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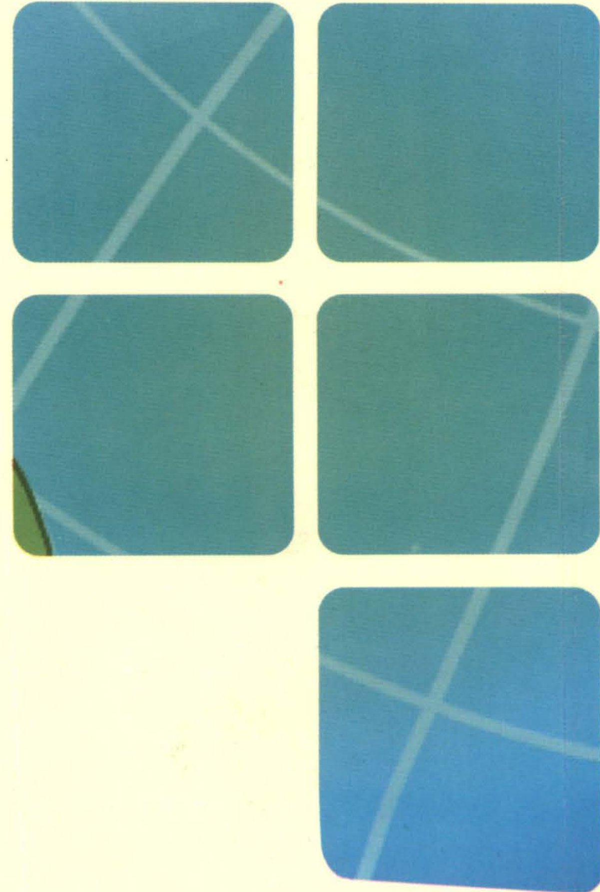
COMPTROLLER & AUDITOR GENERAL OF INDIA

Journal of Management & Training

DECEMBER **2009**

Registration No. 42913/84

Volume XXV (December 2009) @ Comptroller and Auditor General of India



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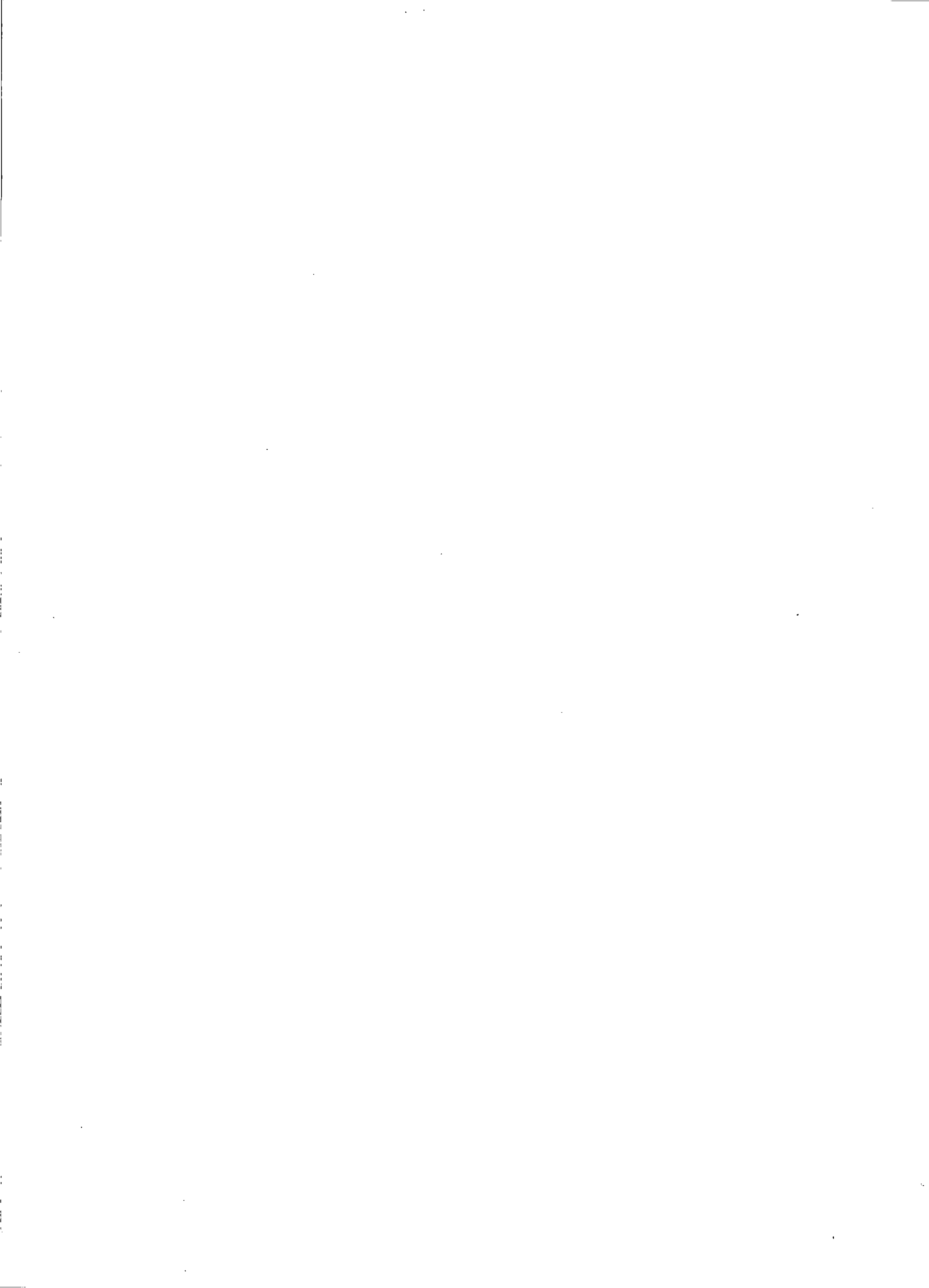
Journal
of
Management and Training
December 2009

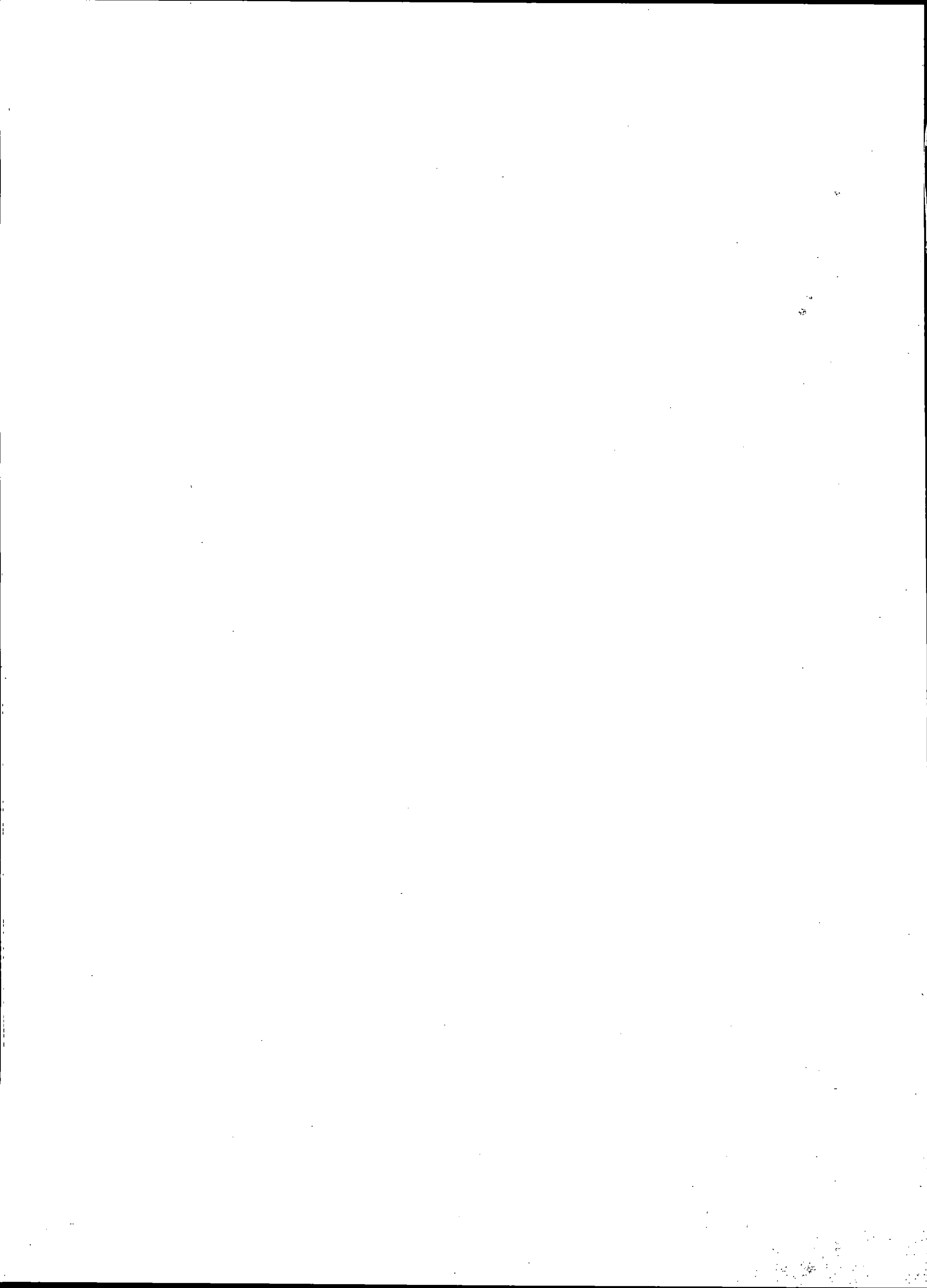
Comptroller & Auditor General of India
New Delhi



CONTENTS*

Sl. No.	Title	Page
	Editorial	
	Addresses	
1	Welcome Address of the Comptroller & Auditor General of India at newly constituted Audit Advisory Board	1-5
2	Inaugural & Keynote address of the Comptroller & Auditor General of India in National Seminar on e-governance	6-8
	Articles	
1	Risk Based Internal Auditing By Shri Ajit Patnaik	9-17
2	Establishing An Internal Audit Framework For A Regulatory Organization By Shri Venkatesh Mohan	18-24
3	Taxation of International Transactions in India- By Ms. Sangita Choure	25-37
4	Corporate Governance: Points to Ponder By Shri Rakesh Mohan	38-50
5	Building a Results-Based Monitoring and Evaluation System: Crucial Enhancement of Audit Effectiveness By Shri Pravir Pandey	51-60

*The views expressed in the articles by various authors are their own and do not in any way represent or reflect the official policy or views of the SAI-India



Editorial

I am happy to place before our readers another issue of the Journal of Management and Training.

The Journal contains two addresses of the Comptroller & Auditor General of India- one delivered at the first meeting of the newly constituted Audit Advisory Board and other delivered at the inauguration of national seminar on e-governance. The Journal also includes five scholarly articles contributed by IA&AS officers on various topics.

I hope the readers will find the content of the Journal interesting and useful. I also hope that many officers of Indian Audit & Accounts Department will come forward with their contribution for the next issue of the Journal to fulfil our resolution to carry on with the publication of this Journal and to enhance its value to the readers.

(B. B. Pandit)
Director General (Audit)

Welcome Address by Shri Vinod Rai, the Comptroller & Auditor General of India at the meeting of newly constituted Audit Advisory Board at the CAG office, New Delhi

(June 18, 2009)

Distinguished Members of the Audit Advisory Board, Officers of the Department, ladies and gentlemen,

It gives me great pleasure to welcome all of you to this first meeting of the newly formed Audit Advisory Board. I would like to particularly welcome again the members of the new Audit Advisory Board: Prof. C.N.R. Rao, Shri Pratyush Sinha, Shri S. Krishnaswamy Air Chief Marshal (Retd.), Shri D. Swarup, Ms. Reema Nanavaty, Ms. Naina Lal Kidwai and Shri Rahul Roy.

Shri Deepak Parekh, Shri S. Ramadorai, Dr. Prodipto Ghosh and Shri Uttam Prakash Agarwal are not able to attend this meeting due to unavoidable circumstances.

This Audit Advisory Board has been constituted to make the audit effort more responsive and to access views of persons of eminence from various disciplines about their perception of audit and their expectations from it. We always take advice from the Board on all issues relating to public audit in right earnest.

As this is the first meeting of the new Board, in today's agenda, we start with a presentation by the Deputy Comptroller and Auditor General on the role, mandate and scope of audit by the Comptroller and Auditor General of India. This is intended to provide an overview about the public audit function of the C&AG.

I may also draw your attention to our Annual Performance Report for the year 2007-08, a copy of which has been placed in your folder. This Report contains organisation structure of our Department, and its mandate besides our Performance during the year 2007-08.

In our quest for improving the quality of our audit function, recently, we have finalized an Audit Quality Management Framework and issued instructions for operationalizing the Framework across our Department. Assessment of internal controls in Government departments has become an integral part of audit function. We are, therefore, soon issuing a Manual for Evaluation of Internal Controls for the guidance of our staff. We have also finalized a Financial Attest Audit Manual for improving our financial audit practices. Our Auditing Standards formulated initially in 1994 are under a second revision, the previous revision having been carried out in 2002. Simultaneously, we are also refurbishing our internal Peer Review mechanism to make sure that all our field offices auditing Union and State Governments as well as Corporations, Companies and other

bodies under them are carrying out their functions with uniform rigor. These measures are intended to bring our auditing practices in line with best international practices.

Another area I wish to mention is accounting reforms in Government. With a view to bring greater transparency in Government financial reporting, the Government Accounting Standards Advisory Board (GASAB) in the Office of the Comptroller and Auditor General of India (C&AG) has prepared an operational framework laying down the road map for switching over to accrual basis of accounting and forwarded it to the Ministry of Finance. We are making vigorous efforts to sensitize State Governments and to prepare them for movement from Cash to Accrual based accounting. Around 20 State Governments have already agreed in principle to move towards accrual based accounting. We are holding Seminars and also carrying pilot studies in some of the States.

In today's agenda I propose to focus on the following three issues:

The first relates to certain limitations that have a debilitating effect on our ability to add value through an audit process that is effective and conclusive. One of the major limitations that we are faced with is that C&AG has been equipped with no explicit and speedy legal mechanism to enforce his power to seek documents, information and clarifications that are necessary for his audit. Presently, and paradoxically, C&AG's ability to enforce his right to information is even less than that of an ordinary citizen. Though healthy administrative conventions inherited by us from the past ensure that C&AG is able to ultimately prevail most of the times, yet a great deal of time and momentum is lost before C&AG is able to form a conclusive opinion in various matters. There are numerous undocumented instances where this quest remains unfulfilled.

The second most important limitation arises from our inability to track public money to the end point. So long as it remains within the public sector and so long as that segment of public sector falls within C&AG's mandate there is no major difficulty. However, significant sums of public money find their way into those pockets of public sector which are expressly outside C&AG's mandate or his powers in relation to such entities are limited or vague. In recent times, substantial public funds are being passed into private hands through NGOs or Public Private Partnership arrangements as a matter of a well thought out strategy of governance. Unfortunately, mechanism for ensuring public accountability for such funds remains weak.

The third limitation that has surfaced from time to time is that no specific timeframe exists for reaching C&AG's Audit Reports to the ultimate stakeholders of public audit function viz., Members of Parliament and Legislatures as well as the common citizens of this country. Instances have arisen at times where presentation of these reports to the Parliament or Legislatures have been inexplicably delayed thereby robbing these reports of their topicality, time value and due public attention.

The fourth major limitation is manifest in the slow and halfhearted follow up on the C&AG's Reports as well as on observations made in other communications of Audit Department. The mounting backlog resulting from this phenomenon as well as complete lack of response in many cases is not only demoralizing for my staff but also inhibits the very process of audit.

In addressing all these limitations we feel it necessary to strengthen the statutory framework that gives us our duties as well as powers.

The enactment of Comptroller and Auditor General's (Duties, Powers & Conditions of Service) Act, 1971, envisaged in the Constitution, was culmination of almost two decades of thought process. Another 38 years have passed since then. Though, in between, this statute has been amended a few times, albeit, to a limited extent, it essentially reflects the perceptions and realities that prevailed at the dawn of our independence. As I have pointed out already, the journey over the past decades has made us acutely aware about the strengths and weaknesses of this piece of legislation. Also, old mores and practices have yielded ground to other new developments in relation to the processes of governance in both economic and social realms. As challenges before the executive have led to new structures and new methods of administration, audit cannot escape the consequences of such changes. Though audit function has also evolved over the years within the limits permitted by our legal mandate, time, however, has come to take a fresh look at our legal mandate and to redraft it in a manner that helps us discharge our responsibility in a credible and effective manner. I would like to focus on the following key areas which will be addressed by the new audit legislation:

- Firstly, it will define or redefine many important terms like Account, Audit, Information, Record and Public Money to imbue these with the meaning that is in consonance with the current understanding of these terms.
- Secondly, the mandate of audit will bring within its fold entities, whether in the Public Sector or the Private Sector, that receive substantial public funds for execution of Public Sector programmes whether in the fields of infrastructure or social sector.
- Thirdly, the new statute will try to mitigate, to a large extent, the lack of responsiveness from the audited entities to the audit observations and help in speeding up follow-up action.
- Fourthly, it will also ensure that C&AG's Audit Reports reach the ultimate stakeholders i.e. the tax payers and their representatives in various legislatures without any delay, howsoever unintended, on the part of the executive.
- Finally it is also proposed to recognize new modes of evidence like electronic data and methods of evidence taking like seeking declarations from the Government officials and other related persons or recording their statements on oath.

Finally, I would like to draw attention to some of the important work my office has done in the recent years in bringing out reports on subjects like National Rural Employment Guarantee Programme and Nuclear Power which truly reflect high degree of professional competence that is available within the Indian Audit & Accounts Department.

The National Rural Employment Guarantee Act, (NREGA) was enacted with the objective of enhancing livelihood security in rural areas by providing at least 100 days of guaranteed wage employment in a financial year. We took up a Performance Audit of the implementation of NREGA in response to a request from the Ministry of Rural Development, so as to provide assurance that the processes under the Act were put in place and were being adopted effectively by the State Governments.

We noticed significant deficiencies relating to utilization of funds and maintenance of field level records. A noteworthy feature is that subsequent to the original audit, a follow-up check was made in some of the sampled districts. The follow-up revealed improvement in record maintenance especially in some districts. A special feature of this audit is that this is a kind of concurrent audit and not a post mortem. The audit findings are expected to help in carrying out mid-course correction.

In the area of nuclear power, there has been serious fuel crisis for Pressurised Heavy Water Reactors (PHWRS) in recent years affecting nuclear power generation. We, therefore, decided to examine the reasons which led to this situation and to ascertain whether an effective system was in place to ensure adequate supply of fuel to these Reactors so as to meet the target for power generation set out by the Department of Atomic Energy.

Our audit has revealed that though the estimated uranium reserves in the country are sufficient to support the present PHWR programme up to 2020, the country's capacity for generation of nuclear power has been compromised for want of uranium. There had been significant mismatch between the demand and supply of uranium. Deficiencies were noticed in the planning and monitoring mechanism.

One of the noteworthy features of this audit is that on a special request by DAE, we shared the highlights and recommendations contained in the final report with DAE, which is a departure from our regular audit reporting process. Secretary, DAE also discussed the highlights and recommendations with the C&AG.

We have also carried out a performance audit of Delhi Metro Rail Corporation Limited (DMRC) covering various activities relating to implementation of the Mass Rapid Transit System (MRTS) Phase-I. A team from the Indian Institute of Technology (IIT), Delhi was engaged as technical consultants to assist in examination of certain technical matters relating to this performance audit. The IIT examined the issues of contract

management, selection of technologies and selection of routes and corridors. The Performance Audit Report on DMRC is yet to be laid down in Parliament. After it is laid down, we will be sharing the Report with the members of the Audit Advisory Board.

I am looking forward to your advice on any issue, even if not included in the agenda, which you may consider significant for improving the role of public audit in securing good governance and accountability of administration. Your suggestions are valuable and will be taken into account in planning our future course of action.

Thank you.

Inauguration and Keynote address by Shri Vinod Rai, the Comptroller and Auditor General of India in National Seminar on e-Governance held at the CAG office, New Delhi

(21-22 July 2009)

Welcome to this seminar. I'm happy that we in the audit department have taken the initiative to organize this seminar on e-governance. You'd be wondering why we auditors are talking about e-governance. Hopefully by tomorrow afternoon, we'll tell you why. I think there's a method if you think there's madness in audit talking about e-governance; and that method will slowly unfold before you. The only reason why I think it is wise for audit people to start talking about e-governance is that we would also like to partner with anybody on the executive side in the entire roadmap for development of e-governance in this country - maybe in the government sector, maybe in the commercial sector, or PPP - whatever be the system of delivery of public services that the government may decide upon. The entire purpose of holding this seminar is that we learn from each other and when we do audit, we talk as equals with anyone on the executive side.

I remember that in 1990-91, nobody had heard of e-mailing in the government. We started using the internet around 1995-96. Back in 1990, China was still a planned economy and the USSR hadn't disintegrated. In the last 15-17 years, a lot has happened. If we do not keep ourselves abreast of these developments, we'll get left behind from the mainstream. That's why we are in this room. We have to run as fast as the fastest who's in the race.

ICT is galloping ahead and becoming obsolescent as rapidly as it's developed. There has been tremendous success with this kind of ICT- delivery of public service on one hand and regulatory services on the other. However, we just can't take it for granted that we're moving ahead. Ten years back there was a big boom and then a bust. There was a meteoric rise and then an equally rapid decline. Lots of people turned out to be lucky- having been at the right time at the right place. Lots of people also lost a lot of money - if some gain, then some have to lose.

An important thing in development of ICT is what I saw in my 5 years in the Finance Ministry. The commercial and the financial sectors adopted this technology, made best use of it, and went rapidly ahead in its delivery system to that extent where it could bring

about convergence of the multi-level of the services that they were providing. As far as the public was concerned they benefited greatly whether it was to pay a bill, to encash a cheque or deposit a cheque. The ATM machine became popular and also those hand held devices which are mobile - you take them to any corner of the village and you can draw & deposit money, and also get a print-out which is a proof of the fact that money has been drawn or deposited. Man in the rural areas still believes that a scrap of paper in his hands is the proof of the fact that his money is safe. He doesn't know where technology has advanced but he knows that money has been taken from his account and deposited in this small machine if he gets a scrap of paper in return to say that his money has been deposited. The multiagency integration of services has been a remarkable success. You know in Kerala, Akshay has been set up, where you could go to a kiosk and pay all your bills. Say about 15 years back, this system had been introduced where the person who was paying the bill was also being given a receipt. Four years back, we were sending a team to participate in a seminar in Geneva on the banking side, and I got a frantic call from there, saying that, when this team comes, send a blank cheque book along with them. I asked what is it for and they said it's a historic instrument, we want to show it to people what it is all about; the word that they actually used was 'archaic'. I don't know how many countries still use that kind of cheque book but it is still there.

By organizing this seminar and getting together what we hope to achieve is that when you design a system, when you think of the appropriateness of any delivery channel, I'm talking of the policy planners maybe in the Planning Commission, may be in line ministries, don't think that the people doing the audit would come only later and find fault with you. Involve audit upfront. Let's design; let's architecture the entire scheme together. Let's be partners in the entire process. We've a certain expertise and you have a certain expertise. Let's dovetail it. The basic thing is that we can not develop ourselves in silos. I want to give this message. Let's look at everything with an open mind, let's coöperate with each other.

We-the SAI India- have been chairing a global committee on IT for almost 18 years now. We've developed a certain expertise in the area. We've imbibed global best practices and we would very much like to share that; so lets not reinvent the wheel every time; let's learn from mistakes committed by others, let us architecture and design schemes, which through hindsight, have proven to be a success. Rather than looking for remedial actions, let's overcome these issues upfront. The government is spending a lot of money. We have to ensure that this money is spent for the objective for which the Parliament has passed it. In the delivery system, we should ensure that there are no leakages. Scheme should be designed upfront itself by taking into account the experiences or best practices from

institutions in the country or may be outside the country; we don't have to reengineer the skill development part of it. Basically what I'm trying to say is that change in the mindset should take place. Whether it is inclusion, or transparency or innovation in the entire process that is unfolding before our eyes in terms of government spending, money has to be channelised towards the purpose for which the policy planners have approved it. And that's the entire purpose of being together today. Hopefully, those people who've designed these schemes and those in the process of implementing these schemes, those people who're knowledgeable about the processes that are unfolding, maybe in the rural or urban areas, will share their experiences in the course of deliberations today & tomorrow. We from audit will share our experiences in auditing these schemes and the group will disperse much wiser.

Let's all put our minds together. The objective for which we are in this room together is the same and to the extent that we can help in engineering and architecture projects that don't have any fault at any point of time, I think the purpose would have been served. I hope we can go tomorrow from the seminar after having contributed and imbibed something.

Thank you!!!

Risk-Based Internal Auditing

By Shri Ajit Patnaik*, IA&AS

Risk management is as essential to any organization as health management is for individual well-being. Nothing is more destabilizing and regrettable for an organization than to be overtaken by events particularly those preventable. Risks well-managed and controlled while keeping the negative effects in check also enables an organization to avail the positive opportunities to further the interests of the stakeholders. It is akin to a CEO playing like a defender in the game of soccer defending and at the same time playing upfront to create and avail goal scoring opportunities. Enterprise risk management has emerged as a major concern for the management and the stakeholders e.g. the senior management, the share-holders, the audit committee and the public at large. Risk management/mismanagement fraught as it is with potential disasters of shattering magnitude, needs a internal sentinel to keep it in manageable proportions and internal audit has to play this role in an organization. Risk- based internal auditing is an assessment by the internal audit of the efficacy of risk-management steps taken by the management- ` an independent and objective opinion to an organisation' management as to whether its risks are being managed to an acceptable level.'[1]

Risk management process consists of clearly recognizing the **risk context, risk identification, risk analysis and risk treatment.** The objectives of the organization have to be kept in view while identifying the risks to place risk in the perspective. Risk analysis involves detailed discussion of the identified risks in conjunction with the existing controls circumscribing the risk. Where the risk has a element of certainty of occurrence, risk analysis will be a combination of likelihood and consequence. Likelihood of a risk is classified into almost certain, likely, possible, unlikely and rare (values 5-1) . Similarly, impact is classified as insignificant (low financial and operational effect), minor (medium financial and operational effect), moderate (high financial and operational effect), major (major financial and operational effect) and catastrophic (mission critical financial and operating effect). Low, medium, high, major and catastrophic financial and operational loss can be ascribed values progressively (1-5). Where there is an uncertain risk as particular type of behaviour, these are expressed by their values e.g. maximum, minimum and most likely value. Risks and controls are studied to find out the efficiency of the controls in managing the risks.

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* Presently Principal Accountant General (Civil Audit), U.P., Allahabad

IMPACT	LIKELIHOOD	IL-RISK score
Insignificant-objectives unaffected	Rare	1
minor- objectives unaffected	Unlikely	2
Moderate-some objectives affected	Possible	3
Major- major objectives affected	Probable	4
Catastrophic-closure of the organisation	Almost certain	5

Any score (IL) above 9 may require to be taken as significant. Risks with huge potential loss and low probability of occurring will require a different treatment than an event with low potential loss but high probability of occurrence though the IL scores may be same. Any event having implication of closure of the organization, though rare, will have to be classified as significant. In public health care, risk treatment decisions have to be both quantitive and qualitative- to be expressed in monetary terms as also in terms of quality of life. Thus, managements have to weigh their judgement in terms of the arithmetics of the consequence and likelihood score. (See table above)

If there are a large number of risks against pre-determined criteria, risks have to be evaluated to prioritize them. Risks have to be classified as acceptable or unacceptable depending upon risk tolerance level of the organization. The organization may decide to accept risks associated with some activity which is essential or because of the adverse cost- benefit equation in treating the risk.

Risk maturity of an organization indicates the degree to which the organization appreciates its risks and has taken steps to manage them. Risk enabled managements have good understanding of management of risk and have a developed system of internal control with a complete risk register; risk managed organizations have in place an enterprise-wide risk management system that has been communicated to all concerned; riskdefined organizations may have a compiled list of risks but the risk register may not be complete; risk aware organizations do not have a risk register and only few managers are aware of the risks while in risk naïve organizations no formal approach to risks mitigation would have been developed.

Internal Audit of Risk Management.

Internal audit has a key role to play in the risk management process by way of providing assurance to the Board of Governance that the significant risks are being handled by management effectively and that an effective internal control system is in place. The main role of internal audit in regard to Enterprise Risk Management is to assess the rating ,treating , reporting of the risks and the installed control system. The roles

which are outside the domain of internal audit are- fixing the risk appetite, deciding and implementing risk response and taking responsibility for risk management. As riskbased internal audit is not possible in risk aware and risk naïve organizations, Internal Audit may choose to do consultancy for identification and rating of risks without being the owner of the process. Risk based internal audit (RBIA) can be taken up in risk enabled, risk managed and risk defined organizations.

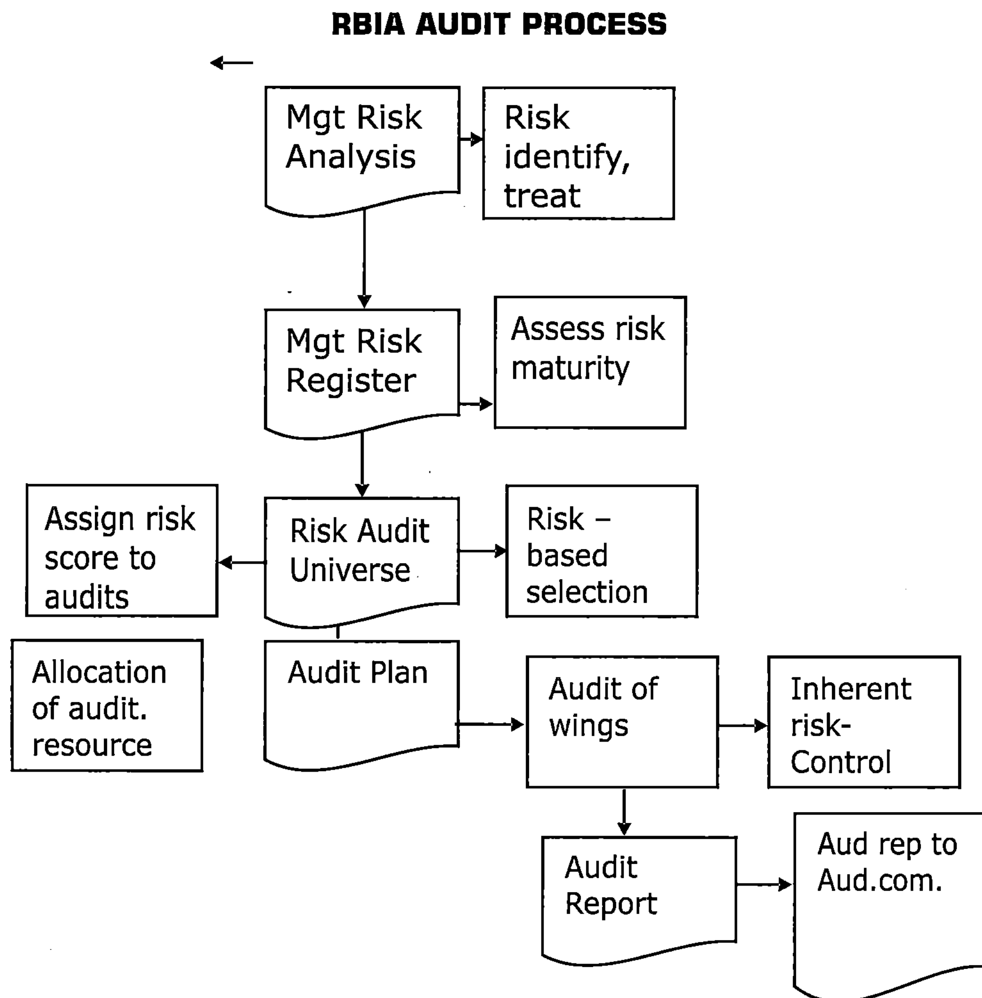
Performance Standard 2010 of the Institute of Internal Auditors states that the Chief Audit Executive (CAE) should prepare risk-based plans to priorities audit engagement. Implementation standard 2010.A1 and 2010.C1 require risk-based plans while preparing assurance and consulting engagements.

Internal audit has evolved from compliance audit to examining the efficiency and effectiveness of processes to risk based internal audit..

Risk management-based internal auditing premises its approach in generating an assurance that the risks are being managed within the risk tolerance limits fixed by the management. It takes into account all the logical processes required to achieve the goals of the organization. It is independent of the incumbent people in the organization as the process map is not required to be changed with change of people. The logical processes are compared to the actual system in place. The systembased internal auditing (SBIA) takes into account actual systems in place and the related controls. In RBIA, audit is directed at significant risks whereas system based audit is cyclical; the audit universe is all the activities of the business as opposed to focus on financial and operational. In RBIA, the internal audit will consider the risk maturity of the organization i.e. the extent to which the organization has internalized the risk management processes. It will formulate the audit universe -list out all the audits required to provide assurance that all inherent risks above the risk appetite are suitably managed. In the traditional methodology, audit would comment and make recommendations about efficacy of internal controls i.e. all or how many controls are actually working ; in RBIA the emphasis is on how effectively the management is monitoring that the controls are working. RBIA will require specialists apart from Internal auditors whereas traditional audits are done by internal auditors only. Another major difference is that in RBIA no recommendations are made as it is the responsibility of the management to formulate risk policy and recommendations are made only in risk naïve and risk aware situations unlike traditional audit where recommendations are made for correcting the weaknesses. Unlike traditional audit since the executive is involved in the audit process in RBIA as the owner of the risk policy, it has greater acceptability possibilities by the executive.

Internal audit risks comprise of inherent risks (IR), control risks (CR) and detection risk (DR). Detection risk is the risk of the Auditor failing to detect a material misstatement in the financial statement and thereby making an opinion which needed to be modified and also failing to detect unjustified transactions at the transaction level. Detection risk could be the result of unsuitable audit procedure, inadequate supervision or insufficient quantum of selected audit area. **Audit risk** can be represented by the formula IR*CR*DR. Chief Audit Executive should plan appropriate strategies to keep detection risk within tolerable limits since the audit has to provide reasonable assurance only.

RBIA AUDIT PROCESS



The first stage is to check whether the **risk register** as developed by the Management is complete and meaningful. The audit plan has to be tailored as per risk

maturity of an organization. The significant risks i.e. those above the risk appetite of the organization can be identified by interviewing the top management, holding risk workshop and by examining the accounts of the organization. Looking for fraud risks in doctoring of financial statements, misappropriation of assets and corruption prone areas may be useful. Similarly, areas of likely health care fraud may have to be seen trough the audit microscope.

The next stage is the culling out of the **risk audit universe** i.e. deciding on the risks on which opinion is required by the management. If the risk is within the risk appetite, no audit is taken up. If some risks above the risk appetite are tolerated by the management, the audit is conducted depending on available audit resources. Where management have transferred the risk as in insurance policy, audit will be necessary to check all the risks have been transferred as decided. If a risk has been terminated, it will form part of audit plan to see that the remaining risks consequent on termination are being managed. Risks examined by third parties e.g. external auditors are taken up by the Internal Audit Department (IAD) if assurance is to be provided through IAD. Existing classifications within risk appetite may require revaluation after periodic intervals. A suggested **risk appetite table** is given below-

Loss of cash flow if risk happens	**Less than Rs. 25000**	**25000-1lakh**	**1 lakh-10lakhs**	**10 lakh-25 lakh**	**Above 25 lakh**
Description	insignificant	minor	significant	major	catastrophic
Impact value	1	2	3	4	5

Annual Audit Plan is compiled based on the risk audit universe for approval by the Audit Committee. The Annual Audit Plan incorporates the plan for individual audits specifying the schedule for each audit, the earmarked personnel and the risks and processes included in each audit.

Audit frequency can be fixed depending upon the score assigned to the inherent risk, the resultant of likelihood and impact score lines. Likelihood and impact score for audit frequency of inherent risks are-rare(1), unlikely(2), possible(3), probable(4), almost certain(5); insignificant (1), minor (2), significant (3), major (4) and catastrophic (5) respectively. For IL scores ranging between 15 - 25, 9-12 and 5-8, the audit periodicity can be annual, biennial, triennial respectively. Below 5, audit need not be taken up unless the impact of an event is catastrophic.

Annual	Biennial	Triennial	No audit
15-25	9-12	5-8	1-4

Audit units are selected based on the inherent risk score, the risk appetite of the organization, timing and results of last audit. An additional factor desirable to see is risk to audit cost ratio i.e. riskiness coefficient of an audit unit divided by the cost of audit of that unit. Audit units with higher ratio, get prioritized higher. Another qualifying factor to weigh in is, whether an unit with a residual score of 15 had been audited a year before, it may be appropriate to assign a multiplication between 1 to .75 depending on the risk perception of the Chief Audit Executive. Audit, to be effective in terms of time-management, should have at least 3 audits in hand- one audit about to begin, another where audit is being done and one other at the exit conference stage and the third at the report writing stage. Alongside a system development audit can also be taken up.

Total elimination of risks is an impossible endeavor. Keeping the complexity of the risks and the unacceptable economics of total elimination, the practical administrator's approach is to reduce the riskiness of events to the acceptable level keeping practicability and cost risk equation in view. Control structure is the mechanism to keep the risks to manageable and acceptable levels. The control structure consists of control environment, risk assessment, control activities and information sharing and monitoring. **Audit of control activities** relate to authorization and approval procedures, segregation of duties, control over access to records, reconciliations. Audit of the control structure gives considered opinion on the control risk- the actual existence of the controls and their efficacious functioning.

RBIA enables the Chief Audit Executive to deploy scarce internal audit resources for assurance on significant risks instead of thinly spreading on all risks ; hence is more efficient. RBIA unifies the whole process from objectives to audit report through assessment of risk and controls; thus an audit trail is available from the report back to initial auditing. Since RBIA is based on risks entered in the risk register, it requires the management to have a complete list of risks and to fix the risk appetite of the organization. It not only highlights risks that are not properly controlled but also risks that are over- controlled. The audit work will be more interesting and challenging as it will involve non-financial work also. Since it will concentrate on audit of risks above the risk-appetite, many small transaction audits e.g. of petty cash may not be taken up. New areas like environment audit, public relations, clinical risk management may be taken up. Since the internal auditor will have to work in close relationship with the management for

appreciation of management of risk by Management, there is likelihood of loss of independence. However, the CAE will have to keep his flock insulated by enforcing tight discipline. Further, to make the management open its risk management frame-work to internal audit, IA will require a high degree of professionalism and persuasive skill. It will also involve re-orientation of audit staff through training from existing cycle-based audit to RBIA.

Internal audit of Risk Management in health sector-

In health services organisations, risk management means management of both the non-clinical risks e.g. finance and operational and clinical risks like patients and patient care. Adoption of zero-risk policy in health sector is the ideal as 1 in a million policy can cause death of many but it has to be tempered by the economic costs involved. In health care systems as in other human systems, Swiss Cheese model is used for risk analysis and management which states that an organization's defence system against failures are designed as a series of barriers as in Swiss cheese Emmental and the holes which represent weaknesses produce failures when they align at a point of time. An active failure could be a physician's wrong diagnosis and the latent failure could be packaging of two drugs in similar fashion leading to wrong administration of drugs.

The points to be seen in risk-based internal audit of health-care institutions are-

- are there appropriate risk management strategies-a risk management policy document
- has risk management been integrated to corporate governance processes- the active involvement of senior management and Committees
- is risk management being effectively implemented- appointment of a coordinator, existence of a regularly updated risk register, documenting and reporting

Clinical Risk Management

Clinical risk management is an approach to improve the quality and safe delivery of health care by identifying circumstances that expose patients to risk of harm and also taking steps to prevent or control those risks. Events are classified as 'near miss', 'incident', 'adverse events' and 'sentinel events' . 'Near-miss' is a potential event which is intercepted prior to occurrence of the event preventing harm to the patient; an 'incident' is any event that has caused harm or has the potential to harm a patient or visitor for any event which involves malfunction, or loss of equipment or property or for any event which might lead to a complaint; an 'adverse event' is an unintended injury or complication, which results in disability, death or prolonged hospital stay and is caused by health-care

management rather than the disease and 'sentinel' events are those adverse events which are more serious.

The points that audit would focus on are :

(a) is clinical risk management (CRM) integrated to the broader risk management framework? It is important that CRM promotes clinical governance in a Hospital.

(b) Is there a Committee to oversee the clinical risk-management process? Health Service Quality Committees suggest the ways to maintain patient safety and quality in the Hospital, and also analyse such reports of various departments.

(c) Existence and following of appropriate policies regarding medical complexity classification,

Hospital Information System

IT risks in health sector relate to, interalia, security, privacy and identity and access management. Apart from usual risks of security, identity and change management, a major issue in health organizations is the patient privacy management as per requirements of Electronic Protected Health Information Requirements of Health Insurance Portability and Accountability Act (HIPAA)[2], etc. Data theft, data leakage-malicious or unintentional, data loss (as in UK tax and Customs Service 2008) are all potentially serious IT risks leading to non-compliance of HIPAA requirements.

In such a situation audit queries should be :

a) Is there a patient database in the hospital as part of hospital information system?

b) Are there proper patient privacy management policies in the Hospital in general and in the information system in particular?

c) Has Clinical, non-clinical Risk management information system been developed?

d) Has an appropriate security, change, vulnerability, identity and access risk management been developed?

Non-Clinical Risk Management

Health care fraud risk is intentional misrepresentation of material in support of claims or payment of health-care insurance claims or theft of money or property belonging to a health plan or health insurance company. Different types of heath care fraud are phantom billing, up coding (charging for a specialist when the patient has visited a nurse), doctor shopping (going from one doctor to another to obtain many prescriptions for controlled substances), providing unnecessary care (unnecessary tests, surgeries), misrepresenting services (performing uncovered services but billing insurance companies for different covered services), unbundling (charging separately for procedures that are

actually part of a single procedure), delivery of health-care services by quacks, and identity theft (using another persons health insurance card or identification to get health-care services).

RBIA has also to see whether appropriate controls are in place and how far the management has been monitoring and ensuring functioning of the control system in respect of financial and human resource risk management.

In India, risk-based internal audit is yet to be formally adopted in government. There is no formal legislative mandate for internal audit. The auditing still involves to a large extent, compliance testing. Even so the internal audit is not given the importance as an aid to management; it has not been assigned a role in assessment of risk structure; nor do its reports get the required attention for initiating corrective action. In government policies and schemes where there are quantifiable objectives as in Fiscal Responsibility and Budget Management Act, IA has a major role to point out slippages and risks in achieving the objectives. With a total expenditure of Rs. 10,20838 crore with plan component of Rs. 3,25,149 crore in 2009-10 budget of Government of India, IA has a major role to play in assuring implementation of the plan schemes. Lack of trained manpower is also a major bottleneck.

The significant developments since 2002 in the regulation of business governance are sec 404 of the Sarbanes-Oxley Act[3] passed by US Congress in 2002, which prescribes testing by management of its internal control (TDRA-top-down risk assessment), the Committee on Sponsoring Organisations[4] guidelines regarding Internal Control over Financial Reporting and, in India, recommendations of Naresh Chandra Committee, 2002[5] which prescribed disclosures regarding deficiencies in design and operation of internal controls. As PWC Study of 2007[6] says` the implementation of risk management at many organizations is immature at best and chaotic at worst.' Risk management based internal auditing with its emphasis on understanding and assessment of risk management and control system in an organization is the response of internal audit to these challenges.

Reference:

1. David Griffiths Risk based Internal Auditing.
2. HIPAA an act passed by US Congress in 1996 regarding electronic healthcare transactions and health insurance plans.
3. An act passed by the US Congress in 2002.
4. COSO-AICPA,IIA, The American Accounting Association, Financial Executives International and the Institute of Management Association are members.
5. A committee formed by Department of Company Affairs in 2002 on corporate governance.
6. PWC State of the Internal Audit Profession Study 2007.

Establishing An Internal Audit Framework For A Regulatory Organization**

By Shri Venkatesh Mohan,*IA&AS, CIA, CFE

By establishing a risk-based internal audit framework, regulatory organizations will be able to better analyze and measure their risks, as well as more efficiently allocate their internal audit resources.

One way to establish a risk-based internal audit framework is by using the risk-to-objective approach, in which regulators identify, assess, and prioritize all possible threats to the objectives that each function performs. Although this framework was developed in the specific context of a capital market regulator, it can be applied to any regulatory body. This article describes, in sequence, the steps that must be performed to establish a risk-to-objective-based internal audit framework.

COMPONENTS OF AN INTERNAL AUDIT FRAMEWORK

An organization's internal audit framework is multi-dimensional and is comprised of three organizational matrix components. These are the organizations' objectives and goals, risks, and internal controls. The meaning and significance of each component and its relationship to other component requires an understanding of organization-specific activities (e.g., processes and stakeholders) to envision and construct an appropriate internal audit framework.

Generally speaking, every organization has objectives consistent with its mission. To fulfill these objectives, the organization sets goals, which are intermediate, yearly objectives. However, because the environment in which the organization operates is dynamic and sometimes unpredictable, there is a risk that yearly objectives might not be achieved. Environmental risks are both internal and external and controllable to some extent. Internal controls are the systems of checks and balances, policies and procedures, and monitoring and supervision designed to eliminate, transfer, or minimize risks that may hinder an organization from meeting its objectives. Internal audit is an organization's strongest resource for assuring that the management-established

** This article was originally printed in the first quarter of 2008 issue of The Institute of Internal Auditor's GAP News

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internal controls are adequate and effective, which in turn enables the organization to continuously measure and improve operational effectiveness.

COMPONENT 1: OBJECTIVES AND GOALS

The first component of the internal audit framework can be divided into three groups: organization-level Generic objectives, organizational-level statutory objectives, and function-level objectives.

Organization-level Generic Objectives

Organization-level objectives of a capital market regulator can be classified into five generic objectives:

- **Objective 1:** Establish an efficient capital market for disseminating information and disclosures to investors, as well as cost of capital formation and access to capital market.
- **Objectives 2:** Maintain market confidence by taking appropriate pre-emptive and remedial actions against transgressions of securities laws.
- **Objective 3:** Enhance investor and consumer protection by extending or reinforcing the protection of the securities laws.
- **Objective 4:** Promote investor and consumer education.
- **Objective 5:** Reduce the scope of financial crime by establishing appropriate preventive and punitive securities laws.

Identifying these overarching objectives are critical for obtaining a macro-level view of the organization's justification for existence and should form the backdrop of any audit. Information resources of similar organizations, research literature, and consumer opinion reports generally provide a good basis for such identification.

In addition, these objectives enable capital market regulators to efficiently channel private savings into developmental public and private investment opportunities. The main mechanism that facilitates this allocation is the decoupling of savings activities from the investment activities that capital markets effect.

Organization-level Statutory Objectives

Once the objectives have been identified, it's time to examine the jurisdiction's legal framework to evaluate how the objectives have been captured by jurisdictional laws. For

example, the mandates governing a capital market regulator as enshrined in the maw may capture the essence of the objectives as follow:

- Upgrading the efficiency of the capital market and protecting the investors from unjust and unsound practices.
- Paving the way for securities investments in the interest of the national economy.
- Organizing and monitoring the issue of securities in the primary market and specifying the requirements for prospectuses upon offer of securities for public subscription.
- Facilitating and accelerating the process of liquidating the monies invested in securities, ensuring the interaction of supply and demand to determine the prices of such securities and protecting the interest of small investors by establishing sound and just principles of dealings among different investor categories.
- Establishing rules of professional conduct, self-regulation, and discipline for the brokers and those dealing with securities and promotion, and training brokers and other staff at the market with the goal of enhancing their knowledge and efficiency.

Function-level Objectives

After identifying all statutory objectives, regulators need to create a function-level objectives matrix that correlates specific functions to each objective. For example, the main and secondary objectives of the issues and disclosures function in a capital market regulatory organization may be ascertained by referring to relevant laws and regulations.

Relating Function-level Objectives to Organization-level Objectives

This step of the model is the essence of the risk-to-objective-based internal audit framework and involves examining the interrelationships of each function-level objective element. The relationship between statutory objectives and generic objectives allows internal auditors to relate main and secondary objectives to organization-level generic objectives in a one-to-one, one-to-many, or many-to-one format.

For example, when evaluating the secondary objective of the approval granting process during an audit review, auditors should first consider how efficiently and effectively that process fulfills the functional objective of channeling the savings into the securities market. Next, auditors should consider how well the process achieves the

generic objectives of market efficiency (i.e. generic objective 1), market confidence (i.e. generic objective 2), investor protection (i.e., generic objective 3), investor education (i.e., generic objective 4), and preventing breach of the law (i.e., generic objective 5). This exemplifies a one-to-many relationship.

COMPONENT 2: RISK

A proper appreciation of risk and the organization's risk architecture- the second component of the framework- is essential for making sure an organization's objectives are achieved optimally.

Risk analysis of a capital market regulator can be a challenging task given its wide remit and the multiplicity of ways in which its actions can impact the various market players and the public at large. A structured approach to risk analysis may involve various methods of risk identification, including discussions with management, examination of internal documents (e.g. strategic plan and meeting minutes), and literature reviews. Once the risks are identified, auditors should perform a root-cause analysis to prioritize and determine which controls would be appropriate and effective in eliminating or minimizing the risks. A list of situations that can adversely impact a capital market regulator's objectives includes:

- **Risks to objective 1:** Market efficiency (e.g., insider trading)
- **Risks to objective 2:** Market confidence (e.g., financial collapse of a significant number of firms)
- **Risks to objective 3:** Investor protection (e.g., risks resulting from misconduct or mismanagement of institutions)
- **Risks to objective 4:** Investor and consumer education (e.g., inadequate general financial literacy)
- **Risks to objective 5:** Financial crime reduction (e.g., money laundering)

COMPONENT 3: INTERNAL CONTROL FRAMEWORK

The third component of the framework, internal control, has been defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as "a process designed to provide reasonable assurance regarding (a) reliability of financial reporting, (b) effectiveness and efficiency of operation, and (c) compliance with applicable laws and regulations.' COSO also identified the following five interrelated components of internal control:

1. The control environment is an internal infrastructure that sets the organization's tone by influencing its control consciousness and providing a foundation for all internal control components.
2. Risk assessments are an organization-wide identification and evaluation of risks relevant to achieving control objectives.
3. Control objectives are an organization's control policies and procedures.
4. Information and communication is the exchange of information in a way that allows employees to perform their responsibilities.
5. Monitoring is the process of assessing the control environment over time.

Internal control questionnaires, walkthroughs, process flowcharts, and discussions are typical tools for understanding the internal control framework. A walkthrough or process flowchart that is coupled with discussions and an internal control questionnaire can be an effective techniques for understanding the system of internal control and assessing its adequacy to control various organizational processes in the case of a regulatory body. A sample internal control questionnaire, which shows a capital market regulatory organization's linkage of control issues to framework objectives and disclosure function, illustrating the process of understanding the internal control framework is annexed with the article.

A DYNAMIC FRAMEWORK

The risk-to-objective internal audit framework enables evaluating internal controls over function-level processes in terms of their effectiveness to address organization-level risks. This framework can be a dynamic resource that facilitates periodic monitoring of organization-level risks.

Annexure

INTERNAL CONTROL QUESTIONNAIRE

ISSUES AND DISCLOSURE FUNCTION OF A CAPITAL MARKET REGULATOR

(1) What changes, if any, have been suggested or introduced to make the prospectus more comprehensive as a decision-enabling tool during the past few years?

(2) Is the information required to be revealed in the prospectus prioritized as high, medium, and low importance so as to ensure time spent analyzing the prospectus is efficient?

(3) Is the task of capital raising proposals organized along sector lines (e.g., power, hotel) to ensure that adequately skilled staff is recruited or developed to make the process of pre-approval scrutiny of prospectuses more effective?

(4) Is the underwriter sufficiently sound, in terms of net worth, to underwrite the risk? Is there currently any relationship established by regulation between the aggregate underwriting commitment and net worth of the underwriter?

(5) Have any steps been taken to reduce the cost of capital formation under various heads (e.g., legal, accounts related, underwriting, printing, filing)?

(6) Are issuer-specific capital formation requirements properly identified, easy to understand, and listed and disseminated through the website or brochures to facilitate an efficient screening and approval process?

(7) Are there detailed guidelines available for disclosures of various items, including risk factors, to be made in the financial statement proposal?

(8) Does the prospectus require information with regard to projected earnings per share (EPS), pre-issue EPS, average return on net worth, projected and pre-issue net asset value per share, minimum return on increased net worth required to maintain pre-issue EPS, along with comparison of the above figures with industry average?

(9) Are there legal liability obligations cast upon key participants to the capital issuance process by the lead manager, legal advisor, and professional consultants who are best equipped to judge the accuracy and completeness of information provided in the prospectus and feasibility report?

(10) Is there any restriction requiring that the professional consultant, the underwriter, the legal advisor, and the issue manager not be related party to the promoters?

(11) Is the term *'related party'* clearly defined?

(12) Is a maximum period prescribed for refund of surplus application amount to subscribers? Is there a provision regarding payment of interest and penal interest?

(13) Is there a mechanism in place for receipt, acknowledgement, and action regarding customer grievances about non- or delayed receipt of share certificates or dividend warrants?

(14) Does the department communicate with companies' internal auditors, external auditors, compliance officers, or senior management as part of the monitoring, diagnostic, preventative, or remedial regulatory action tools?

(15) Where the object of an offering is to finance a project, the additional capital raised is used over the project period, which may be spread over a year or more. The fund earmarked for the project may idle in different amounts over varying periods and companies would generally invest the idle funds, which will run the investment risk which in turn impact the investors. There is, therefore, a need for seeking disclosure in the prospectuses on how the idle funds would be deployed pending utilization. Are such disclosures required?

(16) Is the name, address and contact number of the compliance officer required to be disclosed in the offer document?

(17) Is there a minimum disclaimer and risk factor font size specified in the offer document to ensure that proper attention is received from prospective investors?

(18) Regarding rights issue, is there a minimum period prescribed for dispatch of letters of offer to shareholders? Is there a requirement as to publication of an ad in the newspaper notifying dispatch of all letters?

(19) Is there a requirement for bond issuers to report to the regulator on fulfillment of their obligation as to coupon payments and payment of principal upon maturity?

Taxation of International Transactions in India

By Ms. Sangita Choure*-IA&AS

With the world economy knowing no geographical boundaries, business enterprises are expanding business operations beyond their domestic frontiers to maximize profits. Taxation of business profits is thus not only a challenging area to Tax Authorities the world over but these challenges change everyday with change in types of business and modalities of carrying on business, with the Internet serving as an important medium of doing business. Taxation of cross border transactions is a complex web influenced by diplomacy, mutual economic interests and ties between countries to attract foreign capital, technology, technical services, human resources, but above all the political will of a government to translate all these factors into domestic tax legislation and Tax Treaties.

Let us now take a look at the various provisions under the Indian Income Tax Act, 1961 (The Act) and the current legal position that prevails:

1. Taxability of International Transactions under the Act

Under Section 5 of the Act, a foreign company or non resident person is liable to tax on income which is received or deemed to be received in India by or on behalf of such person, or income which accrues or arises or is deemed to accrue or arise to it, in India. Section 9 thereafter specifies the certain types of income that are deemed to accrue or arise in India and clause (i) of the said section which is the key clause states " all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India", shall interalia be deemed to accrue or arise in India. Thus liability to tax in India arises out of income of a business connection, property, any asset or any source of income in India.

No income of a Non-resident can be taxed in India unless it falls within the ambit of Section 5 read with Section 9 of the Income Tax Act.

The term *deemed to accrue or arise in India* brings within the net of chargeability, income not only accruing but which is supposed notionally to have accrued. By a statutory fiction income which can in no sense be said to accrue at all may be considered as so

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accruing. The fiction may relate to the place, the person or to the year of taxability. (CIT vs. Bhogilal Laherchand-[1954] 25 ITR 50 SC).

2. Business Connection (BC)

Section 9 of the Income Tax Act provides that income accruing or arising through or from a Business Connection in India shall be income for the purposes of the said section. For the removal of doubts and acknowledging various ways businesses carry out cross border transactions the Finance Act 2003 had with effect from April 2004, clarified by way of Explanations to Section 9 that *Business Connection shall include any business activity carried out through a person acting on behalf of the non resident, who habitually exercises in India an authority to conclude contracts; or habitually maintains stock of goods/merchandise in India from which he regularly delivers goods or merchandise on behalf of the non resident or habitually secures orders in India mainly or wholly for the non resident.* However, agents having independent status and acting in the ordinary course of business would not construe BC. Further only so much income as is attributable to the operations carried out of India shall be deemed to accrue or arise in India. The above Explanation has only made explicit what was implicit earlier by clarifying the various business activities which would form part of the concept and definition of BC. The Explanation also incorporates features of a Permanent Establishment as prevalent in Double Taxation Avoidance Treaties (DTATs).

The taxability of a BC would depend on two distinct factors- namely Residence and Source. That means a BC doing business in a foreign country then besides being taxed in its home country on the basis of 'residence' link; it will also be taxed in the country in which it does business on basis of 'source' link. The Income Tax Act thus provides for both residence and source based taxation. The source link ambit is very wide and inclusive under the Indian Law as it not only covers business connections but extends to any source of Income emanating from the country. These provisions were applied by the Tax authorities in the VODAFONE case which is discussed later on.

3. Permanent Establishment (PE)

This is a very important legal concept in International Taxation, as it is a compromise between two countries-the Residence State and the Source State for purposes of taxation of business profits. Under Double Taxation Avoidance Treaties, the profits of a Business Enterprise (BE) of one Contracting State are taxable in the other State only if

the BE maintains a PE in the latter State and only to the extent that profits are attributable to the PE. The advantages of having Tax Treaties between two States are that the profits of a PE may be taxed at concessional rates according to treaty than under the domestic law and usually such taxes paid on the PE are allowed as a credits to the BE in the resident country.

Double Taxation Avoidance Treaties under the Act are based on the UN Model.

The definition of PE is common in both the UN and the OECD Model drafts of DTATs followed by the developed countries. The definition of PE in Article 5 of the UN/OECD Model may be taken as a standard one, which is adopted with minor variations in most Agreements. The said Article defines PE as fixed place of business through which the business of an enterprise is wholly or partly carried on. It includes a place of management; a branch; an office; a factory; a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. A building site or construction or installation project constitutes a PE only if it lasts more than twelve months. It does not include facilities solely for the purpose of storage, display/advertising or delivery of goods or merchandise belonging to a BE, maintenance of stock for process by another enterprise or a fixed place of business solely for purpose of purchasing goods/merchandise or collecting information for the enterprise.

An enterprise shall not be deemed to have a PE merely because it carries on business in that State through a Broker or Agent of an independent status-provided that such persons are acting in the ordinary course of their business. Besides the fact that a Company which is a resident of a Contracting State controls or is controlled by a Company which is a resident of the other contracting State, or which carries on business in that other State shall not of itself constitute either Company a PE of the other.

It has been judicially held that the words Permanent Establishment postulate the existence of an element of *Permanent or enduring nature*. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country onto the soil of another country. If this is proved then it is not necessary that any minimum length of time for carrying on the business be prescribed under the provisions of the DTAT. (Fugro Engineers case-ITAT Delhi)

In the realm of E Commerce there are two decisions of the ITAT Delhi, which have held that computierized reservation systems and to the extent business operations have been carried out through them in India constitute a PE in India. *Galileo International Inc V Deputy*

Commissioner of Inome-tax. Non-resident Circle, New Delhi [2008-(114)-TTJ-0289 TDEL] and Amadeus Global Travel Distribution SA v Dy CIT (ITA Nos 2143, 2144 & 2145/Del/2000 and 1022, 1023 and 1024/Del/2005]. The appellant assessees were non-resident companies (USA/Spain) and the business of maintaining and operating systems for providing global distribution services to airlines, hotes, tours/cab operators, using Computerized Reservation System. The assessees were operating through agents in India, who after receiving all the desired information from customers were providing services of booking tickets/hotels/tours etc. Detailed Agreements were in place with the participating airlines, hotels. The Revenue's contention was that there activities constituted a PE in India, to the extent bookings pertained to India and income was thus deemed to have accrued or arisen in India.

The ITAT have held that on basis of the business operations and agreements concluded by the Appellants, there existed Permanent Establish ment in India.

4. Taxation of Business Process Outsourcing (BPO) Units in India

During the last decade or so India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT-enabled entities in India. Such entities are either branches or associated concerns of the foreign enterprise or an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provision of services and answering sales related queries, to the provision itself of services like software maintenance service, debt collection service, software development service, credit card/mobile telephone related service etc. In some cases the entire or major portion of the revenue generating activities of the non-resident enterprise is performed by the BPO unit in India. The extent, to which global profits of a non-resident enterprise are to be attributed to the activities of the BPO unit in India in these various circumstances, has been considered by the CBDT.

(i). The manner and extent of such attribution of profits will evidently depend on the facts of each case and the nature of services rendered by the BPO unit, and the same has to be determined in accordance with the provisions of the treaty applicable and the domestic law. The Board is, however, of the view that in a case where a non-resident, carrying on manufacture and sale of goods or merchandise or provision of services outside India, outsources some of its incidental activities viz. conclusion of contracts and procurement of orders (which enable the core activities to be carried on abroad) to an IT-enabled entity in India, which constitutes a permanent

establishment of the non-resident principal, then the insignificant profit which is difficult to determine and attributable to the conclusion of such contracts or procurement of such orders can be considered to be embedded in the income of the permanent establishment taxable in India, if the price charged in respect of the above services by the permanent establishment is at arms length/fair market price. In such a situation, therefore, no income shall separately accrue or arise or be deemed to accrue or arise to the non-resident principal in India.

(ii). An example of such services by an IT-enabled entity in India could be a case where a foreign company manufacturing computers abroad and also selling such computers to customers abroad, engages or sets up a call centre in India to procure orders from or conclude contracts with customers abroad and also to answer sales related queries on telephone. In such a case, no income shall accrue or arise or be deemed to accrue or arise to the non-resident in India, apart from the income of the call centre.

(iii). Similarly, where a foreign insurance company insuring risks in countries other than India appoints or sets up a call centre in India to attend to calls from customers outside India regarding acquisition of new insurance policy or revision of existing policy, to disseminate relevant information and accept insurance proposals from the customers, while actual policy issuance as well as collection of premium is done outside India by the foreign insurance company, no profits of the non-resident shall be taxable in India, apart from the income of the call centre if the charges paid to the call centre for its services are at arms length/fair market price. Another example of such services could be the case of a foreign credit card company issuing credit cards to customers living in countries other than India, which appoints or sets up a call centre in India to attend to calls from customers outside India seeking to acquire a new credit card, disseminate relevant information and accept the request for issue of a credit card from the customer, while the actual card issuance, the delivery of the card and collection of charges are being done outside India by the foreign credit card company, and the charges paid to the Indian call centre for its services are at arms length/fair market price.

(iv). On the other hand, where a non-resident or a foreign company outsources the whole or part of its core revenue generating business activities to an IT-enabled entity in India, such as the services of a travel agent, software developer, software maintenance, investment consultant, debt collection service, etc., and the IT-

enabled entity in India renders the services either directly to the customers abroad or through the non-resident principal, a considerable portion of the profits derived by the non-resident or the foreign company from its customers abroad would certainly be attributable to the activities performed by the IT-enabled entity in India. If such an entity constitutes a permanent establishment of the non-resident or foreign company in India, such attributed profits would be taxable under the Income-tax Act, 1961 in accordance with the provisions of the relevant tax treaty. (**Circular:** No. 1/2004, dated 2-1-2004).

5. Withholding Tax

All Companies are required to deduct tax at source at the appropriate rate at the time of making certain specified payments or at the time of crediting the account of the Payee, whichever is earlier, with the exception of salary payments where tax is required to be deducted only at the time of making payments. The specified payments liable for TDS are: Salaries; Fees for Professional or Technical Services, Interest Payments, Payments to contractors/sub-contractors, Rent, Commission or Brokerage Payments. Failure to deduct taxes and to deposit them into Central Government Account would invite disallowance of the expenditure itself, interest and penal liabilities as well as prosecution under the Act.

Section 195 of the Act provides that any person responsible for paying to a non-resident, not being a company, or to a Foreign Company, any interest or any other sum chargeable under the provisions of this Act (not being income chargeable under the head Salaries) shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force.

The Explanation to the said section provides that where any interest or other sum as aforesaid is credited to any account, whether called Interest payable account or Suspense account or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

The Section provides for a mechanism to apply for certificates for exemption from deducting tax or receiving payments without tax being deducted, based on CBDT's

notification specifying the cases and the circumstances under which, an application may be made for the grant of an exemption certificate.

Vodafone Case (175 Taxmann 399)

Vodafone International, a Dutch resident company acquired interest of Hutchinson International in CGP Investments a Cayman Islands registered company for US$11.2 billion. CGP Investments, through a number of intermediate companies, held 67 percent equity interest in Hutchinson Essar Ltd an Indian Company. So in effect it was a sale by Hutch of its shares to Vodafone. It was the contention of the Indian Revenue authorities that as capital gains had accrued to Hutch on the sale of shares, Vodafone should have withheld tax and by failing to do so had to show cause for failing to discharge its obligations i.e. why it should not be treated as an assessee in default for failure to withhold taxes estimated to be US$ two billion.

Main Issue in this case

Whether the sale of shares of a Company based in Cayman Islands by a non-resident to another non-resident gives rise to capital gains in India?

The Revenue's contention is that as the intent of Vodafone was to acquire the controlling interest in Hutchinson India Ltd, there was an extinguishment of a right on sale and an extinguishment of a right is termed as a transfer of rights for purposes of capital gains taxes.

Asseesee's (Vodafone) contention is that such overseas transfers of beneficial ownership are not taxable because the transfer of shares took place in a foreign jurisdiction.

The Assessee, Vodafone, had approached the High Court at Mumbai under its writ jurisdiction to quash the show cause notice issued to it by the Income Tax Department and the Court held that the assessee had prematurely invoked the writ jurisdiction while ruling that the Revenue was well within its rights to investigate into facts and that could not be negated by the Writ Jurisdiction. Vodafone's appeal against the High Court order was not entertained by the Supreme Court also stating that the Department had only issued Show Cause Notice to them and referred the matter to the Assessing Officer who is the competent authority to decide upon jurisdiction to tax the purchase deal for withholding tax on capital gains.

The main contention of the Department for justifying the levy of capital gains tax is that the property/capital asset is situated in India and as mentioned hereinabove, that Section 9 of the Act provides for all income accruing or arising whether directly or indirectly through or from any business connection in India, through any property in India or through transfer of a capital asset situated in India. Thus the substantial question of law in this case remains open as of now-though the case is being watched closely by the industry and global tax fraternity as it would determine the tax liabilities of parties in several such cross border deals already finalized and those in the offing.

6. Double Taxation Avoidance Treaties (DTATs)

Agreements for Avoidance of Double Taxation play a very important role in attracting foreign capital and technology. DTATs provide for prevention of double taxation as well as concessional rates of taxes on specified incomes to the residents of the Contracting States. These treaties also aim at preventing discrimination between the tax payers in the international field and providing a reasonable element of legal and fiscal certainty within a legal framework. In addition, such treaties contain provisions for mutual exchange of information and for reducing litigation by providing for mutual assistance procedure.

Under Section 90 of the Act the Central Government is empowered to enter into Agreements with foreign Governments not only for avoidance of Double Taxation of Income but for also enabling tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income or for investigation of cases involving tax evasion or avoidance or for recovery of taxes in foreign countries on a reciprocal basis.

Section 90 impliedly provides that the laws in force in either country will apply in the assessment and taxation of Income in the respective country, except where provisions to the contrary have been made in the Agreement. Where a DTAT provides for a particular mode of computation of Income, the same should be followed irrespective of the Act provisions. Section 90 (2) clearly provides that in case of any conflict, the provisions of the Act or the DTAT whichever are more beneficial to the assessee, will apply.

Where there is no specific provision in the agreement, it is basic law, i.e., the Income-tax Act that will govern the taxation of income *(CBDT Circular: No. 333 dated 2-4-1982.)*

Wherever there is a conflict between a DTAT and specific provisions contained in Income-tax Act, provisions of the DTAT will prevail over statutory provisions contained in

the Act-*CIT v. Hindusthan Paper Corpn. Ltd. [1994] 77 Taxman 450 (Cal.).Elkem Spigerverket A/s. v. ITO [1988] 32 TTJ (Cal.) and AEG Aktiengesselschaft v. IAC [1994] 48 ITD 359 (Bangalore.).*

- Provisions of Section 90 prevail over those of Sections 4, 5 and 9-*CIT v. Visakhapatnam Port Trust [1983] 144 ITR 146 (AP).*
- The provisions of Double Taxation Agreement would constitute 'provisions of the Act' for the purpose of determining the chargeability of income-tax for the purpose of deduction of tax at source-*Gujarat Narmada Valley Fertilisers Co. Ltd. v. ITO [1982] 2 ITD 515 (Ahd.).*

Where a DTAT provides that any income of an Indian resident may be taxed in the other country, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Act and relief shall be granted in accordance with the method for elimination or avoidance of double taxation as provided in such Agreement. *(CBDT Notifn. 91/2008)*

The Government is also empowered to make provisions for implementation of an Agreement by issuing a notification for the said purpose in the Official Gazette. The Supreme Court in the Azadi Bachao Andolan Case *[2003-263 ITR 706]* has reiterated these powers of the Central Government under Section 90 of the Act. It was in this case that the DTAT with Mauritius came under the judicial scanner for capital gains tax avoidance investments made by residents of other countries through the Mauritius route.

The DTATs provides that the assessee would not be taxed for the same income twice. Accordingly, if taxes have been paid in the country with which there exists a DTAA, the assessee can take credit for the taxes already paid in those countries on the income sought to be taxed in India-(Aishwarya *Rai Bachchan-ITAT Mumbai the assessee who is a model and an actress won her case based on these provisions in the US/UK DTATs)*

The role of DTATs is not confined only to the avoidance of double taxation but they also serve as instruments of fostering economic relations, trade and investments. This aspect of DTAAs has been acknowledged in the decision of *Daimler Chrysler India (P) Ltd (120 TTJ 803-Pune)* wherein the issue was of the allowance of benefit of carry forward of losses u/s 79 of the Act to the Indian subsidiary of a German listed company and whether the said company could be said to be one in which the public are substantially interested.

The ITAT held that the Indian subsidiary of a German parent company was entitled to carry forward accumulated losses despite a change in its shareholding due to a merger abroad, by applying the *non-discriminate clause* of the India German Tax Treaty. It was held that the Indian subsidiary of a German listed Company cannot be treated differently from an Indian subsidiary of an Indian listed Company and the Indian subsidiary was a company in which public was substantially interested being a subsidiary of a listed company abroad. The Bench held that the ground reality in today's world is that the role of tax treaties is not only confined to double taxation or to giving relief in respect of an income taxed twice but is an instrument of fostering economic relations trade and investment.

Relief from Double Taxation where no Treaty exists.

Where no DTAT exists, Section 91 provides that if any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India, he has paid income-tax, by deduction or otherwise, under the law in force in that country with which no DTAA exists, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

7. Advance Rulings

The Finance Act 1993 introduced the Scheme of Advance Rulings vide Chapter XIX-B (Sections 245N to 245V) as a tool for non-residents to resolve controversial tax questions whether of fact or law, relating to transactions undertaken or proposed to be undertaken by them. Applications for obtaining such rulings, which are binding on the Tax Authorities as well as the tax payer, can be made to the Authority for Advance Rulings (AAR), an independent judicial body, under the aforesaid Chapter XIX. A sufficient plethora of case law has been developed by way of Rulings of the Authority which provide valuable guidance to the non-residents as well as Indian assessees in planning for investments and other commercial transactions with foreign companies.

In the *Foster's Australia Ruling of the AAR (302 ITR 289)* the issue before the AAR was of the Sale Agreement executed in Australia for sale of the Foster's Brand/Trademark to SAB Miller, UK and grant of perpetual license to them in relation to Foster's brewing intellectual property confined to India and consequential capital gains tax, if any. The assessee's claim was that the there was no tax liability in India as the capital asset

(brand) was not located in India at the time of sale, but in country of domicile- Australia and the same was transferred in Australia as the Agreement was executed there. The Department's contention which was accepted by the AAR, was that the brand transferred had generated sufficient goodwill in India and had tangible presence here and was also put to use here. It was held that a Trademark/Brand registered in India and nurtured and used in business in India represents property situated in India. Capital gains arising on transfer of such property are taxable in India in the hands on the non resident transferor, irrespective of the sites of the execution of contract and irrespective of sites of delivery of such Intellectual Property Rights (IPRs).

8. Transfer Pricing and International Taxation

An epitome on International Taxation would be incomplete without mention of Transfer Pricing. Though this topic is a complex one requiring a separate elucidation, it is proposed to deal with it very briefly here. Simply put Transfer Pricing is the process of adjusting the prices of cross border transactions between related/associated parties to work out the taxable income under International Transactions. The Transfer Pricing provisions generally follow the OECD guidelines.

Provisions relating to Transfer Pricing as contained in the new Section 92 and 92A to 92F have come into force with effect from assessment year 2002-03. In terms of these provisions, income from an international transaction is to be computed having regard to **Arms Length Price,** between Associated Enterprises.

Meaning of Arms Length Price

Section 92 of the Act provides for computation of income from international transaction of associated enterprises having regard to the *Arms Length Price.* The Explanation to the Section introduced w.e.f. April 2002, has for removal of doubts clarified that the Arms Length Price will also determine the allowance for any expense or interest arising from an International Transaction

Clause 2 of the said Section provides that in an international transaction, wherein two or more associated enterprises have entered into a mutual agreement or arrangement for the allocation /apportionment/contribution to any cost or expenses to be incurred in connection with a benefit , service or facility provided/to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to or as the

case may be contributed by any enterprise shall be determined having regard to the Arms length price of such benefit, service or facility as the case may be.

Meaning of Associated Enterprise (Sec 92A)

Two enterprises are considered to be associated if there is direct/indirect participation in the management/control/capital of an enterprise by another enterprise or by same persons in both the enterprises. The factors taken into consideration to determine management and control include: direct/indirect shareholding having 26 percent or more of voting power; Advancing loans of 51 percent or more of the total assets, appointment of more than 50 percent of the Directors; sale of manufactured goods at influenced prices and dependence on IPRs owned by either parties.

Meaning of International Transaction (Sec 92B)

International Transaction has been defined to be a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, *sale or lease of tangible or intangible property or provision of services, or lending/borrowing money or any other transaction* having bearing on profits, income, losses or assets of such enterprises. It includes any mutual agreement or arrangement for *allocation/appprotionment/contriburtion to any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided* or provided to any or more of such enterprises. Thus the definition is all encompassing and provides for both income and expenses computation based on Arms Length Price.

Determination of Arms Length Price (Sec 92C)

Five methods have been prescribed for determining the Arms Length Price: Comparable Uncontrolled Price; Resale Price; Cost plus; Profit Split; Transactional and Net Margin Method. The choice of the appropriate method is determined with respect to the nature and class of transactions, the classes of associated persons, the functions performed by them and other relevant factors. The section provides taking into account the arithmetical mean where more than one price is determined. Further, if the variation between the Arms Length Price and the actual price at which the international transaction has been undertaken does not exceed five percent of the latter, then the price at which the international transaction has actually been undertaken shall be deemed to be the Arms Length Price.

Further in terms of Section 92CA, a Transfer Pricing Officer (TPO), on a reference being received from an Assessing Officer, is required to determine the Arms Length Price of an international transaction by an order, and the AO is required to compute the income having regard to the price so determined by the TPO. Guidelines have been issued by the CBDT to maintain uniformity of procedure and for the smooth and effective progress of work in this new and important area of taxation.

Conclusion :

Thus the entire gamut of provisions of the Act whereby a deeming fiction income is taxed if it accrues directly or indirectly from any source, property or capital asset in India, as clarified by the CBDT by its various circulars and the judiciary and the Authority for Advance Rulings, interpreting the provisions of the Act as well as the DTATs, by applying them to facts of some very complex cases and the amended provisions relating to Transfer Pricing, shows how the law relating to taxation of international transactions has evolved in India. It's a very challenging field both for the business enterprises and the tax authorities due to the complexity of the facts and the ever-changing business scenario across the globe. The Vodafone case has added a new dimension to the taxability of cross border transactions and once again the tax provisions are put to test in this complex field. However the proactive approach adopted by the Government by introducing the Alternate Dispute Resolution Mechanism within the Income Tax Department would now provide a forum to assessees to get an expeditious settlement of uncertainties of tax implications of International Transactions.

Corporate Governance: Points to Ponder*

By Shri Rakesh Mohan**, IA&AS

It was believed that Indian companies were insulated from scams like Enron and World com; but Satyam has proved this to be otherwise. The Satyam episode has brought Corporate Governance at centre stage and has imparted to importance like never before. Yet, it would not be untruthful to say that Corporate Governance has never been taken seriously by the India Inc. Had this not been the case Satyam may have never happened. How did the regulatory frame work fail? Here is what seems to have gone unnoticed.

Securities and Exchange Board of India (SEBI) was satisfied with the signing of listing Agreements by the listed companies; Company Law Board adopted a laid-back attitude and the government behaved like an ostrich. Everything was (is) left to the Auditors who are accountable only to a loosely knit peer group. Barring a few honourable exceptions, Independent Directors and Audit Committees have been show cased for the sake of compliance; they are more loyal to the promoters and CEOs than to the shareholders. The lackluster Regulators would have never been able to detect a scam of the magnitude of Satyam. It was B. Ramalinga Raju's own confession of wrong doing which left everyone red faced and without an alibi. But for his confession of wrong doing the fraud in Satyam could have continued undetected for many more years. I fear there are many more 'Asatyams' lurking within the Indian Inc and all of those are flourishing on the sticky wicket of corporate governance.

Through this article I endeavour to bring out some serious shortcomings in the Companies Act, in the Listing Agreements and in the actual implementation of the Corporate Governance which allow enough space for scams like Satyam to engender. This article also covers my experience as a manager and auditor of some public sector enterprises in India.

Corporate Governance Defined.

Organisation on Economic, Cooperation and Development (OECD) has defined Corporate Governance as under:

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* Published in the December 2009 issue of 'The Chartered Accountant', journal of the Institute of Chartered Accountants of India

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"Corporate Governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the Board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company's objectives are set and the means of attaining those objectives and monitoring performance".

In other words corporate governance is about commitment to values and ethical business conduct. It is about how an organization is to be managed. This includes its corporate and other structure, its culture, policies and the manner in which it deals with various stakeholders. Corporate governance guidelines and best practices have evolved over a period of time. The Cadbury Report on the financial aspects of corporate governance, published in the United Kingdom in 1992 was a land mark. Cadbury Code made 19 recommendations addressing the structure, independence and responsibilities of Boards, effective integral financial controls; and recommendation of the directors.

The Sarbanes-Oxley Act, which was signed by the USA President George W. Bush into law in July 2002, has brought sweeping changes in financial reporting. This is perceived to be the most significant change to federal securities law since 1930s. Besides directors and auditors, the Act has also laid down new accountability standards for security analyst and legal counsels.

In India, the Confederation of Indian Industry (CII) took the lead in framing a desirable code of corporate governance in April 1998. This was followed by the recommendations of the Kumar Mangalam Birla Committee on Corporate Governance appointed by the SEBI. The recommendations were accepted by SEBI in December 1999, and are now enshrined in Clause 49 of the Listing Agreement of every Indian stock exchange.

In the Indian scenario public sector companies began-and still do-as off shoots of a Ministry or a department. Hence, these companies more often than not tend to be run, at least in the initial stages, more like a government department than a corporate entity with commercial objectives and expected to generate a cash surplus. Since many state enterprises are incorporated with socio-economic objectives subservient to the political philosophy of the government, their commercial objective get obfuscated. Needless to say such entities even though corporate in form and commercial in orientation tend to often turn into expenditure centers instead of profit centers. There are instances galore

where public enterprises have eroded their capital base. According to the latest report of C&AG of India for the year 2008-09, equity capital of 72 (out of 281) central government companies had got completely eroded. At the state level the position is even more alarming. Most of State Government Companies have not prepared their financial statements for more than ten years. In 123 companies (in 14 out of 28 states) where accounts have been finalized the accumulated losses were to the order of Rs.23,473.28 crore and their net worth was negative to the extent of Rs. 15,484.28 crore. Nothing could be more indicative than this of the absence of Corporate Governance in these companies.

Legal Framework of Corporate Governance in India

A. CLAUSE 49 OF LISTING AGREEMENT OF SEBI

I. Board of Directors

Composition of Board

The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the Board of Directors comprising of non-executive directors.

Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

II. Audit Committee

- **A qualified and independent audit committee** shall be set up. Each such committee shall have minimum three directors as members. Two-thirds of the members of the audit committee shall be independent directors.
- All **members** of the audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise, and
- The **Chairman** of the audit committee shall be an independent director.

The Role of the Audit Committee shall be the;

- oversight of company's financial reporting to ensure that its financial statements are correct, sufficient and credible,

- to review the annual financial statements before its submission to the Board for approval,
- to review the quarterly financial statements before their submission to the Board of Director for its approval,
- to review functioning of whistle Blower mechanism.

III CEO/CFO Certification

The CEO i.e. Managing Director and the CFO i.e. the Finance Director shall certify to the Board that:

(a) they have reviewed the financial statements and the cash flow statement for the year and that, to the best of their knowledge and belief,

I. these statements do not contain any materially untrue statement or do not omit any material fact or contain statements that might be misleading,

II. these statements together present a true and fair view of the company's affairs and are in compliance with the existing accounting standards, applicable laws and regulations,

(b) there are, to the best of their knowledge and belief, no transaction entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.

IV. Report on Corporate Governance.

There shall be a separate section on corporate governance in the Annual Reports of the company with a detailed compliance report on Corporate Governance.

B. THE COMPANIES ACT, 1956

The following important amendments introduced in the year 2000 to Sections 217 and 292 of the Companies Act, 1956 (made applicable from December 13, 2000) set the tone for Corporate Governance in the Country:

(a) Directors' Responsibility Statement: Section 217 (2AA)

The Board's report shall also include a Directors' Responsibility, Statement, indicating therein:

(i) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(ii) that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;

(iii) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(iv) that the directors had prepared the annual accounts on a going concern basis.

(b) Audit Committee-Section 292 (A)

(1) Every public company having paid-up capital of not less than five crore of rupees shall constitute a committee of the Board knows as "Audit Committee" which shall consist of not less than three directors and such number of other directors as the Board may determine of which two thirds of the total number of members shall be directors, other than managing or whole-time directors.

(2) Every Audit Committee constituted under sub-section (1) shall act in accordance with terms of reference to be specified in writing by the Board.

(3) The members of the Audit Committee shall elect a chairman from amongst themselves.

(4) The annual report of the company shall disclose the composition of the Audit Committee.

(5) The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

(6) The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.

(7) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.

(8) The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board.

(9) If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefor and communicate such reasons to the shareholders.

(10) The chairman of the Audit Committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.

(11) If a default is made in complying with the provisions of this section, the company, and every officer who is in default, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to fifty thousand rupees, or with both.

Role of Board of Directors

The key to organizational health is a thoughtful and committed Board of Directors which sits at the heart of the enterprise. It is the responsibility of the Board to keep a balance between the external and internal pressures on the organization in order to ensure its survival. Board is expected to give a clear direction to the business and create the emotional climate in which its people can align and attune themselves to its directions. It is the Boards' job to ensure that sufficient number of Board members are pointing in the same direction, are committed to a common purpose, hold similar values and exhibit similar behaviour, so that the enterprise can function in unison to enable it to perform effectively and efficiently.

A corporation needs effective management to keep its day to day operation running, but it also needs to ensure that the enterprise sustains itself over the long term to deal with the complex web of customers, suppliers, staff, local communities and the change of political, physical, economic, social, technological and trade environment that impacts its business. Effective stewardship on the part of Board of Directors is an imperative to negotiate an enterprise through this maze. If this is not recognized by the Board of Directors, incompetence and corruption can multiply. As the Chinese saying goes, "**The**

Fish rots from the head!" whether or not this is literally correct, it is indeed a powerful metaphor for the Board of Directors to consider.

In my association with the public sector enterprises, I observed that managing directors were changed very frequently. Some of them had no business skill or experience. Many of them even lacked business like attitude and an aptitude for business. Often Board of Directors were packed with friends of the chief executive or representatives of various interest groups such as a woman and a minority/or a weaker section to serve a large variety of esoteric ends far removed from the ends of business. A stereotype joke about the public sectors Boards of directors is that these are comprised by the **'un-worthy, appointed by the unwilling, for unnecessary'.** It should be remembered that both **'the cream and the scum rise to the top"** which must be discouraged at all costs.

How independent are the Independent Directors ?

Independent directors are supposed to be watchdogs the ones that are responsible for safeguarding the interest of minority shareholders. In several instances of corporate fraud it has transpired that independent directors have clearly failed in their duties. Satyam adhered to corporate governance rules, appointing appropriate number of independent directors with excellent credentials, including the dean of a top business school in its home town of Hyderabad and a professor at Harvard Business School. But, concerns have been expressed that some of the directors may have been too close to Satyam Chairman to have acted truly independently. It is evident that all of the independent directors failed to ask tough questions about the misdeeds of the Chairman. Imagine just a few months ago India's fourth largest software services exporter, Satyam Computers Services, received a Golden Peacock award from group of Indian Director for excellence in corporate governance!

A majority of independent directors enjoy employment elsewhere. At present one can be Director on the Boards of as many as 15 listed companies. Directorship in unlisted companies may be an icing on the cake. The sitting fee of a director has been raised to Rs. 20,000/- and some independent directors are taking Rs. 8 to 12 lakh per company in commission alone. Add to this the sitting fees and their total annual income from this source alone can go up to Rs. 12 to 16 lakh.

So an independent directorship can render a person richer by almost Rs. 2 crore a year! What, then, is the difference in remuneration between non-executive director and an

independent director? Also, since high profile people are often invited to sit on the Boards of companies, sitting fees in their case might be greater to match their public profile and stature. But the real challenge is in having a balanced, qualified and dedicated Board. This ideal situation rarely exists. Corporate scandals of Enron and WorldCom (and now Satyam) have revealed how independence of Directors has been compromised by a cozy relationship between the CEO with so-called independent directors. It is again ironic that in 2002, Board of Enron was judged as one of the 5 best Boards by the" *Chief Executive*" magazine. Even more ironic is the fact that the chairman of its audit Committee was no less a person that the dean of Standard Business School.

Government nominees on company Boards

Former SEBI Chairman M. Damodaran had questioned the contribution of the government nominees on Boards of public sector companies to the functioning of the companies they are required to serve. During a CII conference, he said: "We don't want people who walk in the Board rooms, as representatives of constituents". "Do they continue to represent government and government alone when they are inside the Board rooms or they look in totality about the interests of the company forgetting from what source they come from"? he asked.

Boards are at the centre stage of the governance process. Therefore, the debate on nomination of government nominees in the Board of PSUs is vital and should be carried out on a continuing basis. It may be important to retain good people on the Boards, but bottom-line is that they should also add value to the functioning of the Boards. Dignitaries should not be nominated just to grace the Board, but should be seen to be adding value. It is thus necessary that they should be trained so that they understand the expectation of the company. Also, they need to be challenged to live up to this profile.

There is a need to move away from the concept of having a specified number of directors to achieve a balance of varied interest. This certainly leads to over-regulation. It is to be seen whether an "overly prescriptive regime" has dampened innovation. Recently Steel Authority of India, an enterprise of the Government of India, requested government to reduce the number of its directors to 16 from the existing 24. Many companies have started feeling that their Board are overcrowded and that quite a few of such members are not adding any value to the company.

The seven directors on the Board of the Company, I worked with, were heads of various government departments/corporations. They were all overly preoccupied with their own responsibilities and had hardly any time to give a serious thought to the business of that company. During my tenure of five and half years with the company, I witnessed almost 35 Board meetings but interestingly none of them had more than 3 to 4 directors, in attendance. Majority of meetings were concluded on the basis of quorum. There were occasions when Board remained un-constituted for more than 6 months and the company was run by civil servants, in addition to their normal duty.

It is hardly surprising that in many cases directors do not fit their role because directorship is too often seen only as prize having been awarded at the end of a successful managerial or professional carrier. Directorship in public sector enterprises may also be awarded to accommodate an inconvenient politician or an acquaintance or kith and kin of the CEO or the Chairman. Such nominee directors often feel too exalted to seek to educate themselves about the corporate or individual responsibilities into which they have entered or as to the roles and tasks that are demanded of them or how they can make their best personal contributions to the governance of a company.

Limitations of Clause 49 of Listing Agreement and Section 292(A) of Companies Act.

Detailed Guidelines have been laid for corporate governance under clause 49 of Listing Agreement of SEBI. However, for the unlisted companies, as per my knowledge, no specific guidelines have been issued. The only section that deals with one component of Corporate Governance i.e. the Audit Committee is the section 292(A) of the Companies Act, 1956 which reads as follows:

"Every public company having paid-up capital of not less than five crore of rupees shall constitute a committee of the Board, known as "Audit Committee".

But this section has its own limitation in as much as it restricts the application of this section to the companies having paid up capital not less than Rs. 5 crore. This may be alright for private sector companies, but Government's contributions in a public enterprise, in form of paid-up capital, may not be that high. Yet, indirectly, governments finance such companies through subsidies, loans and guarantees against loans taken from banks and other financial institutions as well as by transfer of public land at nominal prices. For instance, Govt. of India has provided Rs. 240 crore in term loans and guarantees to M/s. MECON Ltd., besides the paid up capital. However, this company has

not constituted an Audit Committee or appointed any Independent Director because its paid up capital is less than 5 crore and thus is not a listed company.*

Further the key word in Section 292 (A) is *'Public Company'*. Public Company means a company which is

(a) not a Private Company;

(b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed;

(c) a private company which is a subsidiary of a company which is not a private company.#

Any company (whether a private or a government) can be registered as private company or even as a society if its Articles of Association so provides. The Companies Act does not restrict a government company from getting itself registered as private Ltd. company or a society.

Some examples of government companies registered as Society or Private Ltd. are Delhi Tourism and Transportation Development Corporation (DTTDC), a company of Government of Delhi, MECON Ltd., Bokaro Power Supply Corporation (P) Ltd. (BPSCL) and NTPC-SAIL Power Supply Co. (P) Ltd. (NSPCL) which are subsidiaries of SAIL, and many more. Subsidiary company means an entity where another company holds more than half in nominal value of its equity share capital.

Shareholding patterns of NSPSCL and BPSCL are as under:

NSPSCL (NTPC-SAIL Power Supply Co (P) Ltd.)	**BPSCL (Bokaro Power Supply Co. (P) Ltd.)**
Paid up capital : Rs. 330.80 crore	Paid up capital : 168.05 crore
SAIL- 50%; NTPC -50%	DVC 50%; SAIL-50%

In both above examples although these Companies have huge capital base and are fully financed by public sector companies (SAIL & NTPC), technically these are not subsidiaries of either SAIL or NTPC as neither holds more than 50% of shares in these companies. Because of such technicalities both above companies are private company and, therefore, they are under no obligation to constitute an Audit Committee or to appoint Independent Directors on their respective Boards.

* Audit Committee now constituted and Independent directors appointed on persuasion of the Audit.

Section 3 (1) (iv) of the Companies Act, 1956

Similarly, there are several other companies where states and central governments have invested thousands of crore of public funds but there is no semblance of Corporate Governance in them as there paid-up capital is less than rupees 5 crore or because these companies have been got registered as 'private limited companies'. In the absence of a formal allegiance to the norms of corporate governance, proper utilization of the government funds as well as their security are always at risk.

Symptoms of Corporate Collapse

Sir Bob Garratt in his book "**The Fish Rots from the Head**" attributes following situations to corporate failure:

One man rule	Non participating Board	Unbalanced top team
Lack of management depth	Weak finance function	A combined chairman and chief executives' roles

I have observed many of these symptoms in companies owned by the State Governments where CMD and MD is often the same person and is all in all. His word is final. Even the Board Members fall in line with him. MD/CMD have been found taking advantage of their seniority status in the civil service cadre to which he as well as several of his colleagues on the Board belong to. As pointed out in the foregoing paras, generally the Boards have been non-participating and the decisions are managed through the minimum quorums and sometimes approval obtained by circulation without any discussion worth name. The top team happens to be always unbalanced because the gap of hierarchical status, between the CMD and other executives, is often very wide. The executives are supposed to carry out the orders of MD/CMD without asking any question. Lack of management depth is prevalent at every level. Generally the top executives lack the understanding of commercial activities of the enterprise. Most of the time, they are inclined to run the company like a department. The financial management is invariably weak as there are hardly any qualified professional in the department; most of them are anyway recruited and promoted on the recommendations of colleagues and friends and not through merit. Due to this inefficiency and callousness, accounts of the companies are always in arrears for years together. (Some companies have not prepared their accounts since their very inception).

The job of the Board's Chairman is to design and chair the process of Board's meetings and monitor subsequent activities. The Chief Executives' role is to run the

business. These are both powerful position and the two people concerned, therefore, need to have mutual respect and to agree in a way of working together. If this is not the case, the power balance swings either-ways which is unhealthy and the directors are left to cope with a lop-sided Board; either the chairman tries to run the total business or the chief executives tries to overshadow the chairman. A similar situation had arisen in the company where I worked. The MD and the Chairman were at logger heads for an entire year. The corporation suffered a great deal on account of their lack of synergy.

In many cases, agenda papers are not circulated in advance. Far too much time is spent discussing trivia. Important points are taken up for discussion to the end of meeting when the concentration of Board members starts to sag. On many occasions even the minutes of the Board meetings are recorded differently than what was discussed and agreed to during the meetings.

Conclusions

On the basis of experience and wisdom gained by me, as recounted above, I suggest that issues involving corporate governance, which are beyond the ambit of Clause 49 of Listing Agreement and not covered by section 292 (A) of the Companies Act either, need to be seriously delivered and resolved before more damage is done to the public interest (exchequer) or before another "Satyam" like phenomenon arises in India. This is an important issue for a large number of PSUs, where billions and billions of public funds are invested and yet are not covered either under Clause 49 of Listing Agreements or the section 292(A) of the Companies Act. The interest of stake-holders (here taxpayers) in such companies are obviously at great risk.

The message of corporate governance should reach everyone, especially to those who are not convinced about its benefits. The message should go loud and clear to companies for whom it is mandatory, but are complying with its requirements only 'in form' and not 'in spirit'. Let companies see that governance goes beyond the Boardroom and conforms to all processes and levels within an organization.

Some Analysts say that the market watchdog, SEBI lacks the teeth for ensuring compliance with standards of corporate governance, while other says that its rules and regulations do not go far enough. The debate on corporate governance should be directed into these issues and determine whether it is adding value to the company.

Corporate governance should indeed be embedded in the corporate culture and procedures and not be seen as merely an element of compliance. After Satyam, investor's

confidence is badly shaken. The degree of firmness with which the government and the regulators uphold the standard of corporate governance would decide how the foreign investors react and what will be the level of investment in a country.

Note: The views expressed in this article are entirely those of the author and the editor and the publisher of this Journal do not necessarily endorse them.

Building a Results-Based Monitoring and Evaluation System: Crucial Enhancement of Audit Effectiveness

By Shri Pravir Pandey*, IA&AS

"Good Governance is not a luxury - It is vital necessity for development"

(World Bank, 1997)

1. INTRODUCTION

1.1 With globalization, while the role of the State has changed and evolved, it is apparent that good governance is key to sustainable socio-economic development. States are being challenged as never before by the demands of the global economy and new modes of information technology ensure greater participation and democracy. Governments all over the world are struggling with internal and external demands and pressures for improvement and reform in public management. Whether it is the issue of greater accountability and transparency or effectiveness of development programs or matters of political interventions, Governments must be increasingly responsive to internal and external stakeholders to demonstrate tangible results. "The clamor for greater government ineffectiveness has reached crises proportions in many developing countries where the state has failed to deliver even such fundamental public goods as property rights, roads, and basic health and education" *(World Bank, 1997).*

1.2. Results based Monitoring and Evaluation (M&E) system or framework is a powerful public management tool that can be used by policy makers and decision makers to track progress and demonstrate the impact of a given project, program or policy. At the same time, it provides auditors with concurrent data and information on the progress of a project, program or policy right from the conceptualization stage. The emphasis here is on pre-implementation data and not only on post-implementation data, which largely has been the concern of auditors. Results-based M&E System differs from traditional implementation-evaluation focused audit and moves from emphasis on inputs and outputs to a greater focus on outcomes and impacts.

1.3. Building and sustaining a results-based M&E system is not easy. It requires continuous commitment, time, effort and resources but it is durable once the system is built; the challenge is to sustain it. Developed countries, particularly those of the

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Organization for European Cooperation and Development (OECD) have had as many as twenty or more years of experience in M&E but developing countries are just beginning to use this key public management tool.

2. CHANGING STRUCTURES OF GOVERNMENTS

2.1. Decentralization, deregulation, commercialization and privatization are such reforms which have increased the need for monitoring and evaluation at regional and local levels of Government. As these initiatives are undertaken by the Governments, there will be a continuing need to monitor and evaluate performance at different levels of the Government. For example, the constitutional 73rd Amendment Act 1992, which came in effect from 24.04.1993, envisages a 3 tier Panchayati Raj system with a key role to play in 29 functions of the eleventh schedule of the Constitution. Panchayati Raj Institutions (PRIs) come under the purview of audit. This systematic devolution causing democratic decentralization poses major challenge for Audit as even in a small state like Uttarakhand, there are 7335 units and the 12th Finance Commission has allotted Rs.97.2 crore to the state for their use between 2005-06 and 2006-07. The PRIs functionaries are not yet properly conversant with standard accounting practices and have no independent data-base of their own. Having yet to evolve an independent system to assess the efficacy of their strategies from planning and design stage to implementation, they are dependent completely on audit who are supposed to audit once in five years for Key Gram Panchayat units. Thus, there is no concurrent mechanism for mid-term correction and the possibility of misuse or wastage of funds remains realistically large.

2.2. With changes in Government size and resources, there are many internal pressures on Governments to downsize and reform themselves. Governments are experiencing budgetary constraints that force them to make difficult choices and toward deciding the best use of limited resources. In this scenario, the role of a well-designed M&E framework assumes great relevance.

3. DEFINITION OF MONITORING & EVALUATION

3.1. The OECD (2002) defines M&E as follows:

Monitoring is a continuous function that uses the systematic collection of data against specified indicators to provide management and stakeholders of an ongoing policy intervention with the indication of the extent of progress and achievement of objectives and progress in the use of allocated funds. Evaluation is the systematic and objective

measurement of an ongoing or completed project, program or policy including its design, implementation and results.

3.2. Monitoring and evaluation go together. Monitoring gives information on where a policy, program, or project is, at any given time, and its relation to respective targets and outcomes. Evaluation gives evidence of why targets and outcomes are, or are not, being achieved. It seeks to address issues of causality. M&E systems move beyond output-oriented audit areas to the realm of outcomes and impacts. It is important for evaluative information to be present throughout the life-cycle of a project and not just at the end of it. Monitoring can be done at the project, program or policy levels. For example, in looking at infant health, one could monitor the project level by monitoring the awareness of good prenatal care in six targeted villages. At the program level, one could monitor to ensure that information on prenatal care is being targeted to pregnant women in a whole region of the country. At the policy monitoring level, the concern could be to monitor the overall infant morbidity and mortality rates for that same region.

3.3. Evaluation, like monitoring, can also be conducted at project, program or policy level. For example, privatization of water supply system or electricity system; a project evaluation might involve the assessment of the improvement in water fee collection rates in two states. At the program level, one might consider assessing the fiscal management of the government's systems, while at the policy level one might evaluate different model approaches to privatizing public water supplies.

Table 1

Complimentary Roles of Results Based M&E

Monitoring	Evaluation
• Clarifies programme objectives	• Analyzes why intended results were or were not achieved.
• Links activities and their resources to objectives	• Assesses specific casual contribution of activities to results.
• Translates objectives into performance indicators, compares actual results with targets.	• Examines unintended results
• Reports progress to managers and alerts them to problems	• Provides lessons, highlights specific accomplishment or programme potential and offers recommendations for improvement

3.4. Evaluation in the context of an M&E system does not solely refer to the classical audit approach of after-the-fact-assessment of projects, program or policies. It has a much broader context; it is a continuously available mode of analysis that helps program managers gain a better understanding of all aspects of their work from design through implementation and onto completion and subsequent consequences. This "self-analysis" by the government or any organization, which provides step-by-step evaluation, will provide a powerful and authentic insight to audit during the course of test-audit and reviews.

3.5 EVALUATION, WITHIN THE M&E FRAMEWORK, ASKS QUESTIONS

"Why"? Question: That is what caused changes being monitored?; **"How" Question**: What was the sequence or process that led to successful and unsuccessful outcomes?; and **"Compliance and Accountability" Question:** that is, did the promised activities actually take place and as planned? Traditional audit-focused systems are designed to address compliance. However, this approach does not provide policy makers, managers and stakeholders with an understanding of the success or failure of a project, program, or policy. This approach is oriented to highlight the failures of an implementation, but rarely provides a causal analysis for a better understanding. Results-based M&E system addresses the **"So what" Question**: So what that output has been generated? So what that activity has taken place? So what that output of these activities has been counted? Results-based M&E system provides feedback on the actual outcomes and goals of Government actions.

3.6. Monitoring progress toward national goals requires that information be derived in logic model from all results levels, at different time-frames, and for different needs of stakeholders. A common audit strategy is to measure outputs. For example, number of health professional trained or number of Oral Re-hydration Therapy (ORT) given to manage children diarrhea. M&E design framework goes beyond output assessment; it measures and documents results on the basis of logically designed indicators of every aspect of the project or program, and reflects the outcomes and ultimately the associated national goal, for example, reduction in child mortality under 5 years of age due to ORT.

3.7. Government seeks to align the expenditure framework with policy outcomes, but measuring the organization's performance in respect of achieving outcomes is important. The efficiency of service delivery, the quality of program and policy implementation, and the effective management of resources are a few examples.

Table 2

Key features of implementation monitoring versus results monitoring

Elements of Implementation Monitoring (traditional audit approach for projects)	**Elements of Result Monitoring (used for a range of intervention and strategy)**
• Description of the problem or situation before the intervention	• Baseline data to describe the problem or situation before intervention
• Benchmarks for activities and immediate outputs	• Indicators for outcomes
• Data collection on inputs, activities and immediate outputs	• Data collection on outputs and how and whether they contribute toward achievement of outcomes
• Systematic reporting on provision of inputs	• More focus on perceptions of stakeholders
• Systematic reporting on production of outputs	• Systematic reporting with more qualitative and quantitative information on the progress towards outcomes
• Directly linked to a policy intervention	
• Designed to provide information on administration, implementation and management	
• Issues as opposed to broader development effectiveness issues	

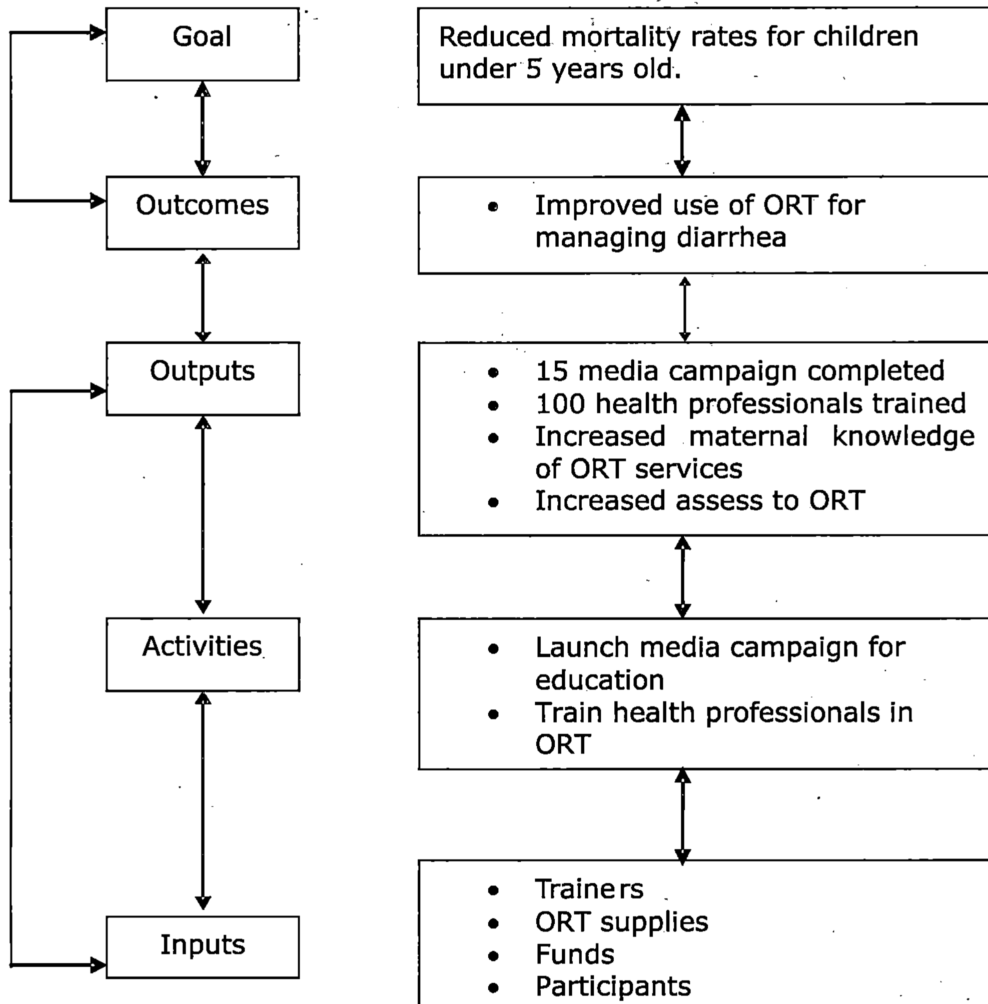
Source: Adapted from Fukuda-Patt, Lopes and Malik, 2002

4. Many Applications for Results-Based M&E System

4.1. There are many growing needs for accountability and demonstrable results and so the uses and application for Results Based M&E systems have also increased. Results-based M&E systems have been successfully designed and used to monitor and evaluate at all levels project, program and policy. Information and data can be collected and analyzed at any and all levels to provide feedbacks at any point of time. For example, any project or program would have the following logical flow of events: Inputs→Activity→Output →Outcomes→Impact. In this way, the information can be used to better inform policy makers, decision makers, general public, and other stakeholders. This readily available source of data and information can effectively enhance the incisive capacity of audit.

Table 3

Illustrative logic model for one national development goal



Source: Binnendjik, 2000

4.2. M&E can be conducted at local, regional and national levels of Government. M&E can be thought in relation to levels of administrative complexity (project to program to policy) or geographically. Only the specific indicators may be different as the stakeholders' need for information will also be different for each level of Government. M&E system provides a continuous flow of information that is useful both internally and externally. The internal uses of the information from the M&E system can be used as a crucial management tool for decision makers. Likewise, the information from an M&E system is extremely important for auditors who are seeking a reasonable level of assurance of the performance of the public sector. The auditors, who are expecting demonstrable results and impact from Government action and tax monies, will be immensely benefited from

concurrent, multi-level data and information thrown up by the M&E system.

5. The Technical Side of M&E Building Institutional Capacity

5.1. Designing and building M&E systems that can produce reliable, timely and relevant information indicative of the performance of Government projects, program and policies includes the ability to successfully construct indicators; the means to collect, analyze, aggregate and reflect the performance data in relation to the indicators and their baselines. Building such capacity is a long time effort. M&E system ensures monitoring and tracking at each level of the results at the input, activity, output (implementation), outcome and impact (goal) levels. The statistical capacity is an essential component of building a results-based M&E system. The information and data should be valid, verifiable, transparent and widely available to the Government, interested stakeholders and the auditors. Many countries, for example, Egypt, Columbia, etc., have enhanced their internal evaluation capacities through an M&E system which aids external evaluation/audit by ensuring that large amounts of irrelevant data is not dumped on auditors (*World Bank, 2001*).

6. M&E Experience in Developed and Developing Countries

6.1. A large majority of the 30 OECD countries now have Result-based M&E systems. Arriving there was neither an easy nor a linear process for them. According to a recent survey, Australia, Canada, Netherlands, Sweden and the United States have the highest evaluation culture among OECD countries (*Furubo, Rist and Sandahl, 2002*). In recent years France, Germany and the Republic of Korea, under strong internal and external pressures, have also adopted M&E systems in their governance.

6.2. A recent OECD survey provides a useful overview of the extent to which a result based M&E focus has permeated and taken root in OECD country budgetary and management systems and practices. For example, "most governments today include performance information in their budget documentation and that information is subject to some form of audit in half of the countries. Though the current debate in the internal public management and budgeting community on the distinction between outcomes and outputs is relatively new, the distinction between the two categories of results is used in most or all organizations in 11 out of 27 countries" (OECD 2002).

Table 4

Australia

Australia was one of the earliest pioneers in developing M&E systems, starting in 1987. A variety of factors contributed to Australia's success in building strong M&E systems. Initially, budgetary constraints prompted the government to look at ways of achieving better value for money. Australia had two important institutional champions who advocated M&E systems for the government the Department of Finance and the Australia National Audit Office.

(Source: Mackay, 2002)

Republic of Korea

In terms of public policy evaluation, the Korean Government uses two approaches: a performance evaluation system introduced in 1962 and an audit inspection system established in 1948. Performance evaluation has been carried out by organizations within or under the Prime Minister's Office. Auditing and inspection are carried out by the Board of Audit, the supreme audit institution. The Asian economic crises of the late 1990s brought about new changes in evaluation practices in the executive branch. "The new government in Korea asserted that the national economic crisis, caused by foreign exchange reserves, resulted from lack of efficiency of the public sector management. This assessment became an opportunity for reinventing government in Korea, which brought forth unprecedented restructuring of government organizations as well as nongovernmental organizations....." (Lee 2002) The Board of Audit has become stronger and more effective as it is better informed with multi-level concurrent data and information from government and organizations.

Malaysia

Among developing countries, Malaysia has been at the forefront of public administration reforms, specially in the area of budget and finance. Budgetary reform focused on greater accountability and financial discipline among the various government agencies. On a very bold initiative by the supreme audit institution of Malaysia, demonstrating foresight, innovativeness, dynamism and commitment to ensure value for money in projects and policies, the Malaysian Government instituted M&E systems in various organizations across the Government. The result has been improved budgetary system performance, financial compliance, quality management, productivity, efficiency in governmental operations, and improved management of national developmental efforts.

7. M&E Challenges Facing Developing Countries

7.1. The challenge of designing and building a results-based M&E system in a developing country is difficult, and not to be under-estimated. The construction of such a system in India is a serious undertaking, and will not happen overnight. Developing countries building their own results-based M&E systems face challenges both similar to and different from those of developed countries. Demand for and ownership of such system - most basic requirement - may be more difficult to establish in developing countries. For example, a recent World Bank and African Development Bank study found that "......... the key

constraint to successful monitoring and evaluation capacity development in Sub - Saharan Africa is lack of demand. The lack of demand is routed in the absence of a strong evaluation culture, which stems from the absence of performance orientation in the public sector" *(Schacter, 2000).*

7.2. In developing countries, for example, India, political will and institutional capacity may slow progress. Difficulties in inter-ministerial cooperation and coordination can also slow down the progress towards establishment of M&E systems. In this context, a highly placed champion like audit, willing to assume the political risks in advocating results-based M&E is essential. The presence of a national champion like Comptroller & Auditor General of India can go a long way towards helping India develop and sustain M&E systems.

7.3. Developed and developing countries alike are still working towards linking performance to a public expenditure framework or strategy. If these linkages are not made, there is no way to determine if the budgetary allocations in respect of programs are ultimately supporting a success or failure. Furthermore, there would be no means of providing feedback at interim stages to determine if physical adjustment could be made to alter projects or programs, and thereby increase the likelihood of achieving the desired results.

7.4. Creation of a more mature M&E system requires inter-dependency alignment and coordination across multiple governmental levels. This can be a challenge in India because, the government is loosely inter-connected and is still working towards building strong administrative culture and transparent financial system. In the developing world countries like Brazil, Chile, Turkey, Malaysia and Uganda have developed successful M&E systems. Such reforms focused on greater accountability and financial discipline among various government agencies; this helped audit in these countries to ensure enhanced accountability, improved budgetary system performance, improved financial compliance, quality management, productivity, efficiency in government operation and management of national development efforts (*World Bank, 2001*).

8. Reporting the Findings

8.1. Well-designed M&E systems can provide critical, continuous and real time feedback on the progress of a given project, program or policy. Using the findings to improve the effective needs and coverage of audit is one of the main purposes of constructing a result based M&E system. The main point of the M&E system is not

simply to generate continuous results based information, but to get that information to audit in a timely manner so that more timely and constructive performance feedback can be given by audit to Governments and organizations.

8.2. **Strengthen Parliamentary Oversight**

Strengthening Parliamentary Oversight is another important way to share and disseminate information. There are various agencies that provide parliaments with oversight, for example, the United States General Accountability Office (GAO), the audit office of the Congress, or the National Audit Office for the Parliament in the United Kingdom. Parliaments in various countries are starting to ask for performance information as a part of their oversight function. Audit can use this very effective tool of results based M&E systems to provide in depth and extremely authentic oversight to the Indian Parliament. The Office of the Comptroller & Auditor General of India can become a key partner in developing well-designed M&E systems within the organizations of the executive. In Canada, the Treasury Board produced a "guide for the development of a results based management and accountability framework". It is "intended to serve as a blue print for managers to help them focus on measuring and reporting of outcomes throughout the life-cycle of policy, program or initiative" *(Treasury Board Secretariat of Canada, 2001).*