessary.

prescribed for the committees to examine the audit reports and make their recommendations? Should PACs be given constitutional status with clearly defined duties and responsibilities?

### **Auditing the Accounts of the CAG's office**

The CAG's office is also dependent upon public funds for functioning and therefore must be held accountable to Parliament for its spending decisions. Under the present arrangement there is no external audit of the accounts of the CAG's office. The CAG appoints one of the Accountant Generals to audit the accounts. The paper feels that the accounts of the CAG must also be scrutinized independently. In countries like the UK and Australia independent auditors perform the job of auditing the accounts of the CAG but a parliamentary committee oversees their work.

**Question # 10:** Do you think an external agency should be given the task of auditing the accounts of the Indian Audits and Accounts department?