AUDIT OF CONTRACTS
DEFINITION OF A CONTRACT

A Contract is a written agreement between two parties for supply of goods or execution of works or a promise to do so for consideration paid or payable in future.
Audit of contracts

• The responsibility of conclusion of contracts for works to be done and supplies to be made and of enforcing them rests with the Executive.

• Scrutiny of these contracts or agreements constitutes one of the important functions of audit.

• The objective of such a scrutiny is to see whether the contracts or agreements have led to loss or wastage of public money and also to ensure that the rules and regulations provide reasonable security against malpractices.
Audit of contracts

Audit must see that:

i. The terms of a contract are precise and definite.

ii. Standard forms of contracts have been adopted.

iii. No contract involving an uncertain or indefinite liability or any condition of an unusual character should be entered into without the prior consent of the competent financial authority.

iv. Similarly, terms of a contract once entered into should not be materially varied without the prior consent of the competent financial authority.

v. Contracts should be placed only after inviting open tenders and the lowest tender shall be accepted. In cases where it is not considered practical to invite open tenders or to accept the lowest tender, the reasons for deviations should be recorded.

vi. In selecting the tender to be accepted, the financial status of the tendering individuals and firms must be taken into consideration, in addition to all other relevant factors.
Audit of contracts

vii. No order for supplies should be placed without at least a written agreement in regard to price.
viii. Provision in contracts for safeguarding government property are entrusted upon contractors.
ix. Deviations from contracts are approved by authority not inferior than the original contract.
x. Audit should also see that any payments are in accordance to the strict terms of the contract or in excess of the contracted rates are with the consent of the competent financial authority
xi. Cases in which there is evidence that an officer or agent of a contracting department has an undue common interest with the other contracting party should be examined in detail.
SOURCE DOCUMENTS

The following are the main source documents to be checked in the audit of contracts and agreements:

i. Contract files maintained by the departments or institutions.
ii. Accounts and payment vouchers received from the treasuries.
iii. Administrative Approvals and Technical Sanctions of the competent authority forming the basis of the contracts.
iv. Portfolio Registers maintained by the Integrated Audit Unit Section.
v. Bills for supply of Stores.
vi. Copies of Contracts and Agreements.
vii. Any other documents that would facilitate effective audit.
AUDIT LEVELS - CENTRAL AUDIT

Audit of contracts is conducted at two levels

- Central Audit
- Local audit

1) Central Audit at headquarter office

i. Copies of contracts and agreements relating to purchases of the value of Rs 5 lakhs and above are obtained and examined in Central Audit.

ii. All rates and running contracts, as well as all important and unusual contracts, are scrutinized irrespective of the amount of contract.
iii. The departmental officers send monthly lists of all contracts entered into by them besides copies of all contracts and agreements for purchases of the value of Rs 5 lakhs and above, all rate and running contracts, and of all important and unusual contracts included in the monthly lists for scrutiny of

i. sanction;
ii. contractors;
iii. the nature of the work or materials to be supplied;
iv. brief particulars of rates, important conditions, etc.; and
v. the delivery or completion.

iv. In cases where no payments have been made during the entire contract period, which is generally very short in respect of contracts entered into by civil departments, specific inquiries may be made from the departments concerned to ascertain if the contract has actually been operative; if so, details of the vouchers through which the payments were made and other relevant particulars may be called for.
1) AUDIT OF SANCTIONS:
In conducting audit of sanctions to purchases, contracts, etc., the broad principles of financial propriety on ‘Audit of Expenditure’ should be borne in mind and the original records leading to the issue of the sanction should be scrutinized in Central Audit.

2) AUDIT OF ACCEPTANCE OF TENDER/CONTRACTS/ AGREEMENTS :
   i. Complete particulars of quantities and rates/prices should have been furnished, the rates/prices stipulated being firm.
   ii. Important and material clauses relating to delivery schedule, place of delivery, inspection of stores, dispatch instructions, particulars of consignee, etc. should have been clearly specified and not omitted.
iii. Provisions relating to payment of sales tax, excise duty, etc. should be checked with reference to the instructions issued by the Government from time to time. Vague provisions such as "sales tax will be paid, if legally leviable" should be objected to and the contracting officers asked to state in definite terms whether sales tax, excise duty, etc, are payable and, if so, the rates, basis of payment, etc.

iv. Tenders issued in the latter part of a financial year should be specially scrutinized and any tendency on the part of the department to resort to rush of expenditure brought to notice.

v. Suppliers should furnish a solvency certificate for the contractual amount, Audit should verify that there no facts have been suppressed in the documents connected with the solvency certificate and that the financial interests of Government have been adequately protected.
vi. Purchase order should have been signed by an authority competent to enter into contracts. If, however, this has been signed by an authority not competent to enter into the contract, it should be verified that a certificate to the effect that the competent authority has approved the purchase is recorded thereon, mentioning also the designation.

vii. The contract should have been sanctioned by a competent authority.

viii. In respect of contracts entered into with a firm, each one of the partners, or the duly constituted attorneys in the case of absent partners, should have signed all the documents constituting the contract. In the latter case, the original powers of attorney duly registered in a court of law will be verified and an attested copy obtained for audit purposes.
ix. The contract should not have been entered into by or on behalf of a minor.

x. Security deposit, if any, should have been furnished in the appropriate form and of the correct amount and within the period stipulated in the contract.

xi. All the conditions and requirements printed on the contract form should have been complied with.

xii. Penalties leviable under the terms of the contract should have been enforced in the event of any default or breach of the conditions.
3) **AUDIT OF BILLS FOR PURCHASES AND SUPPLIES OF STORES**

i. Audit Officer should satisfy himself that the sanctions and agreements have been properly audited and bear suitable audit endorsement.

ii. It should be verified in auditing bills of contractors or suppliers that:
   
   a. The purchase of the stores has been sanctioned by the competent authority;
   
   b. All purchases of stores are made in accordance with the instructions laid down Financial Rules or the similar rules of the Governments concerned.
   
   c. Splitting the requirements has not been done to avoid the necessity for sanction of the competent authority;
d) The rates charged in the bills are in conformity with those in the agreements.

e) Inspection certificates have been furnished with the bills.

f) Claims in respect of railway freight, insurance charges, etc. are duly supported by cash receipts.

g) The prices claimed in respect of contracts are in conformity to prevailing in the market.

h) The actual dates of dispatch/delivery of stores conform to those stipulated in the contracts/agreements in cases.

i) Payments of taxes is as applicable on date of supply.

j) Discrepancies or deficiencies, if any, have been duly taken into account before releasing final payments for supplies.

k) The stores have been delivered within the stipulated period and belated deliveries or slippages, if any, have been regularized by the competent authority.
Local audit of contracts, bills for purchases, etc.
The following are the main types of cases that may be examined in local audit:

i. Acceptances of tenders, including Rate/Running Contracts and Supply Orders

ii. Amendments to Acceptances of Tenders

iii. Disposal contracts

iv. Arbitration cases
i. Demands received from other indenting officers at the relevant time were consolidated and bulked as far as possible to secure the advantage of lower prices for bulk supplies and, if so, whether the aggregate of the quantities ordered for the individual indentors in the contracts entered into for the purpose.

ii. Availability of sanction of the competent authority for effecting purchases on the basis of a single tender or negotiations and of recorded reasons for resorting to this method of purchase.

iii. Opening of all tenders on the due date and their authentication by the designated officer numbered and initiated with date by the officer opening them.

iv. Availability on record of the comparative statement and whether it was verified with reference to the original tenders.
v. Whether any tender received belatedly after the stipulated date had been included in the comparative statement and considered, and whether orders of the competent authority were obtained for doing so.

vi. Whether the lowest offer was accepted in each case. In case this was not done, whether adequate justification adequate reasons had been provided in writing for rejecting the lowest offer should be examined; the difference between the lowest offer and that accepted should also be quantified.

vii. In cases where more favorable or advantageous offers were rejected on the ground that the firms were untried, it should be examined whether the feasibility of placing a trial order on the firms was considered with a view to achieving economies and appropriate action taken.

viii. Whether the successful tenderer had indirectly derived any advantage over the other tenderers because of the insertion of certain special conditions; it should be particularly examined whether acceptance of these special conditions resulted in any increase over the prices actually quoted.
ix. Whether the difference between the purchase price finally accepted and that estimated in the tender is within the limits prescribed; if not, it should be examined whether confirmation about the availability of additional funds was obtained.

x. Whether the contract was placed on a registered firm; in case this was not done, whether sanction of the competent authority was obtained and obtaining appropriate security, guarantees, etc. were insisted upon for adequately safeguarding government’s interests.

xi. Office orders and other instructions issued by the Purchase Organisation on incidence of sales tax, excise duty, etc.

xii. Disposal contracts.

xiii. Arbitration cases.
STAGES OF POSSIBLE FRAUD AND CORRUPTION IN CONTRACTS

REQUIREMENTS DEFINING STAGE

i. Inadequate needs analysis
ii. Inadequate information about potential suppliers
iii. Inadequate review of existing and required inventory
iv. Unduly short supply period
v. Needs analysis is product rather than needs oriented
vi. Someone other than the user defines the user requirements
vii. Unwarranted involvement of senior officials
STAGES OF POSSIBLE FRAUD AND CORRUPTION IN CONTRACTS (Contd.)

BIDDING AND SELECTION STAGE

i. The specifications are not clearly defined
ii. A very limited no. of offers are received
iii. Documentation involves unusual involvement of an official
iv. Suspicion about conflict of interest
v. Evidence of early receipt of information by some contractors
vi. Request for proposal is not properly advertised
vii. Unusual handling of the bidding process
viii. Evaluation criteria is not consistent for different bidders
ix. Exception to the tender deadlines
x. Changes in the bids made after their formal receipt.
xi. Lowest responsive bidder is not selected
xii. Contractor submits unrealistic bids indicating collusion or bid rotation
xiii. Unusual withdrawal of bids
xiv. Re-bid results identical to original bids
xv. Successful contractors use competitors as sub-contractors
xvi. Justification for single source procurement is inadequate
STAGES OF POSSIBLE FRAUD AND CORRUPTION IN CONTRACTS (Contd.)

CONTRACT PERFORMANCE & EVALUATION STAGE

i. Changes in a contract result in the large increase in the cost of goods and services
ii. Changes made without adequate explanation
iii. Unwarranted contract extension
iv. Complaints about the quality of goods and services received
v. Inadequate inspection and quality assurance of goods and services received
vi. Evidence of overcharging and duplicate billings
vii. Dubious invoices
viii. Insufficient pre-audit of contractor payments
ix. Contracts repeatedly awarded to one contractor
x. Unduly high labor payments
ILLUSTRATIVE CASES ON CONTRACT AUDIT

i. The Company incurred an extra expenditure of Rs.4.91 crore due to extension of existing contract instead of inviting fresh tenders and allowing higher diesel cost component.

ii. Department's failure to monitor and to take prompt action for obtaining benefit of ED exemption resulted in loss of Rs 9.11 crores to Government.

iii. Avoidable payment of escalation charges due to delay in acceptance of tenders

iv. Abnormal delay in sanction of tender by the State Government resulted in avoidable payment of escalation charges of Rs 1.12 crores to the contractor

v. Incorrect entries of receipt/ utilisation of Bitumen in Consumption Statement led to acceptance of substandard road works of `0.65 crores and loss to Government.
THANK YOU
Audit of Frauds

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FRAUDS DEFINED

• Intentional misrepresentation of financial information
• By employees or by management or by third party
• It involves deception
• Obtaining of financial advantage
Fraud may involve

- Manipulation, falsification or alteration of records or documents
- Misappropriation or misapplication of assets
- Suppression or omission of the effects of the effects of transaction from records or documents
- Recording of transaction without substances
- Misapplication of accounting policies
FACTORS INFLUENCING FRAUDS

➢ Motivational Factors
  – Economic
  – Greed
  – Prestige or recognition
  – Moral Superiority

➢ Organizational
  – Weak management—insecure, insensitive, too strict, lack of judgment, unqualified employees etc
  – Inadequate internal audit, excessive regulations, red-tapism
FACTORS INFLUENCING FRAUDS (cont.)

- Organizational (cont.)
  - Inadequate accountability,
  - Lack of segregation of duties
  - Previous history of frauds in organization
  - Cognitional atmosphere
  - Low awareness of regulator requirements
  - Lack of transparency in system
TYPES OF FRAUDS

- Bribery to influence a person in performance of duties
- False statements and false claims
- Embezzlement
- Conflict of interest
- Payment on false invoices of non-existent companies
- Purchase for personal use
- Split purchases
TYPES OF FRAUDS (cont.)

- Advance Payments on false information
- Over or under invoicing
- Undue use of authority for unlawful pecuniary gain
- Nepotism or favoritism
- Direct/indirect support in evasion of taxes or duty
- Unfair recruitment
- Collusive bidding, Price Fixation or Bid rigging
HIGH RISK AREAS OF FRAUD

Auditor should identify high risk areas for audit which includes;

a) Contracts of service/procurement
b) Inventory management
c) sanctions/clearances
d) Program management
e) Revenue management
f) Cash management
g) General expenditure
AUDIT EVIDENCES

Sources of evidences;
(a) Documents from Auditee
(b) Report of Internal Auditor
(c) Interviews
(d) Inspections/Observations
(e) Questionnaires
(f) Confirmation with other related parities
(g) Results of analytical review
(h) Expert opinion
THANK you