

[CO-OPERATIVE AUDIT MANUAL CHAPTER I

I-1 INTRODUCTORY

1. Background and objectives. -Maharashtra has always been in the forefront in the field of co-operation. Be it simple agricultural credit societies, urban banks, housing or large industrial undertakings like sugar factories or spinning mills, Maharashtra has always led the way. The first co-operative society in the country was started in a small village in the erstwhile Mumbai state nearly century ago. From then onward, it has been a success story and the time has now come when co-operators have establishing their own fertilizer complex, Oil Complex and dairy complex.

2. Historical retrospect. - Audit of co-operative societies, traditionally has been audit by the officers of the co-operative Department working under the control of the Registrar on whom is cast the statutory responsibility for the annual audit of all co-operative societies. It is perhaps due to the fact when the select committee appointed to draft the first Co-operative Societies Act, considered the question, it had only two alternatives either to provide for audit by Government officials or leave the societies to themselves to get their accounts audited by unqualified auditors, as even the Companies Act then in force did not prescribe any qualifications for the auditors. In fact, there was no professional body of auditors then in existence. Sir Fredric Nicholson, whose monumental report paved the way for enactment of a special statute for registration of co-operative societies, was of the firm opinion that the ***“law should not only provide for establishment of an audit, but for efficiency of such audit.”*** The Select Committee reporting as early as the beginning of last century, realizing that the co-operatives would require a number of privileges and concessions, stressed the need **for a compulsory annual Government audit** *“for all registered societies. Such an audit is necessary to prevent fraud on unintelligent ryots, which, apart from the immediate hardship, which it would cause, could not fail to have a most fatal effect in discrediting the system of co-operatives. We, therefore, consider that an annual Government audit should be obligatory in the case of all registered co-operative associations and that such audit should include (a) an examination of all books, registers and accounts with particular attention to overdue debts and (b) a valuation of the assets and liabilities of the associations”*. The consideration behind this view is to safe guard of interest of Government investments in these societies, and unavailability of qualified accountants, as well as the members of the societies are not aware of financial transactions and business practices.

3. Statutory provisions for compulsory official audit. -Presenting the new legislation (the Co-operative Societies Bill) Sir D. Ibbetson, in his admirable memorandum, had observed that since co-operative societies were to enjoy exemption from the general Law and facilities of a special nature, it was necessary **“to take such precautions as may be needed in order to prevent speculators and capitalists from availing themselves, under colorable pretexts, of privileges which were not intended for them”**. He added, **“It has been considered advisable that an official audit should be compulsory in all cases** and this has been provided in Section 21. There is no doubt that such an audit will give the outside public and the members, more confidence in management, and even when no financial assistance may be received from Government, the societies will obtain valuable privileges under the Act and it is reasonable that they should at the same time be

obliged to submit their accounts too some check, which must in this country take the form of **an official audit**".

4. Developments during 1974-2012. - In view of the above considerations, the provisions in the old Act passed in 1904, regarding the system of audit of co-operative societies through the agency of Government officers responsible to the Registrar, found a place also in the 1912 Act and subsequent State Legislations. So far as Maharashtra is concerned, the same provisions with further amplifications were contained in the 1925 Act, which brought into operation a system of State controlled and State managed audit, continue to exist even to-day, in spite of later developments in the concept and the technique of audit and the setting up of a statutory body for regulating the profession of audit. A host of committees and commissions, both at the State and all-India level as well as a number of conferences of co-operators have considered the question of the agency for audit and have largely come to the conclusion that audit of co-operative societies should continue to be State controlled and that the Registrar of co-operative Societies, should continue to shoulder the responsibility for arranging for the annual audit of co-operative societies, burdened as he is with numerous other important duties and functions. *This is because, every body is agreed that audit should not only be efficiently conducted, but should also be independent of the co-operative societies to be audited.*

The time has changed, the burden on the Registrar has taken a huge mounting position as the number of societies has been increased tremendously, and has crossed the number of lacs of societies. The Registrar is unable to audit the all societies, within the prescribed time limit, that the every society must be audited once in the year. The changes have taken place in 1986 by amending the Cooperative Societies Act. The Section 81 has been amended as 81 (1) (b) introducing the concept that, the societies should got their accounts audited themselves, as the qualified auditors are available, for those societies to which no Government Assistance or any finance from Financial Institutes is not available. These societies have to get their accounts audited once in a year from the panel of auditors maintained by the Registrar, or by a Chartered accountant holding a certificate in cooperative audit issued by the institute of Chartered Accountants of India. However, the right of auditing these societies has been reserved by the Registrar in case he ascertains the reasons for the same, and can assign the audit to the Government Auditors, by recording in writing the reasons for such audit.

The task of audit of Government Auditors has been limited by the Section 81(1) (A), to the audit of societies which have been given financial assistance including guarantee by the State Government, or Government undertakings, from time to time, and the accounts of the Apex Societies, State, and District Level Federal Societies, District Central Cooperative Banks, Cooperative Sugar Factories, Urban Cooperative Banks, Cooperative Spinning Mills, District and Taluka Cooperative Sale and Purchase organizations, and any such Society or class of Societies which the State Government may, from time to time, by notification specify. Then after, the Government had specified the Urban Cooperative Credit Societies, Salary Earner's Cooperative Societies, and Primary Agriculture Cooperative Credit Societies by a Notification No. CSL. 1096/ CR-146/ 15-C, dated 11.11.1996.

4.a) 97th Constitution amendment :-The Government of India has amended the Constitution of India, in 2009 by adding Article 243Z, under which the State Government is required to amend their cooperative societies Act, as provided in the Constitution. The provision in Constitution allows the Societies to get their accounts audited once in a year from the panel of Auditors prepared by the Registrar and approved by State Government.

Accordingly the Section 81 of the Maharashtra Cooperative Societies Act is entirely amended, authorising the societies to get their accounts audited from the Panel of auditor, approved by the State Government and prepared by the Registrar or an authority authorized by State Government in this behalf, possessing required qualifications and experience as may be prescribed.

4b) This has given the societies to choose auditor from the panel approved by the State Government. The professional auditor includes the Chartered Accounts and their firms, Certified auditors and Government auditors as explained under the section 81 of the Act.

I-2 AUDITING

1. Financial accounting and auditing. -Accounting is the art of recording and classifying business transactions in terms of money. In other words, it is the job of the accountant to record the multitude of business transactions from original documents like vouchers, statements, receipts, etc., and also their accumulation in books of original entry like the cashbook and the journal and also the ledgers. Auditing is the verification of the accuracy, genuineness or authenticity and correctness of the accounting records and statements and reporting on these to the proprietors. Auditing may be done by internal auditors or by statutory auditors or by both. The internal auditors maintain a continuous check while the outside statutory auditor provides periodical review as an outsider.

Financial accounting and auditing is primarily concerned with the determination of income earned and ascertaining financial position as on a particular date. Financial audit is concerned with the critical review and interpretation of financial statements, namely, the profit and loss account and the balance sheet, together with the supporting schedules furnishing particulars of the various assets and liabilities. The aim of financial auditing is to safeguard the interests of the proprietors and the creditors of the business.

2. Auditing as a tool of management. -It has now been realized that accounting and auditing, which is the review aspect of accounting, can also be regarded as a method of management or as a tool for improving the efficiency or effectiveness of management. Although managerial or administrative accounting and auditing deals with the same data collected from the financial accounts and records, they are not confined to information of a business transaction. Its object is to bring about scientific managerial planning and ensure sound managerial decisions. This it does by furnishing complete historical data and pointing out consequences of alternative decisions and helps to prevent errors of judgment. It makes possible comparison of performance with anticipated results.

3. Financial auditing is a review of the results of past actions. Administrative auditing is a critical review of the soundness and propriety of the decisions taken in the past and helps management to correct mistakes and improve methods.

Societies, which have undertaken manufacturing or processing activities, are required to maintain cost accounts in order to ascertain the costs of their products. Cost accounts to be reliable, must be reconciled with financial accounts. Although cost accounts are primarily meant for furnishing information to the management about the costs under different heads incurred for manufacturing or processing, review or auditing of cost accounts forms part of regular auditing and auditors in charge of societies, which have undertaken manufacturing and processing activities, must be conversant with cost accounts so as to be able to intelligently criticize them.

4. Cost Auditing - Section 81 (2A) and (2B) was introduced in 1986 regarding Cost Audit for the societies, or class of societies to whom the cost accounts are to be maintained and cost audit from the member of Institute of Cost and works Accountants of India should be done. In case the Government has opinion that it is necessary in the public interest and in relation to any society, or class of societies, for ensuring management thereof in accordance with sound business principles or prudent commercial practices, the cost audit may be ordered. However, the cost audit rules are not framed till this date or no such order has been issued by the Government. The Central Government has made compulsory for the cooperative Sugar Factories to maintain Cost Accounts and get done the Cost Audit from the Cost Accountant.

In 2013, the above cost audit provisions are amended with respect to “society’s interest” instead of “public interest” and the responsibility of cost audit is cast on “the Society” instead of “the Registrar”.

5. Operational efficiency and Ratio Analysis :- Operational efficiency is measured by working out of number of ratios connected with the various aspects of financial management. In order to fulfill adequately his role as **friend, philosopher and guide** of the societies, the auditor should be able to report to the management ***not only what has happened but how it has happened and also to predetermine and point out what would happen,*** so as to assist the management in arriving at sound decisions. Ratio analysis is a vast subject and involves a close study of not only methods of financial accounting and cost accounting, but also knowledge of the technical aspects of the business transactions.

It has, however, to be observed that the audit of Co-operative Societies as at present conducted, though wide in scope in fact wider than the field covered by auditor of joint stock companies is still basically financial in nature and very few auditors attempt to conduct what may be termed an efficiency audit or methods audit. The number is increasing as the auditors are being trained for efficiency and methods of audit. Since most of the Societies, which have undertaken manufacturing and processing activities, do not maintain some sort of cost accounts which can be reconciled with the financial accounts so that their accuracy can be tested, auditors of large manufacturing undertaking like co-operative sugar factories or spinning mills, will have themselves to carry out what can be termed as “efficiency audit”.

6. Various types of audit. - The concept of audit has undergone many changes during the past few years and very few auditors can now be content with merely reporting on the balance sheet and the profit and loss account. The diversity of activities undertaken by Co-operative societies and the complexity of their transactions, necessitate that the auditor should not only have a sound theoretical ground in the writing up of accounts and their scrutiny in audit, but also call for a high degree of skill and discernment so as to be able to comment on the financial as well as technical aspects of the transactions. The various aspects of audit work enumerated in the foregoing paragraphs provide a glimpse of what is expected of the future auditor. Various types of audits are introduced in the past two decades, such as Social Audit, Energy Audit, Technical Audit, Policies, Procedures and systems audit, Information System audit, M-VAT Audit, Tax Audits, etc. these are also to be get acquainted by the auditors.

7. Recent changes in Cooperative Audit :- After 97th constitutional amendment, the Maharashtra Cooperative Societies Act is amended to give effect to the constitutional amendment. There are many changes in the Act to provide autonomy to the societies, member economic participation, principle of democratic control, appointment of

professional independent auditor and to remove the control of Registrar and Government. The Societies has been empowered to appoint their auditor from the panel of auditors prepared by the Registrar and approved by the State Government. The auditor has to carry out the audit as provided in Section 81, Rule 69 and Auditing standards as notified by State Government. The audit fees shall be as prescribed and notified by the State Government for such audit.

I-3 MANUAL

1. Need for the updating Manual. - Since 1962, the audit wing of the Department was separated from its administrative wing primarily with a view to attract better talent and to ensure better quality of audit from those who had opted for the audit line. During these years, there has not only been a steep rise in the number of Co-operative Societies of different types, but there has also been a well marked diversification in their activities and a vast expansion of their business operations. It has always been of policy of the State Government of encourage Co-operatives to take up new and varied activities. Besides granting them a number of privileges and tax concessions, the State has also been granting them liberal financial assistance not only by granting them loans and subsidies, but also by contributing towards their share capital. The state has become a business partner sharing their profits as well as their losses. Auditors have thus an added responsibility of safeguarding the interest of the State by ensuring that the funds provided by it, are not misappropriated or misutilised. It is, therefore, necessary that audit should be not only strict, but also efficient and for this purpose, the auditors have to equip themselves with necessary knowledge and apply due skill and diligence in the performance of their duties.

The techniques of accounting and auditing have not remained during the period, but have undergone numerous changes and have developed significantly over the years. Co-operatives are rather slow in adopting new and improved system of accounting and look to their auditors to guide and assist them to maintain systematic accounts. This manual attempts to set out in detail the practices and procedures which are appropriate in light of present day circumstances having due regard to the handicaps suffered by the Co-operatives arising out of their small size limited resources and democratic set up.

During the years following independence, there has been a vast increase in the number and types of Co-operative Societies and a considerable expansion of their transactions. Whereas the auditor of the good old days had to audit accounts of simple rural and a few urban Societies, with small turnovers, the auditor of today has to audit complicated transactions of a variety of Societies, like Sugar Factories, Spinning Mills, Co-operative Banks, Industrial Estates. Housing Colonies, etc. Although he might have adequate theoretical grounding and basic skill, he would still require guidance on a number of important matters. After the insertion of Section 81 (1)(b) in the year 1986, the statutory audit is carried out by the certified auditors and chartered accountants. The auditors are appointed by the societies as per amendment made in 2013. The need for a sort of handbook containing instructions and guideline on all-important aspects of his work is being keenly felt. This manual is meant to give him practical guidance in the day-to-day performance of his duties. No attempt is made to impart any theoretical knowledge regarding auditing to him as there are many books on audit which he can refer for his guidance. However the auditors need to avail additional information and reference material from various sources from time to time as may be required.

The first audit manual was prepared in 1974 for the guidance of the auditors. Since then, several changes have taken place, in Accounting and Auditing. The *conventions of accounting became the accounting standards*. The standards for Auditing are also formed

at National and International level by concerned accounting bodies. The recording of accounts has been computerized, which need different methods of audit. The Cooperative Societies have also changed their accounting policies, and accounting procedures, and have computerized their accounts and management information systems, which requires to introduce the guidance to the auditors. The contemporary knowledge of auditing is required to be introduced.

In view of the 97th constitutional amendment, the Maharashtra Co-operative Societies Act is amended Section 81 (5 B), to give effect for criminal and civil action to be initiated by the auditors. There are other amendments in the Act and Rules which also requires the auditors to acquaint himself. The societies have to provide accounting policies adopted for preparation of their accounts to the auditors. Therefore, it has been felt necessary to update and revise the audit manual.

2. Objectives of the Manual. -The objectives of this Manual are, therefore, as under: -

- (i) To serve as a **ready handbook of practical guidance** to auditors of Co-operative Societies.
- (ii) To serve as a **codified handbook of departmental instructions** and **Government instructions** relating to Co-operative accounts and audit.
- (iii) To serve as a **ready reference book** to auditors and those who are responsible for maintenance of accounts and to **decide the scope of audit of these societies.**
- (iv) Above all, **to help to improve the quality of audit work and maintain a high standard of audit.**

3. Scope of the Manual. -In this manual, an attempt has been made to explain the general principals of audit, the various techniques adopted by the auditors and the processes and procedures to be carried out during the course of audit in general and **audit of Co-operative Societies in particular** with special reference to the circular instructions issued by the Registrar from time to time. The special features of the audit of different types of societies are also dealt with. The criteria laid down by the Registrar for awarding audit classification, the procedure for follow-up of audit, the basis and scale for assessment of audit fees and procedure for recovery of audit fees is explained in detail. Besides explaining the general procedure of work, such as examination of cash methods to be adopted for reviewing operational efficiency and the tests to be applied for determining the financial soundness, operational efficiency and Co-operative character of different types of societies is also explained. Instructions for the drafting of audit reports and special reports, filing in the schedules and other accompaniments to the audit memo are given, which, it is hoped, will ensure uniformity in the drafting of audit reports. Standard audit programs and instructions regarding audit of different types of Societies are explained. Important legal decisions affecting auditors are also given. The modern method of recording accounts on the computers has been explained with its verification systems.

It has, however, to be emphasized that having due regard to the diversity of the activities undertaken by the Co-operatives and the complexity and variety of their operations, it is not possible in a manual of this size and nature to deal exhaustively with all the problems to be met with by the auditors. It is also not claimed to be a complete statement on the work involved. However, an attempt has been made to deal exhaustively not only with routine matters, but also with most of the important aspects of audit work with which many of the members of the audit staff may not be familiar. The auditors will find in this manual solutions to most of their problems, which, they face during the course of discharge of their duties. In brief, it is hoped that this manual will provide necessary guidance to the auditors and enable them to equip themselves with the requisite

professional skill and knowledge for the performance of their duties. Considering the evolution in the field of accounting and auditing, the techniques of auditing through computers and auditing with computers is given in this manual for ready references.

I-4 AUDIT: MEANING AND SCOPE

1. Meaning of Audit. -The origin of audit can be traced to the need to ensure that a person who came into possession of money or property belonging to another has properly accounted for by him. Thus, in the beginning, it was merely a scrutiny of cash transactions and the auditor merely “heard” or was satisfied with oral explanations to “pass” the transactions as genuine and correct. The Industrial Revolution in England gave a Philip to the organization of large undertakings for carrying on large-scale industrial and commercial operations. As the capital required for these ventures was beyond the ability of any one individual or even a partnership, it has to be collected from a large body of persons who formed a joint stock company and became their-share holders. The management of these companies, however, had to be entrusted to a small body of persons elected by the general body of the share-holders, who came to be taken as Directors of the company. Proprietorship and actual management having thus been separated, the shareholders needed some arrangement under which they would be assured that their interest had been properly safeguarded. In order to see that the board of directors has conducted the operations of the company in the best interests of the shareholders and also to assure them about the safety of their investments, accounts maintained by the directors had to be subjected to an **independent** verification by a person appointed by the shareholders. The auditor thus serves as a **link of trust** between the shareholders who are the proprietors of the business and the board of directors who manage it, which is absolutely necessary in any system of corporate finance.

2. Definition of Audit. -The concept of audit, however, has undergone considerable change during the course of time and audit has now come to mean **“such a close and careful examination of the account books, documents and other records of a business or other organization as shall enable the auditor to satisfy himself whether or not the balance sheet and the profit and loss account have been properly drawn up, so as to exhibit a true and fair view of its financial operations.”** An audit may, therefore, be described as a **“critical examination by an auditor, of the documentary and other evidence from which the profit and loss and the balance sheet of an organization have been drawn up, in order to enable him to report that they present a true and fair view of the summarized transactions for the period under review and of the financial position of the organization as at the end of the period.”** From the above definitions, it will appear that the auditor examines the evidence, mainly consisting of account books, registers, vouchers, statements, minutes, etc. and some times, he has to go even behind the books of account and inspect the actual assets themselves and call for confirmations from clients. It has, however, to be remembered that the examination of the accounts must be such as to enable the auditor to report thereon.

The Institute of Chartered Accounts of India in its publication of the Statement of Standard Auditing Practices :- Basic principles Governing an Audit (SAP 1) describes audit as **“ the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such examination is conducted with a view to expressing an opinion thereon.**

It means that, the auditor has to express an opinion on the financial statements. Financial statements generally mean the statement of affairs as on particular date (balance

sheet) and statement of operations (profit and loss accounts / Income and expenditure statements) for a financial year of any entity. The opinion on financial information is expressed after careful examination of books of account, documents, records and vouchers. That is, before an opinion is pronounced, evidence is gathered and tested to form the basis for framing an opinion.

The Institute of Chartered Accountants Of India has issued a comprehensive definition describing modern auditing. As “*a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report*”. Another concept of auditing is “*Auditing is the process by which a competent, independent person accumulates and evaluates evidence about quantifiable information related to a specific economic entity for the purpose of determining and reporting on the degree of correspondence between the quantifiable information and established criteria*”.

The information under audit need not necessarily be accounting information. However, information must be in a verifiable form. There should be standards or criteria for evaluation of the information. **And the auditor should not only be a competent person but he should also have an independent mental attitude.**

It would thus be seen that certification of the balance sheet and the profit and loss account has come to be looked upon as the main function of audit. In the minds of the general public, however, prevention and detection of frauds and embezzlements constitutes such an important function of the auditor as to overshadow his other functions. This is quite natural, since auditing involves a complete or at least an exhaustive checking of the transactions and the manner in which they have been recorded.

3. Purpose of Audit : - Detection of frauds and errors. -Examinations of accounts by an independent outside agency no doubt acts as a deterrent and moral check and also facilitates early detection of frauds and errors. Since the auditor has to carry out an intelligent and exhaustive scrutiny of the accounts before he can report on them, there can be no question about the auditor’s responsibility for detection of frauds except those which have been deliberately perpetrated by those who are at the helm of affairs or those committed by trusted employees which even with the application of due skill and diligence, he could not be expected to detect.

The sound and more important function of auditor are to **detect error**. As regards detection of errors, it is needless to point out that both from the point of view of the management and the employees themselves, this is a great advantage. The auditor during the course of his examination of the accounts and inspection of documents would come across numerous errors and irregularities, which might be *bona fide, mistake* resulting from carelessness or ignorance on the part of the accountant. Such errors and irregularities, which are common in most co-operative societies and can be considered as minor or of no importance should be got rectified and corrected as and when they are noticed. However, it has also to be born in mind they might also have been committed deliberately in order to conceal frauds and misappropriations, perpetrated by the management or the employees and would call for a more detailed probe. Although, most of the errors that we come across in well managed co-operative societies are likely to be mere clerical errors which can be and should be got rectified on the spot, there are also likely to be errors of principal which will have to be explained to the management. *The mistakes which cannot be rectified on the spot shall be, issued in writing to the management for rectification and*

to submit rectification report. Care should be taken that the errors which are of the serious nature including fraud, embezzlement, misappropriation, misapplication and of serious financial irregularities should be reported in audit report.

The arithmetical accuracy of the accounts can be tested by drawing up the Receipts and Payments Statements of the trial Balance. However, mistakes in posting of personal ledgers can only be detected when the personal ledger balances do not agree with the balance in the totals or the controlling accounts. In computerized accounting methods this work of the auditor is no more required. However, he has to verify the correctness and efficiency of the system and procedure followed for data processing. Besides clerical errors discussed above there would also be other types of errors. These are compensating errors, which compensate or cancel each other. There are also errors of principle, many times knowingly committed by those in charge of management. These are difficult to detect and only a very careful examination would reveal such errors. Errors of principle arise when a transaction has been entered in a fundamentally incorrect manner, such as entering revenue expenditure as capital expenditure, or when the normally accepted principles have not been followed such as wrong valuation put on an asset, failure to bring into accounts known liability or provide adequate depreciation on wasting assets. Auditors should take utmost care while passing the entries for compensating errors, principle errors and rectifying errors as these may lead to frauds and misappropriations subsequently.

4. Advantages of Audit. -The main advantage to be derived from a system of audit is that the proprietors of the business, who, in case of a co-operative society, are its members, the depositors and financing agency of the society and the Government which also has a considerable financial stake in the affairs of co-operatives, are assured that the accounts are properly maintained and they are not being defrauded by dishonest office-bearers or employees. They will have present before them statements showing the true position of the affairs of the society and its earnings. Audited accounts are also relied upon for purpose of assessment of income tax and sales tax and also for disbursement of Government loans and subsidies. The directors or the committee members are also assured that there would be no undue criticism against them. The auditor's report would thus protect the management from unwarranted criticism and at the same time assure the shareholders and the creditors about the safety of their investment.

I-5 DUTIES AND RESPONSIBILITIES OF AUDITORS

1. Duties of the co-operative Auditor. : - We have seen in a previous paragraph that audit in its generic sense is a critical and intelligent examination of the books of accounts of a business with the vouchers and other documents in order to be satisfied that the operational results for a particular period and the exact financial position of the business as at the close of the period as reflected in the profit and loss account and the balance sheet are correct. The auditor has also to see that, these statements have been prepared in accordance with the generally accepted accounting principles and the accounts give all the information required by law. The duties of the co-operative auditor are, however, much more comprehensive. It has been laid down in section 81(2) of the Maharashtra Co-operative Societies Act, 1960; the audit shall include an examination of the overdue debts, if any, the verification of cash and securities and valuation of the assets and liabilities of the society. Examination of overdue debts has been made a special responsibility of the auditor, in view of the far reaching consequences, such overdue debts have on the working of co-operatives, in particular, co-operative credit institutions, which are in large numbers. In any system of credit, existence of overdue debts is a symptom of weakness and it is

necessary, therefore, that the position of co-operative societies in regard to their overdues should be under constant watch with a view to reducing their proportion and arrest their future growth.

As regards the verification and valuation of assets and liabilities, the responsibility of the auditor of a co-operative society is the same as those of the auditor of a joint stock company. However, having due regard to the vast financial stake of the State in the affairs of many of the societies, the special position allotted to co-operative societies in the general scheme of development particularly in regard to the improvement of the lot of the weaker sections of the society and the numerous concessions and privileges enjoyed by them, audit of co-operative societies has to be made more strict. Close and careful inquiries will have to be made to ensure that the assets have been properly valued and that all known liabilities have been brought into account.

Besides this, the Section 81(2) lays down the duties of the auditor which is as under. The audit shall be carried out as per auditing standards notified by the State Government from time to time and shall also include examination or verification of following items, namely

- (i) Overdues of debts, if any.
- (ii) Cash balance and securities and a valuation of the assets and liabilities of the society.
- (iii) Whether loan and advances and debts made by the society on the basis of security have been properly secured and the terms on which such loans and advances are made or debts are incurred are not prejudicial to the interest of the society and its members.
- (iv) Whether transactions of the society which are represented merely by book entries are not prejudicial to the interest of the society.
- (v) Whether loans and advances made by the society have been shown as deposits
- (vi) Whether personal expenses have been charged to revenue account
- (vii) Whether the society has incurred any expenditure in furtherance of its objects
- (viii) Whether the society has properly utilized the financial assistance granted by Government or Government undertakings or financial institutions, for the purpose for which such assistance was granted
- (ix) Whether the society is properly carrying-out its objects and obligations towards members.

2. Responsibilities of the Auditor. :- It will thus be seen that the auditor of a co-operative society has not merely to check and certify the correctness of the balance sheet and the profit and loss account, but has to examine many other things besides. Co-operative audit embraces all the circumstances, which determine the general position of the society and its achievements. Thus, for example, in case of co-operative credit societies and banks, the auditor has to see that the loans are given for proper objects and periods and on adequate security as per latest concepts of co-operative finance. He has also to examine the repayments in order to ascertain book adjustments, improper renewals, etc. He has further to note whether timely action has been taken for recovery of dues and overdues. In case of agricultural marketing societies, he has to see that the society has undertaken pooling, grading and joint sale of members' produce and does not act merely as a commission agents. In case of farming societies, he has to see that the lands been pooled and cultivated jointly. In case of other societies, he has to see that the business is conducted on proper lines in accordance with co-operative principles and that all canons of business and financial propriety are being duly observed. In short, the auditor is required to satisfy himself that the society has been working on sound lines and that the members take sufficient interest in the affairs of the society and that the committee members

understand duties and responsibilities and attend to them with due regard to co-operative principles.

It has always to be borne in mind that the auditor **of a co-operative society has not merely to check the accounts and point out faults, but he has to function as its friend, philosopher and guide.** The members of the committee look to him for guidance in all important matters. He has to act as the financial adviser of the societies and suggest ways for improving their affairs and increasing their usefulness to their members.

As per amendments in 2013 in MCS Act, auditor has to submit special report to the Registrar in respect to irregularities in financial transactions and losses to the societies. He has also to submit specific report regarding criminal action to be taken against the culprits and lodging the first information report (**FIR**) with the concerned authorities after obtaining permission from the registrar.

3. Auditor's powers to go beyond the books of accounts. : - The powers given to the auditor under Section 81(3) to summon any person who is or has been an officer or employee of the society and any member or past member of the society and call for information and require production of books or documents in their possession, gives the auditor power to go beyond the books of accounts and records of the society and supplement the information gathered from the books of accounts by making personal enquiries with the members and others and satisfy himself about the genuineness and correctness of the transactions recorded in the books.

If any deficiency or loss has occurred as a result of negligence, misfeasance or misconduct on the part of the committee or any officer or member of the society, the Registrar, acting on the report of the auditor, has power to assess damages caused to the society for the loss suffered by the society. For this purpose, auditor has to submit special report as provided in sub section 5B of the section 81. The auditor has thus not only to play the critical role of a watch dog to watch the interests of the members and creditors of the society, but the blood hound spirit into him has also to be brought into play to ensure that unsocial elements, which control the affairs of the society, do not avail of the agency of the society or its funds for their personal benefits.

Under provisions of Rule 49 of the Maharashtra Co-operative Societies Rules, 1961, no bad debts can be written off unless they are certified as irrecoverable by the auditor.

4. Auditor to assist and advice management of societies. - It will thus be seen that in many respects, the work of the auditor of a co-operative society exceeds the boundaries of what is generally considered as audit in its general sense and **includes within its purview not only the critical and verification aspect, but also an appraisal from the viewpoint of operational efficiency, financial soundness and co-operative vitality.** It also includes tendering advice and rendering assistance on all matters connected with the working of the society. The auditor has, therefore, to cultivate a **keen sense of observances** and he should try to make his audit as effective and useful as possible, by observing and examining every thing that he comes across during the course of performance of his duties. He should at all times think of the possibilities for improvement and tender suitable advice to the committee.

The auditor should also remember that he has to deal not only with the books of accounts and records, but has also to supplement the information available from the books, by calling for clarification and explanation. He has to put intelligent questions so as to elicit the required information, without arousing any suspicious in the minds of those whom he questions. During the course of performance of his duties as an auditor, he has to

deal with all sorts of people from junior ledger clerks to highly paid executives and directors who are honorary workers and are particularly susceptible to any sort of adverse comment and are, therefore, required to be handled with great care and utmost courtesy.

I-6 COOPERATIVE SOCIETIES AUDIT: FEATURES AND DIFFERENCES

1. Difference between the audit of co-operative societies and of joint stock companies
Auditor's responsibility to the Registrar and Society - We have so far seen that the main object audit of a co-operative society is to safeguard the interests of the members and the creditors. The management is also required to be made aware of the errors and irregularities committed by them and the paid staff and advised to rectify them. However, it has to be remembered that audit of all co-operative Societies once at least every year is the statutory responsibility of the **Registrar and Society** and hence the primary responsibility of the auditor is to the **Registrar and Society** who has appointed and authorized to carry out the audit. As early as 1915, the Maclegan Committee appointed by the Government of India to review the progress of the Co-operative movement in the country had reported that. ***"It is through audit alone that an effective control can be exercised over the movement and its was clear that it was never intended that the Registrar's activities outside audit should be confined to inspection or enquires. The auditing staff from whatever source they may be paid, are in our opinion, responsible to the Registrar and must be mainly controlled by him. Their reports are primarily intended for his information."***

2. Other distinguishing features: - A joint stock company is undoubtedly an association of capitalists, who have come together only to earn profits. The important result of audit they normally expect is to disclose the amount of profit available for being distributed as dividend. In case of Co-operative Societies, however, the Registrar to whom the auditor has to submit his report, is keen to know how far the society has been successful in achieving the objects for which it was established, the extent to which the members have benefited and whether the working of the society is being conducted according to Co-operative principles, as well as its earning capacity.

The scope of Co-operative audit as we have seen, is much more wider than that of a joint stock company. Whereas the auditor of a joint stock company has merely to report on the correctness of the profit and loss account and the balance sheet, the auditor of a Co-operative Society has to see many other things besides.

In a joint stock company, the directors are shrewd businessmen whereas the members of the committee of Co-operative Society are mostly laymen and do not possess any business acumen. Audit of a co-operative society has, therefore, to be not merely critical, but corrective and educative.

The auditor of a joint stock company is not concerned as to how the business is managed. It is not his duty to advise the management. The auditor of a Co-operative Society, however, is its friend, philosopher and guide. The members of the committee expect him to guide and assist them in the management of the society.

Whereas the auditor of a joint stock company has merely to report whether the profit and loss account and the balance sheet has been drawn up in accordance with the provisions of the Companies Act, the auditor of a Co-operative Society is required to point out infringement of the provisions of the Act, Rules and the byelaws of the society. Where these infringements have financial implications, the auditor of a Co-operative Society has to point out them specifically so that the Register may institute proceedings for assessing damages, etc.

It will also have to be noted that whereas a company may include in its profits all accrued interest and other unrealized income, Co-operative societies cannot take into account overdue interest. All interest accrued or accruing in accounts in which the principal is overdue has to be excluded from profits.

It will thus be seen the Co-operative audit has to be more searching and comprehensive so as to gauge and assess the extent to which members and the general public have benefited by the society and the approach of the auditor has to be different from that of an auditor of a joint stock company.

3. *Special features of Co-operative Audit:* - We have already seen that the duties of the auditor of a Co-operative Society are much more extensive than those of the auditor of a joint stock company, who has merely to certify the correctness of the balance sheet and the profit and loss account. It has further been laid down in sub-section (2) of section 81 that audit shall include an examination of the overdue debts, if any, the verifications of the cash balance and securities and a valuation of the assets and liabilities of the society. The auditor of a Co-operative Society has not only to conduct his audit according to the normally accepted principles, but, since his responsibility for the proper conduct of audit, he has to follow the provisions of the act, rules and Byelaws and instructions issued by the Registrar. These features have been elaborated in the following paragraphs.

4. *Examination of overdue debts:* - Examination of overdue debts, as we have seen has been made a special responsibility of the auditor in view of the far-reaching consequences of such overdue debts of the working of credit societies which outnumber the rest. Examination of overdue debts also involves a careful assessment of chances of their recovery and their classification into good, doubtful and bad. The auditor has also to see the due action is taken for recovery of dues and overdues.

5. *Valuation of assets and liabilities.* - The term “valuation” used in this sub-section is a wide term and denotes the proper application of the various test that are generally applied by auditors for the valuation of different types of assets and also includes the verification of such assets. The auditor has also to see that all known liabilities are brought into account and where the amounts are not certain, the estimates made have been reasonable. The auditor has also to see that the provisions made are adequate. The auditor has to also see the standard accounting principles for valuation of assets and liabilities are followed by the society, and variation to them should be recorded in his report.

6. *Adherence to Co-operative principles.* - Co-operation is a method of doing business and in conducting their business operations; Co-operatives are required to observe certain well-defined principles. The amended Act provides society as “ society means a Cooperative society registered, or deemed registered under the Act, which is an autonomous association of persons, united voluntarily to meet their common needs and aspirations through a jointly owned and democratically controlled enterprise and adhering to the cooperative principles and values.’ Whereas a joint stock company is an association of capitalists, a Co-operative Society is an association of individuals who have come together merely not to earn profits on their investments but to secure resources and services required by them. The important result expected in the audit of a joint stock company is the amount of profit available for distribution while the primary concern of the auditor of a Co-operative Society is to ascertain how far the society has achieved the objects for which it has been organized and how far it has succeeded in furthering the moral and material well being of its members.

7. Observance of the provisions of the Act, Rules and Byelaws. -The auditor of a joint stock company does not bother to see whether the administration of the company is conducted on right lines. A Co-operative auditor, however, is not only required to point out all cases of infringement of the provisions of the Act, Rules and the Byelaws of the society, but also of the directives contained and suggestions made in the various Government Notifications and Circulars issued by the Registrar and Government from time to time. Where these infringements have financial implications, he has to include them in a separate schedule with necessary particulars so as to enable the Registrar to initiate action under section 88 of the act. However, where they have no financial implication, he has to submit a special report furnishing particulars and suggesting remedial action by the Department and the federal society of which the society is affiliated.

8. Furtherance of public welfare and safeguarding of public funds. :- We have seen that Co-operative societies have an important role to play in bringing about the desirable change in the moral and material well being of our people. The agency of Co-operative Societies is availed of wherever possible in preference to other forms of business organization and a number of valuable privileges and concessions, both administrative and financial, have been granted to them as the cost of the taxpayer. The auditor during the course of his audit has to see that these privileges and concessions are not misused and that the operations of the society are conducted with due regard to the interests of the common man.

9. Personal verification of members and examination of their pass books:- We have seen that in order to ascertain whether the books of accounts show the correct position of the affairs of the society, the auditor has not only to compare the entries in the books with the receipts, vouchers, statements of accounts and other documents, but has also to make thorough inquiries by calling for explanations and personal verification of the members' accounts. In case of agricultural credit societies and other rural societies, the auditor is required to call for and examine the entries made in the passbooks issued to members and get the outstanding balances confirmed in his presence. *Personal verification of members' accounts is a very good safeguard to prevent manipulation of accounts by dishonest employees and office-bearers of societies and by putting intelligent questions, many cases of frauds and other serious irregularities have come to light which would not otherwise have been possible.*

We have already seen that under provisions of Section 81(3) of the Maharashtra Co-operative Societies Act, the auditor has been given power to summon members and compel them to produce their pass books and statements, receipts and other documents issued to them by the society in the course of their dealings with it. The auditor has thus powers to go behind the books of accounts and these he must avail of in order to ascertain the true position of the society.

10. Assessment of damages. -If any deficiency or loss has occurred which can be attributed to the negligence, want of proper care, misfeasance or misconduct on the part of the committee or any officer or member of the society, the auditor has to submit special report in accordance with the provisions of sub-section 5B of Section 81. The Registrar, acting on the special report of the auditor and after examining into the conduct of the persons concerned, has power under section 88 to assess damages and order the person responsible to pay to the society the amount assessed by him. The auditor has thus not

only to play the critical role of watching the interests of the members and creditors of the society, but also, in view of the numerous opportunities available to unscrupulous office-bearers to commit frauds and misappropriations, the blood hound spirit in him has also to be brought into play, wherever necessary.

11. Certification of Bad debts. : - Rule 49 of the Maharashtra Co-operative Societies Rules lays down that bad debts can be written off only when they are certified as such by the auditor. The procedure laid down in the Rule requires that all bad debts and irrecoverable losses, before they can be written off against the Bad Debts Funds or the Reserve Fund or the Share Capital, should have been certified as bad debts or irrecoverable by the auditor. However, this provision is not applicable to Co-operative Credit Structure Entity (i.e. PACS, DCCB, SCB). Such entity shall write off its bad debts on approval of its General Body in conformity with guidelines of RBI and NABARD.

12. Awarding audit classification to the society. : - After completion of his audit, the auditor is required to award an audit classification to the society, which he has audited. All Co-operative Societies are awarded a classification letter, A, B, C, or D according to certain well-recognized principles as laid down in this manual and as may be specified by Registrar from time to time. The audit class of a society indicates the degrees of success achieved by it, its financial stability and its operational efficiency. A list of societies together with their latest audit classification is published by the Registrar.

12-A . Adherence to Accounting Policies :- Societies have to adopt the accounting policies which must be in consistent with Accounting Standards issued by State Government or The Institute of Chartered Accountants of India (ICAI). The society has to prepare and publish the adopted accounting standards with changes thereon in the notes given with financial statements. The accounting policies adopted by the society which are consistently followed by the society. If changes are made in the accounting policies which has no material effect on financial statements need not be reported by the auditor. However, the changes in the policies which have material effect on the financial statements, need to be reported by the auditor.

I-7 QUALITIES OF AUDITORS

1. Auditor- (1) a friend, philosopher and guide: – We have already seen that the auditor of a co-operative society has to function as its friend, philosopher and guide. He has to tender advice on all financial and administrative matters whenever his advice is sought and suggest ways for improvement of their affairs and for increasing their usefulness to their members. Co- operative audit has not only to be critical but also **curative and educative**. The auditor has not only to point out mistakes, but has also to suggest ways to avoid their recurrence in future. He has also educate members of the committee and also the ordinary members and point out ways for improving it's working and increase its usefulness.

The auditor has not only to criticise the actions of the management, but has always to think of the possibilities for improvement and tender suitable advice to the committee.

2. Qualities required of an Auditor. - The foremost quality that an auditor should have is an **abundance of commonsense**. He has to cultivate a **keen sense of observation** and has always to be on the look out for whatever is unusual or irregular. Since the time at his disposal is always limited, being required to complete the audit within the time prescribed in the Act, he has to plan and carry out his work methodically and thoroughly so as to

ensure that all important matters receive adequate attention and nothing which is irregular or out of the way escapes his notice. The work he has to do being mechanical and tiring, he is required to ***possess a good deal of patience***. All the same, he is required to ***apply due care and skill*** in the performance of his duties lest he may be charged with negligence. He has always to be ***diligent and hard working*** and at the same time ***guard himself against methods which tend to be mechanical or appear to be short cuts and are, therefore, fatal to accurate and efficient audit***. **Accuracy, concentration and patience** are the three invaluable qualities, which every auditor must possess. He is also required to have a ***quick grasp and ability to read between the lines*** so that he cannot be deceived.

Since the work involved is voluminous and many times beyond the capacity of any one individual, the auditor has to rely on his assistants to carry out most of the routine work so as to keep himself free to attend to the more important matters. He has, therefore, to map out his work methodically and distribute it amongst his assistants, with ***clear instructions as to what is to be done, why it is to be done and how it is to be done***, he has further to instill in them a ***sense of loyalty and faithfulness*** and at the same time to ***encourage and assist them to think for themselves*** and make their own contributions. All this calls for considerable ***supervisory skill and administrative talent***.

3. Attitude towards non-officials. - It has to be noted that the auditor has not only to deal with the books of accounts and records, but has also to supplement the information available from the books by calling for clarifications and explanations. But putting intelligent questions, he has to elicit the required information without arousing any suspicions in the minds of those whom he questions. During the course of the performance of his arduous duties, an auditor of a co-operative society has to deal with all sorts of people from simple junior clerks to highly placed executives and director, who are shrewd businessmen and many of whom on account of their wealth and social status might not regard the auditor as an important person. The auditor should, therefore, possess necessary ***tact and talent*** to deal with men and matters. He has always to remember that office-bearers of co-operative societies are mostly honorary workers, who are particularly susceptible to any sort of adverse comment and are, therefore, required to be handled with ***great care and due courtesy***. At the same time, he should have the ***courage of his convictions*** and be ***bold enough*** to express in no uncertain terms his findings and his opinion on the genuineness and propriety of the transactions examined by him.

4. Honesty and sincerity: - Lastly, he is required to be ***honest and sincere***. *He must not certify what he does not believe to be true and must take reasonable care and apply due skill before he believes that what he certifies is true.*

It has to be noted that co-operative societies have an important place in the economic set up of our country. The active assistance, large-scale financial involvement and even partnership in their affairs by the State necessitate that the auditor should apply more than ordinary care and skill in the discharge of his duties because *audit is the only known method to bring to light errors and grave irregularities*.

5. Independence of the Auditor;- The auditor should be independent in performing his duties as an auditor. He should express his opinion without fear or favour.

I-8 POWERS AND LIABILITIES OF AUDITOR

1. Powers of the Auditor: - **Sub-section (3)** of section 81 of the Maharashtra Co-operative society Act, 1960, provides that the auditor for purposes of his audit, shall have access to

all books, accounts, documents, papers, securities, cash other property belonging to the society or in the custody or possession of the society or any of its officers. He has also the power to summon any person in possession of or responsible for the custody of any such books, accounts, papers, securities, cash or other property of the society and compel him to produce the same at any place at the head-quarters of the society or any branch thereof. Under **sub-section (4)** of the Section 81, duty is cast on every person, who is or has at any time been an officer or employees of the society and every member or past member of the society, to furnish such information in regard to the transaction or working of the society, as the auditor may require.

2. Acts and omissions which constitute offences under the Co-operative Societies Act. -

Section 146 of the Maharashtra Co-operative Societies Act specified a number of actions and omissions by office-bearers and members of co-operative societies, which constitute offences and the following section 147, lays down punishment for such offences. Many of the offences, enumerated in the Section pertain to the duties and responsibilities of the officers, employees and members of the societies with reference to maintenance of accounts and audit. Thus, under section **146 (g)**, refusal by an officer or member of the society in possession of information to furnish to the auditor, information required by him or to produce books, papers and other documents and to give assistance to the auditor constitutes an offence under the Act and under sections **147 (g)**, is punishable with a fine which may extend to Rs. Five thousand. Under clause **146(i)** of the section, failure to comply with the requirements of sub-section (4) of section 81, viz., failure to furnish information in regard to transactions and working of the society, constitutes an offence and is punishable with a fine, upto Rs. One thousand. Disobedience of summons issued by the Auditor will also constitute an offence under this sub-section and also under the Indian Penal Code (**Section-174, IPC**), since auditors are deemed to be public servants under Section 161 of M. C. S. Act. The committee of a society or an officer or member thereof willfully neglecting or refusing to do an act or furnish any information required by the auditor would also commit an offence under clause **(j) of section 146** and under the corresponding clause **(147j)** of the following section, can be punished with an imprisonment for a term not exceeding one month or with a fine upto Rs. Five thousand or with both. It need hardly be mentioned for purposes of his audit, the auditor has to rely on the information available from the books and also the clarification and explanation offered by the officers and members of the society. Under clause **(k) of section 146**, a committee of a society or an officer or member thereof, willfully makes a false return or furnishes false information or fails to maintain proper accounts, commits an offence and under the same clause of the following section is punishable with imprisonment for a term which may extend to one year or with a fine upto Rs. Ten thousand or with both. For disobedience of summons issued by the auditors, cases may also be lodged with magistrates under the Indian Penal Code. However prosecution under this section shall not be lodged, except previous sanction of the Registrar.

3. Additional powers. : - 1) The auditor of a co-operative society is deemed to be a public servant within the meaning of **section 20** of the Indian Penal Code. The authority exercised by him as public servant and also the above mentioned powers, which have been given to him under provisions of the Co-operative Societies Act, are not available to the auditor of a joint stock company. The powers of the auditor of a co-operative society, in particular, the power to summon and compels production of documents and papers from all persons having custody of books of accounts, cash and property of the society, gives the auditor power to go beyond the books of the society and by making personal inquiries

with the members, creditors and other constituents of the society, he can supplement the information available from the books and records of the society about the genuineness and correctness of the entries recorded in the books of accounts of the society.

2) Power to seize records: During the course of audit of any society, if the auditor is satisfied that the books and records of society are likely to be suppressed, tempered with or destroyed or the funds and property of the society, are likely to be misappropriated or misapplied, then he has to report to the Registrar, then the Registrar or the person authorized by him may apply to Executive Magistrate within whose jurisdiction the society is functioning for seizing and taking possession of records and property of the society. The procedure for impounding has been described in section 80 and corresponding rule 68.

4. Audit Memo to be considered by annual general meeting. - Sub-section (4) of section 75 of the Maharashtra Co-operative Societies Act laid down that at every annual general meeting of the society, along with the audited balance sheet and profit and loss account and the committee's report, the auditor's report and rectification report of earlier audit report shall be placed before the members for adoption. Under Rule 30 of the Maharashtra Co-operative Societies Rules, the audit memo is public document and any member of society or of the public may inspect it free of cost in the office of the society or the Registrar and may also obtain copies thereof on payment of the prescribed fee.

5. Auditor's right to receive notice of and attend annual general meeting. : - Sub-section (5) of section 81 also gives a right to the auditor to receive all notices and every communication relating to the annual general meeting to attend such meeting and to be heard thereat, in respect of any part of the business, with which he is concerned as auditor.

6. Auditor to be a "public servant": - Section 161 of the Maharashtra Co-operative Societies Act provides that a person appointed by the Society or Registrar, to audit of the accounts of a society under section 81 shall be deemed to be a public servants within the meaning of section 20 of the Indian Penal Code. Rule 2 (B1) defines the auditor as, "Auditor or auditing firms from panel approved by State Government or Authority authorized by State Government and appointed by Annual General Meeting or by Registrar". Their authorities as public servants adds to their status and afford them additional facilities, which are not available to the auditors of joint stock companies.

7. Authority of Auditors as public servants. : - *Chapter X* of the Indian Penal Code deals with contempt of lawful authority of public servants. Under section 161 of the Maharashtra Co-operative Societies Act, all auditors of co-operative societies are public servants, can be invoked by them as defined in section 20 of the Indian Penal Code. As such, they can invoke the penal provisions contained in this Chapter intended to enforce obedience to lawful authority of a public servant. Contempt of lawful authority of courts of justice, police officers and officers of Revenue and other Government Departments and other persons declared as public servants under various other Acts, are punishable under this head.

Under sub-section (3) (a) of section 81, the auditor for purposes of his audit has been empowered to summon and call for proceedings of any book, accounts, documents, papers, securities, cash and other properties of the society.

Under sub-section (4), any person, who has at time been an officer or employee of the society and every member and past member of the society, is required to furnish such

information in regard to the transactions and working of the society as the auditor may require.

The auditor has thus not only the power to issue summons, enforce attendance and require production of documents, but, under sub-section (4) of section 81, he can put questions and ask for information in regard to any transaction of the society.

8. Consequences of disobedience of summons. - Under section 172 of the Indian Penal Code, absconding to avoid service of summons, notice or order from any public servant, legally competent, is an offence. and shall be punished.

Preventing service of summons is an offence under section 173 (IPC).

Non-attendance in obedience to an order from a public servant constitutes an offence under section 174 of the Indian Penal Code, which reads as under: -

“Whoever, being legally bound to attend in person or by an agent at a certain place and time in obedience to a summons, notice, order or proclamation proceeding from any public servant legally competent, as such public servant, to issue the same, intentionally omits to attend at that place or time, or departs from the place where he is bound to attend before the time at which it is lawful for him to depart, shall be punished with simple imprisonment for a term which may extend to one month, or with fine which may extend to five hundred rupees, or with both.”

9. Failure to produce documents. : - Under section 175 of the Indian Penal Code omission to produce any document to public servant by person legally bound to produce is an offence: which reads as under: -

“Whoever being legally bound to produce, or deliver up any document or electronic record to any public servant as such, intentionally omits to produce or deliver up the same,” shall be punished.

Auditors of co-operative societies have a right of access to books, records, statements, documents, etc. of the society in possession of or in the custody of any person and whoever refuses or fails to produce any document in his possession can be punished under this Section.

Under section 176 of the Indian Penal Code omission to give notice or information to public servant by person legally bound to give it, constitutes an offence.

10. Consequences of refusal to answer questions and giving false evidence. - Under section 177 of the Indian Penal Code furnishing false information as a public servant is an offence. Which reads as under: -

“Whoever, being legally bound to furnish information on any subject to any public servant, as such, furnishes, as true, information on the subject which he knows or has reason to believe to be false, shall be punished with imprisonment and fine.”

Refusing oath or affirmation when duly required by public servant to make it is an offence under section 178 of the Indian Penal Code. **However, the Act does not empower auditors to examine person's on oath or affirmation**, although under section 81(3) (a) and 81(4), he can summon members, officers and employees of the society-both past and present and require them to produce documents in their possession and furnish information required by him. He can no doubt put questions on any subject relating to his audit and refusal to answer questions put by him would constitute an offence punishable under section 179 of the Indian Penal Code.

Under section 179 of the Indian Penal Code refusing to answer public servant authorized to question is an offence:

“Whoever, being legally bound to state the truth on any subject to any public servant, refuses to answer any question demanded of him touching that subject, by that public servant in exercise of the legal powers of such public servant commits an offence under this section and is liable for punishment for 6 months or fine of Rs. 1,000 or both.”

However, under sections 131 and 132 of the *Indian Evidence Act*, a witness is exempted from answering certain questions. If a person gives false answers or furnished false or misleading information to the auditor, then, he will be guilty under section 193 of the Indian Penal Code the relevant portion of which reads as under: -

“...and whoever intentionally gives or fabricates false evidence in any other case (*viz., other than judicial proceeding*) shall be punished with imprisonment of either description which may extend to three years and shall also be liable to fine.”

Since the Maharashtra Co-operative Societies Act does not give necessary authority to the auditors, provisions of sections 180 to 181 of the Indian Penal Code will not apply to statements made before the auditors.

Under section 182 of the Indian Penal Code furnishing false information with intent to cause public servant to:

- (a) to do or omit anything which such public servant ought to do or omit, if the true state of fact was known to him or
- (b) to use his lawful power to the injury of another person in an offence. It has, however, to be noted that the auditor has to verify all information and explanation given to him and should not ordinarily be misled. Any attempt to mislead him by giving false information would constitute an offence under the section.

11. Causing abstractness to public servant. : -Under sections 186 and 187 of the Indian Penal Code obstructing a public servant in the discharge of his duties and omission to assist public servant when bound by law to give assistance are offences. Under section 189 of the India Penal Code holding out of any threat of injury to a public servant is an offence. These provisions have to be read with the penal provisions contained in sections 146 of the Maharashtra Co-operative Societies Act and are intended to assist the auditor in the proper discharge of his duties.

12. Need of above extra powers. : -These extra powers enumerated above have been given to the auditor of a Co-operative Society because of the wider field to be covered by him during his audit. The audit of a co-operative society as we have seen is not expected to be a mere critical examination of the entries in the books of accounts and comparing them with the vouchers and other documents, but includes within its purview personal verification of the members and examination of their pass books. This is necessary because the members of co-operative societies, particularly in the villages, are simple and trusting people and are not always anxious to understand the correctness and propriety of the transactions recorded in their names. Members of societies, particularly members of agricultural credit societies in the villages, have generally and implicit faith in the honesty and integrity of the office-bearers and their trusting nature has been found to have been taken advantage of by unscrupulous persons to further their own ends. The auditor of a co-operative society is, therefore, required to have personal contact with as many members as possible so as to make his audit effective and searching in order to ensure that no undesirable transactions or dealings lie hidden from the surface.

13. Liability of the Auditor: - Nature and extent of liability-The auditor of a joint stock company is appointed by the share-holders and is, therefore, their agent. As such, he is liable to them if as a result of his negligence in the performance of his duties loss has been

occasioned to the company. Although there are very few decided cases in which the courts have awarded damages against the auditors, it has been generally accepted that the auditor would be held liable only where he has failed to apply due skill and care in the performance of his duties. What is reasonable care and skill would depend upon the circumstances of each case. However, the courts have always taken a lenient view having due regard to the nature of the work of the auditor and the meager remuneration paid to him.

14. Responsibility of the auditor to the Registrar / Society. :- As per section 81 (1) (a) society has to arrange to get their accounts audited, at least once in each co-operative year by an auditor from the panel of auditors maintained by the Registrar and approved by Government. In case society has failed to appoint the auditor within the prescribed time limit and also failed to submit return under Section 79 (1B) regarding appointment of auditor and his written consent, then the Registrar has to appoint the auditor. These auditors are responsible to the member as they are appointed by the society in its meeting. However, the responsibility for reporting to Registrar / Society is rest on these auditors.

15. Auditor's responsibility in certifying balance sheet and profit and loss account. :- The form of the auditor's report prescribed under Section 81(5B) and Rule 69 (3) of the Maharashtra Co-operative Societies Rules, broadly requires him not only to certify that the profit and loss account and the balance sheet are not only in agreement with the books of accounts, but also that they give a true and fair view of the state of affairs of the business as at the close of the year and of its earnings for the year. It is, therefore, necessary that the auditor should carry out a careful and exhaustive scrutiny of the accounts to satisfy himself that the whole of the transactions have been properly recorded in the books and that the balance sheet and profit and loss account do show a true and fair view of the state of affairs of the business and its profits. He has further to make careful enquiries and verify the physical existence of the securities and other properties shown in the balance sheet and also to see that all liabilities have been brought into account. He has further to ensure that all statutory requirements have been complied with and that the financial statements have been prepared in accordance with the generally accepted accounting policies and accounting standards issued by ICAI / Government and adopted by the society.

15-A. Opinion from an expert (SA 620) :- The auditor has sole responsibility for the audit opinion expressed and that responsibility is not reduced by auditor's use of work of an expert. If the expertise in field other accounting and auditing is necessary to obtain sufficient, appropriate audit evidence, auditor shall determine whether to use the work of an expert. Auditor shall evaluate whether expert has necessary competence, capabilities and objectivity for audit purpose.

16. Need to carry out further probe when necessary. :- The auditor is required to satisfy himself about the *propriety, genuineness and correctness of the transactions* entered in the books. For this purpose, he has to rely on the vouchers and other documents presented to him by the management and the information and explanations furnished to him. If in the course of his investigation, he comes across anything, which arouses his suspicion, he should probe it to the bottom. But, in the absence of any suspicious circumstances, he is expected to exercise more than ordinary care and diligence and he is entitled to believe in the honesty and integrity of the office bearers and servants of the business. However, unless he is thoroughly satisfied, he should not certify the correctness of the accounts.

Where the auditor is not completely satisfied as to correctness of the accounts or the manner of their presentation, or when his requirements are not complied with, **he should not hesitate to qualify his report** by specifying the points on which he is not satisfied or in respect of which his requirements have not been complied with. Qualifications, which may be considered while reporting, are explained elsewhere.

17. Responsibility for detection of frauds. - With his expert knowledge of accounts, finance and law and with his right of access to all books of accounts, vouchers and other documents and his right to call for any information or explanation from the management, he should be able to detect the existence of any fraud or serious error. **He is required to exercise reasonable care, skill and vigilance in the performance of his duties.** However, he cannot be held liable for not tracing out ingenious and carefully laid out schemes of fraud in the absence of any circumstances which should have aroused his suspicions, particularly when such frauds have been perpetrated by tried and trusted employees or those holding positions of trust and responsibility.

As per amended clause (e) of Sub-section 1 of the section 81, auditor has to report the modus operandi, amount involved, persons involved, in case of financial irregularities and misappropriation or embezzlement of funds or fraud, for which he requires to investigate the records and accounts and relevant records maintained by the others, who are also involved in.

Bearing in mind the above special points relating to audit of co-operative societies, the liability of the auditor for specific acts of commission and omission may be dealt with under the two broad headings-criminal liability and civil liability.

18. Criminal liability of auditors- An auditor of a company who certifies a balance sheet, profit and loss account or any other statement, knowing it to be false runs the risk of being held criminally liable under section 628 of the Indian Companies Act. There is no such provision in the Co-operative Societies Act and the auditor of a co-operative society can be held criminally liable, only if any of his acts constitute an offence under the Indian Penal Code, which is quite a comprehensive piece of legislation. **Thus, the auditor of a co-operative society can be hauled up before a Criminal Court, if he has certified a balance sheet or signed any other statement knowing it to be false.**

19. Civil liability of auditors – As regards civil liability of auditors, there have been many cases in which the auditor has been sued for damages. From the comments made by the judges, while discussing the duties and liability of auditors, the following conclusions may be arrived at, which will serve as useful guidance to auditors of co-operative societies.

An auditor certifying the profit and the balance sheet does not merely guarantee the arithmetical accuracy of the statements, but express his opinion that these statements do display true and fair view of the financial position of the business and its earnings.

20. Auditor must apply due skill and care: - He must apply due skill and care and ascertain that the books of accounts contain a true and correct record of the transactions (*Armitage vs. Brewer and Knot, 1932*). He has to be satisfied that the specific requirements of the Act, the rules and byelaws have been duly complied with. He cannot excuse himself that he was not aware of these provisions. **He must be honest, that is, he must not certify what he does not believe to be true and he must take reasonable care and apply due skill, before he believes that what he certifies is true.** What is reasonable care and skill depends upon the circumstances of each case. Where there is nothing to excite suspicion, very little inquiry will be reasonably sufficient. Where his suspicions are

aroused, he must probe the matter to the bottom. (London and general bank case, 1895). Since he is not supposed to have an expert knowledge of technical matters, he is entitled to rely upon the statements and opinions of officials and other experts on technical matters. Although he is not a valuer, he has to satisfy himself that the various assets have been valued on a *fair and reasonable basis* and he can rely on the valuation certificates furnished by the management only after making due enquiries and after applying necessary tests, that all the properties, securities and other assets shown in the balance sheet were in existence on the date of the balance sheet and that they had been properly valued. Omission to count the cash on hand and carry out necessary inspection of the securities constitutes negligence. *(London oil storage case, 1904 and red.)* (The City Equitable Life Insurance Co., Ltd., 1924).

He has also to see that all liabilities incurred, particularly in respect of purchases made and expenses incurred, are duly brought into account and are not understated. *(Irish woolen co., ltd., 1904).*

21. Auditor's duty in regard to stock in trade and book debts. –In regard to stock in trade, although it has been held that it is no part on the auditors duty to take stock or as a value *(Kingston Cotton Mill's Case, 1896)*, he has to be satisfied not only about the arrangement made for stock taking, but also about the correctness of the valuation by tasting a few of the stock sheets. In case of banks and other credit institutions, he should examine all the book debts and ascertain whether the provision made for bad and doubtful debts is adequate. *(Arthur Green and co., vs. central and discount corporation ltd. 1920).*

22. Liability for damages. - An auditor undertakes considerable responsibilities in that, the statements certified by him, are relied upon not only by the share holders, but also by the creditors, tax collectors and the general public, as representing an accurate picture of the concern, whose accounts he has audited. He has, therefore, to be extremely careful in the discharge of his duties, as if, by the neglect of his duties or due to his failure to apply due skill and care, loss has been occasioned to the institution, he can be held liable for damages where damages has resulted from any mistaken of facts in the balance sheet or any other statement or report submitted by the auditor, the onus to prove that it is not the result of any negligence or breach of duty on his part lies on the auditor. *(Republic of Bolivia Exploration syndicate Ltd.(1914) 1 Ch.139; XLIX The Accountant L.R.61)*

23. Responsibility for work done by clerk. - An auditor cannot escape personal liability by saying that the work was done by his clerk. It has been held that except where judgment and discretion come in, the skill of the clerk must be the same as the skill of the principal. *(Henry Squire Cash Chemists vs. Ball Baker and co., 1911 and mead vs. Ball Baker Co. 1911).* The principal must not excuse himself for his clerk's negligence by saying that he employed a clerk.

24. Extend of detailed scrutiny and enquiry. - The extent of detailed scrutiny of the accounts and the documents and the information and explanations to be obtained are of course the discretion of the auditor. However, he cannot escape liability on the plea that he did not check the particular portion of the work or that he did not ask for an explanation or obtain information on a particular point.

CHAPTER II

II-1 ARRANGEMENTS FOR AUDIT

1. Statutory responsibility of Registrar / Society for annual audit of co-operative societies. – Under Section 81 of the Maharashtra Co-operative Societies Act, 1960, audit of all Co-operative Societies once in a year is the statutory responsibility of the Registrar/ of the Society. The society has to submit the return of appointment of auditor as provided by subsection 2A of the section 75, within thirty days from the date of Annual General Meeting. If the society fails to submit return to the Registrar. If the Registrar is satisfied about non appointment of the auditor by the society, Registrar may cause to appoint the auditor to that society as provided in the Section 81 of the Act.

2. Audit of Co-operative Societies by Auditors appointed by the Registrar / Society - The Maharashtra Co-operative Societies Act, 1960, provides for the appointment of auditor by the society, in case, if the society fails to appoint the auditor within specified time limit in the Act and Registrar is satisfied about this, then only the Registrar can appoint the auditor from the panel of auditors approved by the Government and prepared by the Registrar. The Registrar shall have to appoint the auditor possessing the required qualification and experience as provided under explanation given in section 81 of the Act. The (a) to (d) clauses of the explanation states, qualification of the chartered Accountant, firms of chartered accountant, certified auditors and Government auditors to whom the Registrar can allot the audit by order thereof. The (a) to (d) clauses specifies the experience and qualification as under :-

Sr.No.	Details of auditors	Qualification	Experience
A	Chartered Accountant Firm	Firm of more than one chartered accountant within the meaning of CA Act 1949	Nil
B	Individual Chartered Accountant	Individual chartered accountant within the meaning of CA Act 1949	At least 1 year in audit of Co-operative Society
C	Certified Auditor	Holding degree from recognized university and completed G.D.C. & A.	At least 3 years in audit of Co-operative Society
D	Government (Departmental) Auditor	H.D.C. or G.D.C. & A. or D.C.A.	Satisfactory completion of probationary period.

In addition to above Sr.No. A, B and C requires knowledge of audit of co-operative society and Marathi language and Sr.No. D requires knowledge of Marathi language.

3. Preparation of Panel of auditor :- The panel of auditors is prepared by the Registrar as per the procedure prescribed in Rule 69 (read with Section 81) as under :-
Rule no.69 (f) :-

(i) the Registrar shall call applications before the specified date as declared in the notice for empanelment from eligible auditors and auditing firms by a public notice to be displayed on the official website of the State Government and in any other mode, if required. Such notice shall also be published on the notice board of the office of the Registrar and District Deputy Registrars.

- (ii) Every applicant shall submit only one application to the office of the concerned District Deputy Registrar of the District, where he ordinarily resides.
- (iii) Applications received shall be scrutinized by the Committee presided over by the District Deputy Registrar consisting of the District Special Auditor of the District, representative of the Chartered Accountants of the District, representative of the Certified Auditors of the District as members and the Assistant Registrar (Administration) of the District shall function as Member Secretary of the said committee.
- (iv) After scrutiny, the District Deputy Registrar shall submit list of eligible applicants to the Registrar alongwith their applications and documents. The Registrar may scrutinize the applications recommended by the District Committee.
- (v) Any aggrieved applicant may approach to the Grievance Redressal Committee headed by the Divisional Joint Registrar, Divisional Joint Registrar (Audit), as member and Divisional Deputy Registrar of the Division shall function as Member Secretary of the said Committee and the decision of the Committee shall be final.
- (vi) The Registrar shall cause to display a approved list of auditors and auditing firms panel on the official website of the Government.
- (vii) the Registrar shall classify the societies and auditors for the purpose of audit in the following manner, namely :—

Classification of Auditors and Societies
[under section 81 and Rule 69 (1) (f) (vii)]

TABLE – A

Class	Description of Auditors	Societies to be Audited
(1)	(2)	(3)
A	1) Chartered Accountant Firm 2) Chartered Accountant having at least 5 years experience in audit of co-operative Societies. 3) Joint Registrar (Audit) and Special Auditor Class-I who was completed probation period successfully.	(1) Maharashtra State Co-operative Bank * (2) District Central Co-operative Bank (3) Urban Co-operative Banks having Deposits more than Rs. 25 Crores. (4) Salary Earners Co-op. Banks (5) Maharashtra State Co-operative Marketing Federation * (6) Maharashtra State Co-operative Cotton Grover's Federation.* (7) Maharashtra Rajya Dudh Sangh (Mahananda) * (8) Maharashtra State Co-operative Agriculture and Rural Multipurpose Development Bank (9) Maharashtra State Co-operative Housing Finance Corporation. (10) Maharashtra State Tribal Development Corporation (11) Maharashtra Rajya Sahakari Sangh and Divisional Co-operative Board. (12) Maharashtra State Co-operative Fisheries Federation (13) Maharashtra State Co-operative Consumer Federation (14) Maharashtra State Co-operative Spinning Mill Federation. (15) Maharashtra State Co-operative Power loom Federation (16) Maharashtra State Co-operative Textile Federation (17) Maharashtra State Co-operative Handloom Federation (18) Maharashtra State Co-operative Cotton Grovers Processing Societies. (19) Maharashtra State Co-operative Labour Societies

		<p>Federation.</p> <p>(20) Maharashtra State Co-operative Bank Association</p> <p>(21) Maharashtra State Co-operative Credit Societies Federation.</p> <p>(22) Maharashtra State Co-operative Jungal Kamgar Federation.</p> <p>(23) Maharashtra State Co-operative Sugar Factories Federation.</p> <p>(24) Maharashtra State Co-operative Sugar Industries Development Societies.</p> <p>(25) Maharashtra State Co-op. Cadre Federation and District Coop Cadre Board.</p> <p>(26) Maharashtra State Co-op. Industrial Societies Federation.</p> <p>(27) Other National and State level Co-op. Federation not mentioning above.</p> <p>(28) Co-operative Spinning Mill/ Weaving Mills</p> <p>(29) Co-operative Sugar Factories</p> <p>(30) District Co-operative Milk Union</p> <p>(31) District Co-operative Agriculture and Rural Multipurpose Development Bank.</p> <p>(32) Any other society specified by Registrar from time to time.</p>
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* *Note* : Societies at Sr. Nos. 1, 5, 6 and 7 shall be audited only by Chartered Accountant Firm or a Chartered Accountant or Joint Registrar (Audit) categorized in 'A' Class. Auditors categorized in 'B' Class and 'C' Class are not eligible to audit societies categorized under Table – A. In case of Co-operative Bank, the Government Auditor may conduct re-audit, test-audit or special audit only.

TABLE - B

Class	Description of Auditors	Societies to be Audited
(1)	(2)	(3)
B	<p>1) Chartered Accountant having at least one year experience in audit of Co-operative Societies.</p> <p>2) Special Auditor Class – 2, Auditor Grade - I who was completed probation period successfully.</p> <p>3) Certified Auditor having at least 10 years experience in audit of Co-operative Societies.</p>	<p>(1) Urban Co-operative Bank having deposits up to Rs. 25 Crores.</p> <p>(2) Urban Co-operative Credit Society and Rural nonagricultural credit society having deposit 10 crores and above.</p> <p>(3) Salary earners Co-operative Credit Society having working capital 10 crores and above.</p> <p>(4) Co-operative Starch Factories</p> <p>(5) Co-operative Industrial estates.</p> <p>(6) District Co-operative Labour Federation</p> <p>(7) Sales and Purchase Co-operative Unions (District and Taluka).</p> <p>(8) Housing societies having 100 and more members</p> <p>(9) Co-operative Jinning and Pressing Societies /Rice Mills and Oil Mills.</p> <p>(10) Primary Co-operative Dairy Societies having turnover above Rs. 50 lacs.</p>

		(11) Primary Co-operative Poultry and piggery and livestock Societies having turnover above Rs. 25 lacs. (12) Primary Co-operative Fisheries Societies having turnover above Rs. 50 lacs. (13) District / Central Weavers Co-op. Societies. (14) District and Central Co-op. Consumers stores (15) Co-operative Hospital (16) Mula Pravara Electric Society and Other Elec. Societies. (17) District Co-operative Board (18) District Housing Federation (19) Other District Federal Societies not mentioned above (20) Any other society specified by Registrar from time to time.
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* *Note* : Societies at Sr. Nos. 1 and 2 shall be audited only by a Chartered Accountant and Special Auditor Class- II Categorized in 'B' Class. Auditors categorized in 'A' Class above are also eligible to audit societies categorized under Table - B. Auditors categorized in 'C' Class are not eligible to audit societies categorized under Table – B.

TABLE - C

Class	Description of Auditors	Societies to be Audited
(1)	(2)	(3)
C	1) Certified Auditor having at least 3 years experience in audit of Co-operative Societies. 2) Auditor Grade – 2 and Sub – Auditor who was completed probation period successfully.	(1) Primary Agricultural and Co-operative Credit Societies (PACS) and Primary Krushak and Adiwasi Seva / Grain Bank. (2) Urban Co-operative Credit Societies and Rural nonagricultural credit societies having deposits less than Rs. 10 crores. (3) Salary earners societies having working capital less than Rs.10 crores. (4) Primary Co-operative Dairy Societies having turnover less than Rs. 50 lacs. (5) Primary Co-operative Poultry, Piggery and Livestock Societies having turn over less than Rs. 25 lacs. (6) Primary Co-operative Fisheries Societies having turnover less than Rs. 50 lacs. (7) Sugarcane supply cooperative societies / Transport Coop. societies. (8) All Farming Co-operative Societies (9) Housing societies having less than 100 members (10) Lift irrigation societies (11) Labour contract societies (12) Forest Labour Co-operative Societies (13) All types of Primary Marketing Societies and Food Processing Societies. (14) Primary Weavers Co-op. Societies (Handloom and Powerloom). (15) Primary Industrial Co-op. Societies. (16) BLVA societies

		(17) Primary consumers Co-operative Societies. (18) Social service societies and unemployed youth co-operative Societies. (19) Taluka supervisory unions. (20) Any other society specified by Registrar from time to time.
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* *Note* : Auditors categorized in 'A' Class and 'B' Class above are also eligible to audit societies categorized under Table - 'C'.

4. Removal of auditor from panel :- Rule 69 (g) provides criteria for removal of auditor and auditing firm from the panel shall be as follows :-

(g) The criteria for removal of the name of auditor and auditing firms from the panel shall be as follows, namely :—

- (i) non-submission of audit report as specified in sub-section (5B) of section 81, to the society and the Registrar within the period of one month from the date of completion and in any case before the issuance of notice of the general body meeting ;
- (ii) not-disclosure the true and correct picture of accounts as specified in clause (c) of sub-section (3) of section 81 ;
- (iii) after giving consent for audit by the auditor or auditing firm and after issuance of order of appointment of auditor or auditing firm, audit is not completed within stipulated period as specified in sub-section (1) of section 81 ;
- (iv) non-submission of specific report stating that, any person is guilty of any offence relating to the accounts or any other offences within a period of fifteen days from the date of submission of audit report to the society and the Registrar ;
- (v) failure to file special report to the Registrar if any ;
- (vi) failure to file the First Information Report, if required thereof;
- (vii) non-submission of scrutiny of audit rectification report within six months to the society ;
- (viii) if in the test audit or re-audit of the society it is found that, the auditor or auditing firm is responsible for any commissions and omissions ;
- (ix) if the auditor is borrower of the society and has conducted the audit of the same society without disclosing the said fact to the society ;
- (x) if the auditor or his family member is employee or ex-employee of the concerned Co-operative society ;
- (xi) if the auditor is an auditor or a partner of an auditing firm which is also conducting internal or concurrent audit of concerned Co-operative society ;
- (xii) if the auditor or his family member, as specified under explanation (I) of sub-section (2) of section 75 of the Act, is committee member of the concerned co-operative society ;
- (xiii) if the auditor has conducted audit, without appointment order issued by the society with the prior approval of general body or the Registrar, if any, as the case may be ;
- (xiv) if the auditor is family member of a employee of the department of co-operation:”

II-2 SCOPE OF AUDIT

1. Scope of Audit: The audit of cooperative societies is required to be done as per the provisions contained in the Section 81 and rule 69 of the Maharashtra Co-operative Societies Act and rules made there under. Specific provisions are made under section 81(2), regarding the items that are to be audited by the auditors, details of which are explained elsewhere in the manual. Apart from these items the auditors have to audit as per objects defined, in auditing practices or general customs, which includes the detection

of errors and frauds. The nature of cooperative societies is different from the Joint Stock Companies and other body corporate, regarding the principle on which they run. Cooperative societies are run on cooperative principles i.e. for the benefit of their members. The Commissioner for Cooperation and Registrar of Cooperative Societies has issued various circulars, in regards, to the various items that are to be checked by the auditors of Cooperative Societies. The Institute of Chartered Accountants of India has issued various guidelines on audit, Accounting Policies and standards, auditing practices for the guidance of the Chartered Accountants, which are necessary to include in the scope of audit, as the auditing standards are also included in the Section 81(2) of the Act, in the present scenario as a basis for the audit. The accounting standards that are applicable to the cooperative societies are listed elsewhere in the manual. The Standards on auditing (SA) issued by the institute are given below are applicable to the Cooperative Societies.

Sr. No.	Auditing Standard No.	Name of Auditing Standard
1	200	Overall Objectives of the Independent Auditor
2	210	Agreeing the terms of Audit Engagements
3	220	Quality control – an audit of financial statements
4	230	Audit documentation
5	240	The Auditors responsibilities relating to Fraud
6	250	Consideration of Laws and Regulations in an Audit
7	260	Communication with those charged with Governance
8	265	Communicating Deficiencies in Internal Control
9	299	Responsibility of Joint Auditors
10	300	Planning an Audit of Financial statements
11	315	Identifying and Assessing the risks of Material Misstatement
12	320	Materiality in Planning and Performing an Audit
13	330	The Auditors responses to Assessed Risks
14	402	Audit considerations relating to an entity using a service organization
15	450	Evaluation of Misstatements identified during the Audit
16	500	Audit Evidence
17	501	Audit Evidence – Specific considerations for selected
18	505	External confirmations
19	510	Initial Audit engagements – Opening balances
20	520	Analytical procedures
21	530	Audit Sampling
22	540	Auditing accounting estimates
23	550	Related Parties
24	560	Subsequent Events
25	570	Going concern
26	580	Written Representations
27	600	Using the work of another Auditor
28	610	Using the work of Internal Auditors
29	620	Using the work of an Auditors Expert
30	700	Forming an opinion and Reporting financial statements
31	705	Modifications to opinion in the Independent Auditors
32	706	Emphasis of matter para and Other matter paragraph
33	710	Comparative information – Corresponding Figures
34	720	The Auditors responsibility in relation to other information

35	800	Audits of Financial Statements prepared in accordance
36	805	Special considerations – Audits of single financial statements
37	810	Engagements to report on Summary Financial Statements

Scope of audit accordingly rests on the provisions contained in the section 81(2) and Rule 69 of the Act, Objectives of audit, principle governing the cooperative societies and circulars issued in this regards by the Registrar.

2. The auditors while getting appointments from the societies should obtain a copy of resolution passed in the Annual General meeting in which his appointment was made. The resolution should clearly mention the period of audit. The auditor should carry out the audit as per the provisions of Section 81 read with Rule 69 and any other directions as may be specified by the Registrar from time to time.

3. Submission of Audit Report :- Sub-Rule (b) of Rule 69 (1) prescribe the procedure of submission of audit report by the auditor as :- “the auditor has to complete his audit within 4 months from the close of financial year and the report, also in compact disk shall be submitted to the society and the Registrar, as specified in Sub-Section (5B) of Section 81 of the Act, and also Part – A of audit report, Audit Certificate and audited financial statements shall be uploaded by the auditor on official website of Co-operation Department.”

4. Opinion by the Auditor :- The auditor has to express his opinion about the true and fair position of the financial statement as per Section 81(5B) of the Maharashtra Co-operative Societies Act. 1960. As per Rule no. 69 (3) The auditor shall submit in respect of Co-operative Banks in Form N-1 and in other cases in Form N-2 an audit memorandum to the society and to the Registrar with regards to the accounts, balance sheet and profit and loss accounts or statement of income and expenditure examined by him as on the date and for the period up to which the accounts have been audited, and shall state whether in his opinion and to the best of his information, and according to the explanation given to him, accounting policies adopted by the society as per accounting standards laid down by the State Government or the Institute of Chartered Accountants of India as the case may be, the said accounts give all the information required by the Act in the manner so required and give true and fair view,—

(i) in the case of the balance sheet, the state of society’s affairs as at the end of the financial year or any other subsequent date up to which the accounts are made up and examined by him, and

(ii) in the case of the profit and loss account of the profit or loss for the financial year or the period covered by the audit, as the case may be. While certifying the profit or loss of the society, Auditor shall quantify the effect of shortfall in various provisions, like Non Performing Assets, overdue interest, depreciation and any other provisions relating to expenses over profit or loss and state clearly that, after considering effect of all provisions, whether there is profit or loss to the society.”

Rule 69 (4) further provides that the audit memorandum shall state; -

(i) whether the Auditor had obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;

(ii) whether in his opinion proper books of accounts, as required by the Act, the rules and the bye-laws of the society have been kept by the society so far as it appears from the examination of these books;

(iii) whether the balance sheet and profit and loss account examined by him are in agreement with the books of accounts and returns of the society and give true and fair view of state of affairs and

(iv) whether the accounting standards adopted by the society are consistent with, those laid down by the State Government or the Institute of Chartered Accountant of India and have no adverse effect on the account at finance year status of the society.

5. *Qualification to opinion:* The auditor is required to state in audit memorandum reasons for the negative answers or qualifications as mentioned in sub rule (4) above. Auditor has to express his negative / adverse qualification on financial statement as per sub rule 5 in his audit report. In this regard, the Institute (ICAI) has issued standard on auditing 700 which the auditor should follow while expressing his opinion on financial statement and record the reasons for his qualification.

6. *Appointment letter by society :-* As per Section 81, the auditor has to be appointed by the society in its Annual General Body Meeting and require to issue appointment letter to the auditor and also submit a return under Section 79 (1B). This appointment letter must contain the objective and scope of audit, responsibilities of the auditor, responsibility of the management.

The appointment letter of the auditor broadly should contain the following matters:

- 1) Role of the auditor as per Section 81 read with Rule 69.
- 2) Audit expectations having regard to Cooperative Societies Act, Rules and byelaws of the Society concern.
- 3) Duration of audit, and scheduling of time, audit program in a brief manner.
- 4) Auditor's remuneration, reimbursement of out of pocket expenses as per notification issued by the Government.
- 5) Reporting method and submission of audit report.
- 6) Duties after completion of audit, like Special Report, rectification report, and compliance.

As the Cooperative auditor have been given more responsibilities and powers under the Cooperative Act, the auditor appointed by the society is expected to audit in adherence with Cooperative Societies Act, Rules, and byelaws of the Society concern.

7. *General Terms and conditions of appointments of Auditors:* whether the appointment of auditor is made by the Registrar or Society, the appointment shall be subject to following terms and conditions. However, the Society appointing auditor can lay down some extra conditions regarding scope of audit.

- 1) The auditor must be from the panel approved by the Government and prepared by the Registrar.
- 2) The auditor should not possess any conditions of disqualification.
- 3) He shall not audit the society, without obtaining the appointment order, and complete the audit within four months from close of financial year. The auditor should submit his report within a month from its completion but in any case before the issue of the notice of the Annual General meeting of the Society.
- 4) The audit fee should be as prescribed and notified by the State Government.
- 5) The audit report by the auditor should be in accordance with the instructions issued by the Registrar and provisions containing Rule 69 (1) (b) in three parts viz. part A- serious points and frauds, Part-B General remarks as specified in circular, Part-C miscellaneous objections. The audit report shall also contain the questionnaire specified to various societies, and schedules as per Rule 69, in the formats prescribed by the Registrar.

- 6) The Auditors have to follow the other terms and conditions that are laid down in the appointment orders issued by the Registrar or society.
- 7) The auditor has to submit the information regarding audit of any society, allotted to him, to the Registrar, as required by him time to time.
- 8) The auditor should ascertain about its Registration in the panel maintained by the Registrar, while auditing the society, and specify his panel registration number in the correspondence regarding audit.
- 9) Auditor should also follow the provisions of other Acts, if any, applicable to the audit of concern society. viz. in case of Urban Banks – Banking Regulation Act. Etc.
- 10) The auditor has to verify the audit rectification report submitted by the society and offer remarks about compliance of points he has raised, for the year for which he has audited that society; and submit it to the respective Registrar within the area until last query is complied.
- 11) The auditor has to submit Special Report/ Specific Report as required by the Act, to the Registrar, if he come across with the misutilization of fund by management of society; any fraud or misappropriation in the accounts of the society, by any person responsible with the records and funds and assets of the society. If the auditor observe serious irregularities which have material effect on the working of the society, then he has to submit specific report for further action. In case of misappropriations and frauds he has to lodge the police case (FIR) against the accused persons with the permission of concerned Registrar. In case, the auditor has failed in complying his duty in these regards, he will be liable for action as per provision of Act and Rules, and in case of Government auditor, as per Service Rules of the Government.

8. Duties of the Auditor :- The auditor's duty shall be as per provisions Maharashtra Co-operative Societies Act and Rules and conditions laid down in the appointment letter by the Registrar or Society.

9. Powers of Auditor : Auditors auditing from the panel of auditors, prepared by the Registrar have the following powers as per Maharashtra Cooperative Societies Act 1960, and rules 1961.

- 1) He shall have a access to all books, accounts, documents, papers, securities, cash and other properties belonging to, or in the custody of the society, and may summon any person in possession or responsible for the custody of any such books, accounts, documents, papers, securities, cash or other properties, to produce the same at any place at the headquarters of the society or any branch thereof, at all time, but only for the purpose of his audit.
- 2) He shall have a authority to obtain such information in regard to the transactions and working of the society for his audit purposes, from an officer or employee or former employee of the society, and every member and past member of the society, as per section 81 (4) of the Act.
- 3) He shall have a right to receive all notices and every communication relating to the annual general meeting of the society and to attend such meeting and to be heard thereat, in respect of any part of the business with he is concerned as auditor.
- 4) Under section 5 (a) of the Act, he shall have a power to impound the books of society, if he is satisfied during the course of audit that, some books of accounts or other documents contain any incriminatory evidence against past or present officer or employee of the society; however he has to obtain previous permission from the Registrar, before he impound the concern record of the society, of which he takes audit. After impounding the books or documents he has to give a receipt thereof to the society.

10 Responsibilities of the Auditor :-

- 1) The auditor should audit the societies with due skill, care, and observing professional ethics, integrity.
- 2) He shall have to bring to the notice of the Registrar and the Society, misutilisation of funds, misappropriations and frauds that are come across during the course of audit, and take appropriate action against the persons responsible for the same.
- 3) The Civil and criminal liability will be rest on him, against the negligence of duty, if it is found in the audit of society, which he is auditing.
- 4) Gross negligence will held him responsible to remove from the panel of Auditors maintained by the Registrar, and action from the Indian Institute of Chartered accountant of India, as per Chartered Accounts Act, 1949. However he will be allowed to make representation before the appropriate authority. In respect of certified auditors and Government auditors the action for this will be decided by the Registrar as per circulars issued from time to time.

11. Remuneration of Auditor : - Remuneration of auditor shall be at the rates as prescribed under Rule 74, which reads as :-

- (1) Remuneration of the auditor or auditing firm who has conducted audit of a society shall be borne by the society and shall be at such rates as may be notified by the State Government from time to time depending upon the class of societies and their financial parameters.
- (2) When auditor or auditing firm is appointed by the Registrar on his own, remuneration of auditor or auditing firm shall be at rates as per sub-rule (1) above.
- (3) If the Registrar, orders re-audit of a society after recording reasons thereof, shall specify remuneration payable to such auditors as per sub-rule (1) above.
- (4) When re-audit is requisitioned by society or any member of society, the remuneration of auditor or auditing firm shall be as per sub-rule (1) above :

This rule further provides that, when such re-audit is requisitioned by the society or any member of the society, the remuneration of auditor or auditing firm shall be deposited by such society or member, as the case may be, with the Registrar prior to commencement of such audit :

It also further provides that, if it is found in the re-audit, that the appointed auditor has not conducted audit as per the auditing standards and norms as notified from time to time and if it is proved that he is negligent in performing audit of the society and he has not detected fraud, misutilisation of funds, inadequate provisioning, resulting into loss or profit to the society, then audit fees shall be recoverable as per sub-section (1) of section 156 of the Act, from the said auditor who had conducted the audit and same shall be refundable, to the society and remuneration of re-audit shall be refundable to the society or any member demanding re-audit. The said auditor shall also be subject to action under sub clause (viii) of clause (g) of sub - rule (1) of rule 69 :

This rule also provides that, nothing in the preceding proviso shall apply to the Government Auditors.

- (5) When cost or performance audit of any society is ordered by the State Government as per the provision of sub-section (2A) of section 81, the remuneration of auditor or auditing firm shall be notified by the State Government and the amount shall be deposited by the society with the Registrar prior to the commencement of such audit by him.
- (6) For the audit of the society which is under liquidation or the society on which official assignee is appointed, under the provisions of the Act, the remuneration of auditor or auditing firm to conduct audit of such society shall be specified by the Registrar.”

II-3 DIFFERENT TYPES OF AUDITS

1. Annual audit or statutory audit. - A “periodical” or “annual” audit is generally taken after the close of the year, when the books have been closed and the balance sheet and the profit and loss account are drawn up. This type of audit is compulsory in case of companies registered under the Companies Act, Co-operative societies Act, trusts, societies and other corporate bodies and associations registered under various Acts. It is required to be carried out by auditors possessing the prescribed qualifications. The auditors are required to submit their reports in the prescribed form. Such type of audit, which is compulsory under law, is known as “**statutory audit**” and is generally carried out once a year. Annual audit is taken up and completed as per provisions of Act.

Explanation to Rule 69 (1) (a) specifies types of audit, which includes Annual audit, Test audit, Cost audit or Performance audit, Special audit and Re-audit.

2. Interim Audit. - An “Interim audit” is at times conducted before the completion of the final audit, which facilitates its early completion. As co-operative societies, joint stock companies and other corporate bodies are required to hold the annual general meetings of their members within the time laid down in their respective statutes, an interim audit carried out during the course of the year facilitates early completion of the final audit so that the managing bodies of these institutions are enabled to hold the annual general meetings of the members within the prescribed time and present audited statements of accounts to the members. An interim audit of an audit stock company also enables its directors to declare an “interim dividend” on the basis of profits actually earned. An interim audit also helps the staff of the society to rectify irregularities pointed out in the interim audit report and avoids their recurrence. The management is also enabled to revise its decisions and take other remedial measures in the light of the suggestions contained in the interim audit report.

3. Internal Audit. - Regarding ‘internal audit’, it can be said that most of the bigger organizations find it necessary to set up an “Internal Audit Department” headed by the Chief Internal Auditor, who works under the direct control of the Board and is not subordinate to the Chief Accountant. The internal auditors submit their reports to the Board and suggest improvements. Since the Internal Auditor to go into too many details if he is satisfied that the Internal Auditor works independently of the Accounts Department and has been carrying on his duties efficiently with due regard to the requirements of statutory audit. The annual or statutory audit can therefore, be completed early. However, the cost involved in setting up an Internal Audit Department is considerable and very few Co-operative Societies can afford to set up and maintain in internal audit Department functioning independently of the Accounts Department.

4. Pre-audit. -The term “Pre-audit” denotes proper scrutiny of the claims before payments are made. It is a system under which all vouchers are scrutinized and passed for payment before actual payment is made. This is ordinarily the duty of the Accountant. But, sometimes, independent auditors usually designated as financial advisers, are appointed for the purpose. Such a system is found more suitable in Government Departments and public undertakings. Pre-audits, however, should not be confused with audit proper, which is an independent review of transactions as recorded in the books.

5. Re-audit. - Section 81(6) of the Maharashtra Co-operative Societies Act provides that, “if it appears to the Registrar, on an application by society or otherwise, it is necessary or

expedient to re-audit, Registrar may by order provide for such re-audit.” If, during Re-audit would also be ordered if certain facts of which the auditor was unaware at the time of his audit have subsequently come to light, which materially affect the correctness of the accounts. If re-audits are ordered at are requests of the societies or their members or outsiders, the cost of such re-audits will have to be borne by them as per Rule 74. Where re-audit is being ordered on the resolutions passed by the general meeting of the society, before ordering re-audit, reasons for re-audit should be ascertained and examined in detail and it should be considered as to whether it is necessary to order re-audit. Mere resolution of the society should not be considered as sufficient reason for ordering re-audit. Since all the provisions applicable to the original audit are also applicable to re-audit ordered by the Registrar under Section 81(6), the auditor appointed to carry out the re-audit will have all the powers of the Registrar under Section 81.

6. Test audit under section 81(3)(c) :- The section 81 (3) (c) Provides, “ If it is brought to the notice of the Registrar that, the audit report submitted by the auditor does not disclose the true and correct picture of the account, the Registrar or the authorized person may carry out or cause to be carried out a test audit of the accounts of such society. The test audit shall include the examination of such items as may be prescribed and specified by the Registrar in his order.” This thus means that the test audit is limited to the items that are prescribed in the order itself. This is not on the demand of the society or members of the society. But the Registrar can order it suo-moto. The test auditor has not been given any power like to summon, or otherwise by the Act. He has to submit his report to the Registrar.

7. Special audit :-

The Act prescribes for Special audit under Section 81(7) for the Co-operative bank, if requested by the Reserve Bank of India shall be conducted and report thereof shall be submitted to the Reserve Bank of India and the Registrar. Thus, it clearly means the Special audit is applicable only on the request of Reserve Bank of India.

8. Cost Audit and Performance audit: The Cost audit of certain types of societies shall be directed by the State Government under section 81 (2A) of the Act. The section read as follows:

“ Where in the opinion of the State Government, it is necessary in the interest of society to do so in relation to any society or class of societies for ensuring management thereof in accordance with sound business principles or prudent commercial practices, the state Government may, by order, direct that such society or class of societies shall prepare and maintain its accounts in the form determined by the State Government, from time to time and that cost audit or performance audit or both, of such society or class of societies, as may specified in the order, shall be conducted.

This section also provides for performance audit. The sub rule (2B) of the section 81 provides that, “the cost audit ordered by the State Government should be carried by the Cost Accountant, who is a member of the Institute of Cost and Management Accountants of India constituted under section 3 of the Cost and Management Accountants Act, 1959. The subsection further provides that the society shall cause such audit as per order issued by the Government.

Definition of Cost audit: By the term “ Cost Audit” means the detailed checking of the costing system, technique and accounts to verify their correctness and to ensure adherence to the objective of cost accountancy. The another definition describes cost audit as “Cost

audit is systematic and accurate recording of detailed transactions and operations of manufacturing, contracting, extracting, transporting, supplying, etc., so as to show the actual cost of each individual piece of work, service, or separate process comprised in the operations of the business.”

The cost audit is made applicable to the Sugar Factories by the Central Government. However the State Government has not notified to which type of societies cost audit is applicable. The cost audit rules are required to be prepared.

9. Objects of the Cost audit: The Cooperative Act provides the objects of the Cost audit are:

- 1) The management is working on sound business principles.
- 2) The management has applied prudent commercial practices.

10. Performance Audit :- The performance audit is known as management audit also. The management audit is defined as “ A comprehensive and constructive examination of an organizational structure of a company, institution or branch of Government, or of any component thereof, such as a division or department, and its plans and objective, its means of operations, and its use of human physical facilities.”

The another definition describes the management audit, as “ Management audit is an investigation of a business from the highest level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relation with the outside world and the most efficient organization and smooth running of internal organization.

Management auditing is a method to evaluate the efficiency of management at all levels throughout the organization, or more specifically, it comprises the investigation of a business by an independent body from the highest executive level downwards, in order to ascertain whether sound management prevails throughout, and to report as to its efficiency or otherwise with recommendations to ensure its effectiveness where such is not the case.

11. Cost audit records :- The rules 65(2) requires the society to maintain such books, records and accounts as specified by the State Government by general or special order for the purpose of cost audit.

12. Social Audit: The cooperative societies are organizations run by the people, for the people and to the people. The concept of cooperation to help by one to all and all by one. This concept has socio economic aspect. As the members of the cooperative societies, are formed for the enhancement, prosperity of the common man. The bigger institutions like Sugar Factories, Spinning mills have developed the area by providing facilities like medical, education, social activity centers and also provided employment to the rural people. These benefits to the general public are not presented by the societies, in their social income statement and balance sheet. It is agreeable that these societies have facilitated to the rural and urban people.

The Concept of social audit is described as “ the concept of social audit is a vision that at some future time corporations will assess their social performance in as systematic manner as they now assess their financial performance. Such audit would be required both for public reporting and for internal management purposes. The social benefit derived to the staff, society, and general public are presented in the social income account and accordingly social balance sheet should have been prepared.

CHAPTER IV

IV-1 PREPARATION FOR AUDIT AND FRAMING OF AUDIT PROGRAMS

1. Intimation of audit. - Since every auditor is likely to have a number of societies for audit, he will have to plan and fix up priorities to complete the audit within the time limit prescribed in the Act, and intimate each society he has to audit the probable date on which he would commence its audit. Auditor should intimate the society with a request to the Secretary, Manager or Managing Director of the society to bring the accounts up-to-date and also keep ready the necessary statements and information required by him for purpose of his audit. Sub-rule (8) of Rule 69 of the Maharashtra Co-operative Societies Rules, empowers the Registrar to specify the form or forms in which the statements of accounts and other information required for audit should be prepared by the society. Forms of accounts, statements and other information required for completion of audit would, of course, vary with the type of the society and the nature of the business conducted by it, although many of the statements and schedules are common to all types of societies. It is, therefore, necessary for the auditor to communicate to the society, in advance, the forms in which the statements are to be prepared and what information he would require for completion of his audit. Since the auditor has to certify that he has obtained all the information and explanation required by him for his audit, statements and schedules containing particulars of the operations and the financial position of the society will have to be obtained and thoroughly checked him, before completion of his audit and thereafter they will form part of his office records. For use of auditors a general list of statements that are required for the purpose of his audit is detailed below, except described in paragraph 5 of this chapter. The auditors may enhance it or shorten it as per their requirement and type of society they are auditing.

Statement No.	Particulars of the statement	information to be required
1	Financial statements duly approved by Board of Directors	
2	List of the Managing Committee	
3	List of Sub Committee	
4	List of Managing officers , managers / chief executive officer / branch managers (officer defined in Section 2 (20) of the Act.	
5	List of amendment made in By-laws during audit period	
6	List of overdues	In case of Cooperative Credit Structure Entity (SCB, DCCB, PACS) as prescribed by the NABARD / RBI and in case of other the pro-forma is appended in annexure.
7	List of balances of personal ledger as per schedule and balance sheet	
8	Bank reconciliation statements	
9	List of vehicles, expenses incurred on vehicle	
10	List of movable / immovable assets	Property registered should be maintained as prescribed in the rule. Form no.X-1.
11	List of movable / immovable assets sold during the year.	With details of profit or loss

12	List of members in J-1 and J-2 form	
13	Statement of general information and working of society	
14	Statement of verification of cash, stock and securities by board or authorized person by the board	
15	Loans and advances to directors and their relatives	
16	Other advances given to the directors (such as travelling advance, Anamat, any other advance given for specific purpose	
17	Loans and advances to employees	
18	Demand collection and balance statement	
19	Schedule of investment and confirmation statement	
20	Schedule of NPA / BDDR	
21	Schedule of directors who have absented for 3 or months of board meeting	
22	Statement of misappropriation or embezzlement	
23	Schedule of arbitration, execution and court cases	
Books of accounts kept ready for audit		
1	Day book, Cash book, bank book, subsidiaries cash book and general ledger	
2	All personal ledgers	
3	All committee's and AGM minute book	
4	Bank passbook / statements with balance confirmation certificates of all accounts	
5	Property register	
6	Investment register	
7	Stock book	
8	Movable property register	
9	Demand Collection and Balance register in case of salary earners	
10	Liquidity register in case of bank and credit societies	
11	Share transfer register	
12	Member register in I form	
13	Audit rectification register	

2. Need to give prior intimation. -The intention in giving prior notice to the society of his probably date of visit is to enable the society to write up its accounts up-to-date and also draw up the statements required by the auditor for his audit. If the society is not given prior intimation, it will probably complain that it had no time to prepare the statements and schedules and possibly the writing up of the accounts also might have remained in arrears.

The staff of the society would also be busy in preparing the statements and hence would not be able to attend to the auditor. As a result, the completion of the audit would be delayed.

3. When prior intimation need not be given :- The societies have to appoint their auditor for the current financial year in the Annual General body meeting, prior to close of the financial year. The society is well aware of the auditor who is auditing his accounts hence, the society need not be intimated the program but, the auditor should communicate the dates of his visits to the society.

4. Procedure to deal with complaints. - Sometimes, complains are received by the auditors about mismanagement and existence of serious irregularities in the working of a society. In such case, the auditor, after going through the complaint letter carefully, should refer to his audit notes and queries and see whether the contents of the complaints letter are corroborated from the notes he has taken down during the course of his previous audit, the queries and objections raised by him and replies of the management thereto. However, he need not take any further action beyond acknowledging receipt of the letter and informing the complainant that the points mentioned by him have been taken note of, and would be carefully examined during the course of his visit to the society for audit. However, if the complaints necessitate attention of the administrative officer, he should forward them to the District Deputy Registrar with his remarks. If receives complaint/s from the Registrar, addressing to take cognizance of it, he should carefully examine the points raised in the complaint letter and take necessary notes in his audit report regarding the trueness and materiality of the complaint. If such complaints are of financial nature he should go through the accounts and if necessary take action as provided in the Act, or otherwise of administrative nature he should send report with his comments to the registering authority for further action to taken on his end.

5. Preparation of statements of accounts and information required for audit under Rule 69 (8) of the Maharashtra Co-operative Societies Rules. - The following statement and schedules are always required by the auditor for completion of his audit, irrespective of the type of the society and it is necessary that every society should prepare and keep them ready as soon as intimation of audit is received from the auditor: -

- 1) List of account books and registers maintained by the society, including statutory and statistical books.
- 2) List of files relating to audit including Rectification Report of previous audit, inspection memos and visit reports of officers of the Department, the Reserve Bank, State Co-operative Bank and Central Co-operative Bank, Supervising Union and other Federal bodies to which the society is affiliated.
- 3) Summary of Receipts and payments during the year or trial balance as at the end of the year. If the audit covers part of the year, the statement of Receipts and Payments should be prepared separately for the period from the date of last audit to the date of present audit.
- 4) Trading and Profit and Loss Account for the co-operative year for which the audit is to be taken up and also for the further period if audit for the subsequently period is taken up. Also, balance sheet as at the close of the year and also a tentative one on the date, if the date is next to financial year, up to which the audit is to be carried out. These statements should have been drawn up to comply as nearly as possible with the requirements of Form "N" contained in the Maharashtra Co-operative Societies Rules.

- 5) Bank Reconciliation Statement/s as on the last date of the year, as also the date up to which the audit is to be taken up. Bank balance certificates in respect of all bank balances should be obtained directly from the banks by the auditor himself or the society should be asked to request the banks to furnish these certificates direct to the auditor.
- 6) List of members of the committee and the sub-committees, if any, salaried officers and members of the staff of the society. Where a large staff has been employed only a list of important officers together with their qualifications, grades, present pay, period of service and duties entrusted to them should be obtained.
- 7) Information regarding contingent liabilities and debts incurred, but not shown and also losses made during previous years and provision made therefore.
- 8) List of overdue debts in the prescribed form classifying them as good, doubtful or bad debts and details of action taken for their recovery. In case of societies advancing loans and advances, the list of Non performing assets should be taken, as per guidelines from the RBI/ Nabard or the Registrar, as the case may be.
- 9) Schedules of all types of personal ledger balance such as, -
 - a. Shares and subscriptions.
 - b. Deposits of all types, current, savings, thrift, recurring, cumulative, fixed small pigmy, etc.)
 - c. Loans, cash credits, overdrafts and all other types of advances. Loans and advances due from committee members and other office-bearers should be shown in a separate list also
 - d. Lists of sundry debtors and sundry creditors, suspense payable or receivable provisions made for outstanding liabilities, income received in advance, income accrued but not received.
 - e. List of prepaid expenses, deferred expense and preliminary expenses still to be written off.
 - f. List of unpaid interest on deposits, unclaimed dividend on shares and purchases, bonus payable, etc. (year wise lists should be prepared).
 - g. Inventories of stock on hand including stores, spare parts, raw materials, semi-finished and finished goods in case of processing and industrial societies.
 - h. List of dead stock articles, furniture and office equipment, machinery, tools and implements, etc., showing their purchase price, depreciation charged year after year and written down value.
 - i. Lists of share bonds, securities and other investments including fixed deposits held by the society, giving their face value, book value and market value, supported by market quotations as on the date of their preparation's).
 - j. Particulars of immoveable property held by the society, agricultural land, building plots, building, godowns, etc.
 - k. Lists supporting balance sheet figurers which are not mentioned above.
 - l. Any other statement or schedule considered necessary by the auditor for purpose of his audit.

6. Additional information to be obtained in respect of certain types of societies. -Since examination of overdue debts is the special responsibility of the auditor, particulars of all overdues and action taken for their business operations. Thus, in case of credit societies, information necessary for classifying all overdue debts into good, doubtful and bad will have to be obtained. In the case of urban banks and societies, information regarding their loan policy, collateral security for advances, maintained of fluid resources, etc., will have to be obtained. In many of the societies, arbitration suits for recovery of money or for other claims might have been filed by or against the society. In some cases, suits might have been filed in civil courts. Detailed information on all these matters will have to be

obtained by the auditor. Since the auditor has certify that he has obtained all the information and explanation required for his audit, statements and schedules mentioned above and other information will have to be obtained and checked by the auditor before completion of his audit and thereafter they will form part of the records of his office.

7. Working papers to be maintained by the auditors: The information given by the society to the auditor includes in his working papers. These papers are required for the further actions to be taken on criminal ground or administrative ground. The auditors require to preserve his working papers for this purpose. The following papers / documents and information form the part of audit working papers.

- 1) Byelaws of the Society including amendments made from time to time.
- 2) Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
- 3) A record of study of internal control related to accounting system.
- 4) Copies of audited financial statements.
- 5) Analysis of ratios.
- 6) Letter send to the Society asking explanations, clarifications
- 7) Notes on important points observed during the course of audit.
- 8) Important points of the last years audit report.
- 9) Audit intimation letter and letters regarding current correspondence.
- 10) Extract of minutes of Board of Directors, and sub-committee meeting related to the current years audit.
- 11) Audit program and worksheet of the staff working.
- 12) Current audit's working papers.
- 13) Confirmations and letters asking confirmations
- 14) Answer received from the societies, for the letters issued asking information and clarifications.
- 15) Draft audit report and financial statements.
- 16) Statements of financial information related with current audit.

8. Account Books and Records to be maintained by Co-operative Societies. – a) Section 79 of the Maharashtra Co-operative Societies Act empowers the Registrar to direct any society or class of societies to keep proper accounts with respect to all sums of money received and expended by the society and the matter in respect of which the receipts and expenditure of the society.

Rule 65 of the Maharashtra Co-operative Societies Rules further lays down that every society shall keep the following accounts: -

1. A registrar of members including persons nominated under Section 38 in form "I".
2. A list of active members in form J-1.
3. A list of non-active members in form J-2.
4. A registrar of shares.
5. A register of debentures and bonds, (where capital is raised by debentures and bonds.)
6. Minute book recording proceedings of the general meetings.
7. Record of attendance of general body meeting.
8. Minute book recording proceedings of committee meetings and sub committee meetings if any.
9. Cashbook
10. Day book
11. Bank book

12. General ledger and personal ledger.
13. Stock register.
14. Property register in form X-1.
15. Register of auditors appointed and their written consent.
16. Returns of society in form Y.
17. Register of audit objections and their rectification.
18. Such other accounts and books as from time to time are specified by Government by special or general order for any society or class of societies.

The byelaws of the society also specify what accounts and records are to be maintained by the society and the committee shall determine what additional account registers should be maintained by the society.

b) Cost audit Records: The society has to maintain cost audit records as prescribed by the state Government, in addition to the books and records mentioned above.

9. Special Books and Registers to be maintained by certain types of societies . – considering the business activity carried out by the particular society, they are required to maintain the additional records as may be required in addition to the regular books of accounts, records specified in the Rule 65. Thus, agricultural credit, multi-purpose and service societies will have to maintain a loan register, a register of declarations obtained from their members in accordance with the provisions of section 48 and Rule 47 (Form “M”, prescribed in the Rules). They are also required to maintain an Assets Register showing particulars of the lands held by their members. Societies, which accept fixed deposits, are required to maintain a “Fall Due Register (Due date register)” of fixed deposits. Banks and other credit institutions are required to maintain a “Demand, Collection and Balance” register. Societies, which have undertaken trading or manufacturing activities, such as consumer’s societies, marketing and processing societies and industries societies are required to maintain Purchase and Sales Journals and Stock Ledgers. When the numbers of securities held by a society are many and varied, an “Investment Register separate cost accounts, which will have to be reconciled with financial accounts. If the society has undertaken distribution of controlled commodities, a number of additional books and registers, forms of which have been prescribed by the Civil Supplies or other Controlling Government Departments like excise, are required to be maintained.

10. Duty of Auditor to see that necessary account books are maintained. -It will be seen that besides the statutory books prescribed under the above Rule, different type of societies will have to maintain different books of accounts. Some books are common to all types of societies, which have undertaken the particular types of activities. Rule 69 (3) requires the auditor to report whether in his opinion, proper books of accounts, which give all the information required under the Act, have been maintained by the society. It will, therefore, be the duty of the auditor to see that all societies in his charge maintain proper accounts and if any of the special account book or register is not maintained, he should guide the society for maintaining the book or register. It is needless to add that unless all necessary accounts are maintained more time would be required for completion of the audit.

11. Powers of the Registers to get accounts written, Procedure to be followed when accounts are incomplete. -Sub-section (1) of section 79 of the Maharashtra Co-operative Societies Act empowers the Registrar to direct any society or class of societies to keep

proper accounts in respect of all transactions entered into by the society and to furnish to him such statements and returns and to produce such records as he may require from time to time and the officer or officers of the society shall be bound to comply with his order within the period specified therein. Accordingly, where the auditor finds that the account books are incomplete or the statements and information required by him for purposes of his audit are not kept ready, he should report the matter to the Registrar or to whom powers of the Registrar under section 79 have been delegated. (***Government orders No. CSL. 1467-443-C-3 dated 6-1-1968***). The officers concerned will issue an order under provisions of the Section directing the society and its officers to bring the accounts up-to-date and to furnish necessary statements and information required by the Auditor.

12. Responsibility for maintenance of accounts. -Byelaws of societies specifically lay down that it shall be the duty of the committee to maintain necessary accounts and see that the account books and registers are always maintained up-to-date. In case of the smaller societies, particularly agricultural credit and other societies in rural areas, the secretary himself writes the accounts. In case of the larger societies, however, which maintain a salaried staff, an accountant is usually appointed for writing the accounts and preparing statements. However, since most of the societies except a few in large cities are not in a position to hire the services of competent and qualified accountants, the auditors should advise such societies to get their accounts completed. However, there might be societies the management of which might be indifferent or intentionally avoiding to maintain necessary accounts on some plea or other and the auditor, in spite of his prior intimation, may find that the account books are incomplete and the statements and information required by him for his audit have not been prepared. In such cases, where it is not possible to get the accounts written up and obtain information required for completion of his audit, the auditor should politely apprise the committee of the position and point out to the members of the committee their responsibility in this matter. He should also give necessary instructions to the Secretary and the staff of the society and allow them time to comply with his instructions. If, after lapse of a reasonable time, when he visits the society once again, the accounts are found still incomplete, he should report the matter to the Registrar, suggesting suitable action under provisions of section 79 of the Act.

13. Power of the Registrar to get account written. -Where the society has failed to maintain proper accounts and the order of the Registrar issued under provisions of sub-section (1) of section 79 has not been complied with the time specified in the order under sub-section (2) of the Section, the Registrar has been empowered to take necessary action at the expense of the society through a person authorized by him.

Under sub-section (3) of the section, the Registrar may also order that the cost of getting the account books written up-to-date, assessed to the society, should be recovered from the person or persons whom he considers responsible for not maintaining the accounts up-to-date. Besides, for not complying with the orders issued by the Registrar under the sub-section, such person or persons are further liable to pay to the society an amount up to Rs. 100/- for each day until the Registrar's directions are complied with.

14. Preparation for audit. -Since the auditor renders a professional service, it is absolutely that he should possess necessary technical qualifications and skill for conducting audit, since without adequate theoretical grounding and basic skill, no professional service can be rendered satisfactorily. Although knowledge of bookkeeping, including higher accountancy, budgeting technique, cost accounts and management accounts is necessary, as without this knowledge, he cannot be said to have acquired adequate proficiency to

discharge his duties satisfactorily. It has also to be borne in mind that unless the auditor can himself write the accounts, it is not possible for him to check them and pass them in his audit. It has to be noted that the auditor is required to certify the correctness of the accounts examined by him and no honest auditor can certify the correctness of the accounts presented to him without having properly examined them. ***It is always, therefore, a safe rule not to pass any entry in audit unless the auditor has properly followed its implications.*** It is also necessary that the auditor should get himself fully acquainted with the principles of auditing and the processes and procedures that have to be gone through and the various tests that are required to be applied while conducting different audits, which can only be acquired by undergoing an intensive and rigorous practical training under senior and experienced auditors. Besides possessing a thorough knowledge of bookkeeping and higher accounts and the principal of practical auditing, the auditor has to have a thorough knowledge of the provisions of other statutes, which have a bearing on the working of the co-operative societies. The other statutes, which have a bearing on the working of the co-operative societies. The provisions of Income Tax and Sales Tax act, Limitation Act, Insurance Act, Bonus Act, The Employees Provident Fund Act, Transfer of Property Act, Sale of Goods Act, Contract Act, Registration Act, Stamp Act, etc., which apply to the working of co-operation societies, are required to be studied. Besides, a number of allied acts, such as the Agricultural Produce Markets Act, Agricultural Tenancy and Land Holdings Act, Moneylenders Act, etc., are also required to be carefully studied. The Reserve Bank of India Act, Nabard Act, Banking Regulation Act and Negotiable Instruments Act, also apply to Co-operative banks and their provisions would have also to be studied. The auditor has to submit specific report in respect of financial irregularities and frauds and misappropriation. For this purpose, the auditor has to get acquainted with the Indian penal code, Indian evidence Act, and civil and criminal procedure code to decide the legality of such irregularities.

Most important of all, the provisions of the Co-operative Societies Act and the Rules made there under are required to be studied quite in detail. The auditor should know the provisions of each section of the act and Rules. The byelaws of the society regulating its constitution, management and day-to-day working have also to be going through before commencement of audit. The auditor is also required to be familiar with the content of the various Government notifications and orders and circulars issued by the Registrar, the Reserve Bank of India and the State Co-operative Bank and other Apex level institutions, which have been notified as federal societies.

15. Need to obtain clarification and explanations. - During the course of his audit, the auditor has to be satisfied that the transactions, which he is called upon to examine, are proper, duly authorized and correctly recorded. For this purpose, he has to depend upon the books of accounts and the evidence contained in the receipts, vouchers, bills, invoices and other documents and also minutes of meetings, memoranda and correspondence. He can also supplement the information available from the books by calling for clarifications and explanations. It should not, therefore, be difficult for a trained auditor to satisfy himself about the information by applying proper tests. However, in order to become acquainted with the nature of the transactions and their various aspects, which he has to examine, the auditor should get himself familiar with the type of activities undertaken by the society, the accounting method adopted and the system of internal control in force. It is, however, possible that the auditor may not always be familiar with the type of business conducted by the society, since he is not expected to know the technical aspect of the transactions of different societies he is auditing. There would, therefore, be occasions when the auditor will be required to supplement his knowledge and obtain additional

information about the nature of the transactions. In such cases, by putting intelligent questions, he should obtain the required information to enable him to understand and comment on the transactions in an intelligent manner. *It has, however, to be noted that although ignorance on technical matters may be excused, the auditor should be careful not to put questions, which might betray his ignorance of simple matters.* All the same, it is not safe to pass an entry in audit, if the precise meaning of which is not clear to the auditor. It is, therefore, important that, the auditor, before he commences his audit should acquaint himself with the type of transactions that he is required to check, the manner in which they are recorded and the nature of documentary and other evidence that would be available for the purpose. He cannot, of course, be expected to possess all the technical knowledge of the methods of production and the processes, particularly if the society has undertaken manufacturing or processing activities. In such cases, by going through the list of account books and files maintained and discussing with the technical officers and the accounts staff and also by going round the factory and watching the manufacturing processes, it should be possible for the auditor to equip himself with adequate knowledge of the technical aspect of the working of the society.

16. Need to study process of various systems :- Though the auditor is not technically expert, he has to study the processes of various systems of business of the society. In the manufacturing he has to study the process of manufacturing in detail with the record maintained for recording the process. Such as in Sugar factory, he has to study the process of sugar production, log books maintained for process, and material used, its standardization for a unit of production, wastages for raw material, reasons, delay of process, reasons for delay, break downs and reasons for them. Which he has to turn into financial results, so that he can get the proper results of financial position, and the reasons that have caused to losses occurred by the factory. The same skill he has to apply while studying the systems in Spinning Mills, Oil Mills, Rice Mills, Chemical units and other production units. While auditing service societies like Urban banks, Urban Credits, Insurance Societies, he has to study the service process, by which he can get acquainted about the internal control, and can decide the extent of his checking, as well as can suggest how the improvement is required by the society, to prevent the frauds and misapplications of funds. While auditing computerized accounts he has to study the parameters set for recording the accounts, which should be consistent with the standard accounting policies adopted by the society. If parameters are not set as per accounting policies, the adverse effect on financial position, required to be reported in his audit report.

17. Auditor not to approve entries in audit without proper understanding. - As already stated, an auditor need not have complete knowledge of technical matters, since he cannot be expected to be an expert in all the lines. However, it is his duty to acquaint himself with all the aspects of the working of the society, the accounts of which he is called upon to examine and certify. Care should, however, be taken to see that the questions to be asked do not betray his ignorance of simple matters, as it is likely that such ignorance might be taken undue advantage of by unscrupulous people. He should also take care not to arouse suspicions in the minds of the persons whom he questions and those around him.

One of the greatest dangers to efficient audit is to approve entries, which are not completely understood, because the auditor is afraid to betray his ignorance by putting questions. It has, however, to be remembered that, should the auditor assume to possess knowledge, which in fact he does not, he will inevitably make mistakes, which might lead him into trouble. ***He should, therefore, not hesitate to ask for information upon technical details of which he has no previous experience or knowledge.*** An auditor must

not approve an entry unless he understands its exact nature and is absolutely satisfied that it is in order. In particular sometimes auditor is afraid to ask questions and consequently approve the entries blindly trusting that they are in order, which is a very dangerous habit which may lead them into trouble. ***An honest admission of ignorance of technical matters and anxiety to acquire more knowledge will always win more respect than an assumption of knowledge which is not in fact possessed the lack of which is almost sure to be discovered.***

18. Audit evidence: The proper evidence should be collected by the auditor before he passes the entry, and draw reasonable conclusions therefrom on which to base his opinion on the financial information. The term '**sufficient**' refers to the quantum or adequacy of evidence. The term '**appropriate**' refers to the relevance and reliability of evidence. Thus the evidence should be adequate as well as relevant and reliable.

What constitutes sufficient appropriate audit evidence in a particular situation is a matter of the auditor's professional judgment. Some of the factors, which influence the auditor's judgment, are as below.

1) Misstatement in the financial information leads to negligence on the part of auditor, if he certifies the same. The degree of misstatement depends on the nature of the item under audit examination, the adequacy of internal control, the nature or size of the business carried out by the society, and financial position of the society, situations which may exert an unusual influence on the management. For example, a sugar factory, has much sugar cane to crush, and the management wants to reduce the sugar cane price and carry over the surplus balance to the next year, where the sugar cane seem to be short, resulting loss. For recoupment of future loss the accountant with the knowledge of management, debits expenses, which are not payable, showing them payable. In this situation the auditor has to sort more information about the expenses that have been provided. The correctness, and genuineness of the records he has to verify. The after only he will be able to pass the entry.

2) **Materiality of the item :-** A material item would need to be supported by more persuasive audit evidence as compared to an item, which is not so material. If, in the above example the amount of expenses payable is minor will not materially effect, however a sizable amount will effect the materially on the financial statement, and the evidence of expenses, is not available, or after calculation it found that the re is no necessity of provision. The effect is more on the financial statement, and the auditor has to take due care and use his skill to find out the proper position.

3) **The experience gained during the last audit :-** If the auditor is auditing the same society, he can use his last years experience regards internal control, integrity of the staff and management, and can rely upon.

4) The results of auditing procedures, including frauds or error, which may have been found. Thus, where an auditor applies certain audit procedures and finds material errors in accounts, he will extend his audit procedures to obtain more persuasive audit evidence. For example if the auditor finds that the there are big differences in the schedules balances and balance shown in the balance sheet, he finds there are recurring mistakes in posting, and totaling, he has to carefully apply his procedures in depth.

5) The type of information available. If in respect of certain items, the quality of information available is not adequate, the auditor should seek more evidence. For example, while certifying the bad and doubtful debts, the security of the advances, is inadequate, it does not reveal from the statements provided by the society, the auditor should ask for the documents creating charge on the property mortgaged, actual verification of the security if it is tangible.

6) Trends indicated by accounting ratios and analysis. By correlating various factors, ratios provide a good indicator to the auditor to cross check whether the position as shown in the financial statements seem reasonable or not, if not, he needs to seek more audit evidence. For example if the gross profit ratio shows growth, though there is no sales effected, the auditor has to verify the reasons for the same. It might be possible that, the stock is overvalued. The stock is dormant and the value is increased while valuating it.

19. Reliability of audit Evidence: The reliability of audit evidence depends on its source and nature as well as on the circumstances in which it is obtained. The generalizations are as follows:

1) For expressing his opinion auditor requires, sufficient and appropriate evidence. The auditor has to confirm about the relevance and reliability of evidence that has been produced to him. Apart from this internal evidence he has to collect the information from outside, by way of confirmations, obtaining abstracts from the banks and sundry debtors and traders. The evaluations of this evidence may be generalized as follows:

- a) External evidence is more reliable, as it is obtained from the outside sources. Therefore, the confirmations received from the customer, traders and other are more reliable in a normal audit situation, than the internal sources of evidence.
- b) Internal evidence is more reliable when the related internal control is satisfactory.
- c) Evidence in the form of documents and written representations is more reliable than the oral representations.
- d) Evidence obtained by the auditor himself is more reliable than the obtained from the society.

IV-2 INTERNAL CONTROL

1. Internal control. -After equipping himself with sufficient knowledge about the nature of the operations conducted by the society and the manner in which they have been recorded, the auditor should proceed to study in detail the system of internal control in existence. In modern times, no business can be conducted without having a sound system of internal control, except very small concerns where the eye of the proprietor is everywhere. Even in small agricultural credit societies, the work of the secretary has to be controlled and supervised by the Chairman and the Committee. The system of internal control in force forms the very foundation on which audit should be based. The audit program in fact cannot be drawn up without complete knowledge of the system of internal control in force. The selection of auditing procedures and processes and their application tests to be applied, and the quantum of detailed checking work to be done, will all depend on the auditor's evaluation of the system of internal control in force.

2. Internal control, internal check and internal audit. -By internal control is meant *“the system established by the management in order to carry on the business of the society in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of the records.”* Internal control thus includes both internal check and internal

audit if there is an internal audit department. Internal check consists of the delegation or allocation of authority and work in such manner as to afford checks on the routine transactions of day-to-day work, by means of the work of one person being proved independently by another, so affording a means whereby fraud is prevented and its early detection facilitated”. Internal audit is described as a “review” of operations and records sometimes continuously undertaken within a business by a specially engaged staff.”

3. *Management of co-operatives and internal control.* –By-laws of co-operative societies specifically lay down the duties and functions of the Managing Committee and other officers, such as Secretary, Managing Director, Manager, etc. In most of the societies, besides attending to policy matters, members of the committee also attend to executive functions and sometimes also take part in the conduct of routine transactions. A close and careful study of the provisions of the byelaws of the society and the practical followed by it should be conducted to understand the nature and extent of the administrative and supervisory functions to be attended to by the members of the committee and other office-bearers of the society and determine how far and in what manner the activities of such honorary workers can be coordinated and fitted in, in order to evolve a sound system of internal control. As regards internal audit, it may be mentioned that, although the byelaws of many societies provide for the appointment of internal auditors and also define their duties and responsibilities, very few societies appoint qualified auditors for carrying out their internal audit. The banks having branches with deposit more than Rs.50 crores are required to appoint auditor for concurrent audit.

4. *Points to be considered while determining quantum of detailed checking.* -In deciding upon the extent of detailed checking work to be carried out, the following points should be taken into consideration: -

- 1) The efficacy or otherwise of the system of internal control.
- 2) Reliability of the records.
- 3) The nature of the activities undertaken by the society.
- 4) The volume of transactions.
- 5) Arrangements for internal audit.

5. *Difficulties in evolving suitable arrangements for internal control in co-operative societies.* -Except in case of very large institutions like District Central Banks, District Marketing Societies, Co-operative Sugar Factories, Spinning Mills and other large societies the staff appointed by the societies is quite meager and it is not possible to evolve any scientific system of internal check. Byelaws of most of the societies provide that the members of the committee and the Secretary in particular should supervise and control the work of the paid employees. Duty is also cast on the members of the committee to see that the accounts are written up properly and up-to-date and also to count cash on hand and verify stock. However, this is rarely found to have been done in practice and in a majority of cases, members of the committee do not have sufficient leisure nor do they have the necessary business acumen to discharge their responsibilities adequately. The federal societies to which the societies are affiliated are no doubt expected to guide, control and supervise their working. However, these federal bodies do not have necessary staff to carry out periodical inspections and they function mostly as coordinating bodies and act merely as a forum to voice the grievances of their member societies.

Auditors of co-operative societies and in particular auditors in charge of the smaller societies therefore, have the added responsibility to assist the societies in their charges to establish an effective system of financial and administrative control, which

would not only ensure that the business of the society is carried on in an orderly way and its funds are not misapplied or misappropriated, but would also ensure the accuracy and reliability of the records maintained and safeguarding of the property of the society. *The auditors should examine carefully the system in operation and should not hesitate to mention in his report, the defects and deficiencies in the system and point out of the managing committee their duties and responsibilities in this matter.* In particular, it should be seen that where the paid staff is inadequate and incompetent, the members of the committee exercise adequate supervision. Even in small rural societies, provided the members of the committee take due interest in the affairs of the society, it should be possible to evolve a system, which would ensure accuracy and reliability of the records and safeguard its assets.

6. Basic principles of Internal Control. -The basic principles of a sound system of internal control are as under: -

- 1) All remittances received should be immediately acknowledged. Official receipts from the printed receipt book signed by the officers authorized under the byelaws to sign receipts should be issued, for all payments made to the society. For remittances, for which official receipts are not issued such as withdrawals from bank, encashment of cash certificates, sale proceeds of investments, etc., necessary arrangements to ensure correct recording of the transactions should be made.
- 2) Vouchers signed by the payee should be obtained for all payments made by the society. All payments should have been properly authorized. A system of making payments only against authenticated vouchers should be introduced.
- 3) All payments in excess of a specified amount, should be made by crossed and order cheques marked "Account payee, not negotiable". It may noted that under the new Rule 107-D of the Maharashtra Co-operative Societies Rules, 1961, all payments except loans to members are to be made by cheques. There are some exceptions given in the Income Tax Act, for payment, which should be made in cash. The limit prescribed in Income Tax act for cash payment is Rs. 20000/-
- 4) All cash in excess of the amount specified in the byelaws should be immediately paid in to the bank. Rule 107-C specifies the maximum amount of cash on hand which can be maintained by different types of societies and also the by-laws lays down that all cash in excess of the prescribed limit should be paid into the nearest branch of the Central Co-operative bank or other approved bank within three days.
- 5) The closing cash on hand should be mentioned both in words and figures along with the name and designation of the officers of the society having custody of the cash. The byelaws should contain specific provision regarding maximum amount of cash to be kept on hand and designations of the officers responsible for its custody. The Chairman and the Secretary should sign the cashbook daily or other officers specifically authorized to do so.
- 6) The work of bookkeeping should not be kept in arrears. The cashbook should always be written up-to-date and the cash on hand verified daily. The general ledger and the personal ledgers should also be posted up-to-date. Personal ledgers balances shall be extracted monthly and agreed with the balance of the total account in the general ledger.
- 7) Monthly statement of accounts, viz., a statement of receipts and disbursements or trial balance, manufacturing and trading account showing cost of goods produced and sold during the month and also a provisional profit and loss account and balance sheet should be prepared by the accountant and kept for consideration before the Board or the Committee. This would not only ensure arithmetical accuracy of the accounts, but would also enable the management to review the state of affairs of the society at regular intervals

and assist them in taking appropriate policy decisions. The bank accounts are also required to be reconciled monthly. The differences in the agreement of various personal ledgers and also branch accounts wherever they exist need to be traced by the society and the balances reconciled at regular intervals.

8) All expenditure incurred should have been duly sanctioned. A statement showing details of expenditure incurred should be placed before the committee from time to time.

9) The committee should meet as often as may be necessary, but at least once a month to consider the affairs of the society.

10) The duties of the paid employees and matters to be attended to by the committee members should be clearly defined. ***There should be a proper division of the duties and responsibilities of the different members of the staff of as to ensure that another checks the work of employee and no person however highly placed has the sole responsibility for all the aspects of a transaction.*** Where the number of paid employees is sufficient to set up an adequate system of internal control, the members of the committee should not only exercise proper supervision over the work of the paid-staff, but also themselves attend to certain specific administrative functions.

11) *The cashier, who receives the cash should have no access to the ledgers and the ledger-clerks should have no concern with the agreement of the ledger balances with the control accounts, which should be attended to by a more responsible officer of the society.*

12) Necessary control accounts should be maintained to ensure correctness of postings of personal ledgers. Where the number of personal ledgers is large, separate control accounts should be maintained for each ledger and all accounts posted to the individual accounts of the members and other constituents should also be simultaneously posted to the respective control accounts so that at any time the total of the personal ledger balances can be reconciled with the balance in the total account in the general ledger.

13) Security as required under Rule 107-B of the Maharashtra Co-operative Societies Rules and by-laws should be obtained from all officers and the employees of the society, who come into possession of cash or other property of the society.

14) All cash, stocks and other property of the society should have been adequately insured. Preferably, a blanket policy insuring cash in safe and in transit, fidelity of staff, etc., should have been taken out. All fixed assets such as buildings, plant and machinery, tools, furniture and equipment, vehicles, etc., and also stock in trade, raw materials, stores, finished goods, etc., should have been adequately insured.

7. Internal Control where the accounts are maintained on computers: Many large societies, even the smaller once are maintaining their accounts on computers. The Computerized environment required more accurate and vigilant system of internal control, as there is possibility of corrupting record, loosing confidentiality of information, and information leakages in the hand of unscrupulous peoples. The main areas of internal control are as follows.

1) The control environment: 1.1 the environment control mainly relates to the security of data, which includes a) Information technology authorization structure. B) Segregation of duties, c) Computer operation to ensure that the system is used only for authorized purposes. D) Restricted access to the authorized personnel only. E) Use of authorized programs only. F) Detection and correction of processing errors.

1.2 System audit: it includes the review and audit of software development, acquisition and maintenance application, database and systems software.

1.3 Ensuring continuity of IT functions: this is possible with back up of data, machines and programs, site and personnel. Business continuity planning prescribes recovery procedures in the event of a disaster.

2) Application Control: Includes: a) file continuity b) Asset protection c) Transaction Control regarding completeness, accuracy and authorization. D) User controls.

3) Accounting Controls

For evaluation of internal control in computerized environment a questioner has been described in the manual elsewhere, the auditors are required to study them, and apply it while auditing these societies.

8. Bank Reconciliation. - Bank Reconciliation statements should be prepared regularly by the cashier or the officer who receives the cash Bank statements or the Pass Book. During the course of their audits, the auditors should compare the debits and credits shown in the Bank statements (or the Pass Book) with the entries in the cashbook and the counter-foils of the paying-in-slips and the cheques issued. Contra items either in the cashbook or the Pass Book should be enquired into. The items in the Reconciliation at the end of the period should be traced through the following period.

9. Evaluation of the system of Internal Control. - In brief, any system of internal control, worth the name, should ensure the following:-

- 1) All remittances received are correctly entered under their respective heads of accounts and all income received is duly brought into account.
- 2) All expenditure incurred is genuine, incidental to or necessary for the business of the society and has been properly authorized and debited to proper head of accounts.
- 3) All the property belonging to the society is properly accounted for and safeguarded.
- 4) All liabilities incurred are properly recorded and due provision is made for all known or expected losses.
- 5) The books and records provide reliable basis for preparation of the final accounts, so as to enable the auditor to certify their correctness.
- 6) The basic principles of a sound system of internal control explained above should be borne in mind. While evaluating the system in operation in the society, the accounts of which are being audited, the auditor should particularly bear in mind: -
 - a) Where there is possibility of collusion as well as combination of duties, which enable one person to conceal irregularities.
 - b) Whether there is possibility of collusion between close relatives, occupying elective posts or salaried employees, working in related part of the business?
 - c) Whether there is possibility of conflict of interest of the society in case of a director or other responsible officer having other similar business interests. Although specific provisions in this regard are contained in the Maharashtra Co-operative Societies Act and the Rules, these provisions are found to be inadequate and can be easily by-passed.

10. Auditing in depth. - During the course of his audit, the auditor has to trace a transaction, through its various stages from origin to conclusion examining at each stage, the voucher, records and authorities relating to that stage and observing the **appropriateness and efficacy** of the system of internal control in operation and exercise of authority by proper persons. Thus, while examining disbursement of loans in an agricultural credit society, it is not enough to compare the entry in the cashbook with the acknowledgement of the borrower contained in the loan bond or a separate voucher obtained for him. Complete verification of the transaction known to the auditors as "examination in depth" involves scrutiny of the following documents, as illustration for loan disbursed in PACS: -

- i) Application for loan received from the borrower and his account in the loan ledger to ascertain details of repayment of previous loans taken by him. His share account will

also have to be seen to ascertain the value of shares held by him and also to check the amounts deducted from the amount of loans sanctioned to him from time to time.

- ii) Normal credit statement to ascertain the credit limit sanctioned to him both for advances in cash and in kind.
- iii) Declaration executed by him under section 47 of the Maharashtra Co-operative Societies Act.
- iv) Resolution of the committee sanctioning the loan.
- v) Application to the bank and resolution of the committee for drawl of the amount from the maximum credit sanctioned to the society and approval of the Bank.
- vi) Loan Bond executed by the borrower.
- vii) Entry in the Loan Register and in the Loan Ledger.

11. Test or percentage checking: - An examination in the detailed manner indicated above, which is known to the professional auditor as “*auditing in depth*” cannot be carried out in respect of all the transactions of a society except where the society is a small institution and its transactions are not many, it should be possible for them to carry out complete checking of all the transactions, in other words, to carry out cent percent checking. However, in case of auditors, who have to audit large types of societies, it may not be possible for them to carry out detailed checking of all the transactions. They should, therefore, carry out a careful evaluation of the system of internal control in operation and if their appraisal proves satisfactory, they may in appropriate cases rely on a test examination of some of the records. It is needless to point out that selection of the period should be made carefully and the examination of the transactions of that period should be sufficiently detailed. *It has always to be remembered that the efficacy of an examination in depth depends on the care and skill with which the intermediate steps are examined.*

The Registrar has issued a number of circulars which contains detailed instruction regarding test checking or percentage checking. These should be carefully gone through and it should be seen that the quantum of detailed checking prescribed by the Registrar in respect of different societies, is carried out. ***It should, however, be noted that the percentages suggested are in respect of normal audits, but where frauds and serious irregularities are noticed, a more exhaustive checking (cent percent if considered necessary) should be carried out in order to ensure that no fraud or irregularity lies hidden unnoticed by the auditors.***

12. Sample audit: Auditor has to express his opinion on the financial position of the society, about the fairness and true position, based on an examination of records of transactions and other relevant information. However, in the large institutes the number of transactions are enormous, and it is not possible for the auditor to check them on cent percent basis. He has to sample them from various transactions. This enables the auditor to complete his audit within reasonable time and cost. The samples decided are so, that the further detailed checking serves no purpose, after the checking of sample transactions. It is almost admitted by the professional bodies, to carry out the audit by the selective verification by sampling. Institute of Chartered Accountants of India of India has also issued the SA 530 on this, which states as, “The auditor should design and select audit sample, perform audit procedures thereon and evaluate sample results so as to provide sufficient appropriate audit evidence.” The objective of auditor when using audit sampling is to provide a reasonable basis to draw conclusions about population from which sample is selected. While designing audit sample, auditor should consider objective of audit procedures and characteristics of population to assist in effective and efficient design of

sample, stratification may be appropriate. Stratification is process of dividing population into sub population.

When determining sample size, auditor should consider sampling risk, tolerable error and expected error. If auditor expects error to be present in a population, large sample needs to be examined to conclude that actual error in population is not greater than planned tolerable error. Auditor should select sample items in such a way that sample can be expected to be representative of population. This requires all items in the population have an opportunity of being selected. After having carried out these audit procedures on each sample item that are appropriate to particular audit objective, auditor should analyze any errors detected in the sample, project the errors found in the sample to the population and reassess sampling risk.

13. Ledger audit: As a part of sample audit, auditor can select his samples from the General ledger for some transactions such as, accounts from the profit and loss accounts where expenditure accounts. For example while checking the stationary account the auditor can select bigger accounts of stationary expenses and that are thoroughly checked. This will cover the most of expenditure made this account. This can be extended to Expenses related to salary and allowances, advertisement, donations, legal charges, repairs and maintenance of assets and vehicle, depreciation, provisions for reserve s and bad debts, Incomes like, commission, miscellaneous receipts, sale of assets, and some reserve accounts.

IV-3 AUDIT PROGRAM

1. Preparation of the programs of audit. -As we have seen, the auditor carried out his work largely be means such as. -

- (a) Evaluation of the system of internal check for both soundness in principle and effectiveness in operation.
- (b) Close and careful scrutiny of the accounts books, vouchers and other documents.
- (c) Agreeing the final accounts, viz., the profit and loss account and balance sheet with the books of account.
- (d) Verification of assets and liabilities.
- (e) Observation, enquire, calling for clarification, making of statistical comparison and such means as may be considered necessary.

Practical auditing thus consists of a proper evaluation of the system of internal control in operation and carrying out certain routine processes and procedures known to the professional auditor as vouching, calling over, posting, casting, carry-overs, etc. However, these are only general terms and since the object of audit is for the auditor to satisfy himself about the geniuses and correctness of the accounts, careful thought will have to be given to the nature of tests to be carried out. It will also have to be noted that the scope of the processes and procedures mentioned above cannot also be clearly define and will depend upon the system of accounting and preparation of records adopted by the business.

From a close study of the provisions of the byelaws of the society and information collected about the nature of transactions and the methods adopted for the recording and careful perusal of the list of books and accounts maintained by the society, the auditor should be able to map out his program of work, for completion of his audit. During the course of his evaluation of the system of internal check in operation, the auditor should try to ascertain loose points existing in the functioning of the society and map out his program, of detailed checking accordingly, so that these loose points would receive special

attention. The arrangements made for proper authentication of the accounts are records should also be ascertained so that responsibility might be fixed whenever occasion arises.

2. Need to prepare programs of audit. -Since the auditor is required to complete the audit within the time allotted for it, it is absolutely necessary that he should prepare an audit program detailing the items of work to be carried out and distributing the work amongst his assistants. The audit program in order to be effective has to be based on a standard model, which would contain all the usual items. The auditor may then adopt the standard program after making suitable additions and modifications therein to take account of the efficacy or otherwise of the system of internal control as revealed by his review of the accounting procedures and of the peculiarities of the activities undertaken. The audit programs will not only record the exact details of the work to be performed by the auditor and his assistants, but will also have columns for the initials of the persons performing each part as and when they complete it. *The auditors even though single-handed, should also prepare audit programs before commencement of their audits.* It has to be noted that every auditor, irrespective of his professional status or academic qualifications, is required to have very clear ideas as to the exact nature and extent of the work to be executed by him. Without framing the audit program, the auditor will be groping in the dark with no clear ideas as to what has been done and how he has carried out his work so that he may be able to prove that he has carried out his work **logically and efficiently** and has **applied due skill and diligence**. Audit program will also guard against possible omissions and ensure thorough and systematic checking thus helping to avoid waste of time and energy resulting from haphazard and unsystematic checking. The auditor will also be able to complete the audit within the time allotted to it. It is, therefore, needless to point out that even when the Auditor works single-handed, he must prepare his audit program.

3. Standard Audit Programs. -The Registrar under his circular No. ADT-552-CP, dated 2nd June 1972, has prescribed the form in which the consolidated audit program for all types of societies should be prepared. Instructions regarding framing of the program should be carefully noted. A program on the lines of the standard program prescribed by the Registrar with suitable modifications as warranted by the type of the society and nature of its activities should be prepared. This program should be referred to quite often and progress of audit ascertained.

The enclosed standard audit programmed is suitable for audit of average-sized credit societies including salary earners' societies, small industrial societies and consumers stores, etc. it is not complete in all respects although most of the items of routine checking and other aspects of higher audit including review, verification and reconciliation which are to be carried out during the course of an audit, are included therein. It has to be modified and developed suitably by the auditors in accordance with the type of business conducted by the society, and additional items may have to be included as warranted by the circumstances of each audit. "For special types of societies, such as farming societies, housing societies, Department stores, sugar factories, spinning mills and other industrial societies transport societies, forest labour's societies, labour contract societies, etc., a number of additional items will have to be included. In case of smaller societies and societies which do not conduct business to which the itemed relate and such items as have no application to the business conducted by the society, will have to be omitted and necessary changes will have to be made in the standard audit program to ensure that all salient features of the different types of societies receive due attention. A consolidated audit program on the line explained above will have to be drawn up for each society in charge for audit and each item of work, as and when completed, will have to be signed by

the members of the audit part concerned. After the work as per the audit program has been completed, the head of the unit should check individual items and satisfy him that all the items of work included in the audit program, have been carried out. The audit program together with the audit notes, queries, draft accounts checked by the auditor, statements and schedules and other working papers should be filed in the file of the society along with the mark-sheet or explanatory note for award of audit classification to the society in the form prescribed by the Registrar.

Format of standard audit program and applicability to the societies is appended as **Annexure I** at the end of the manual.

4. Audit Program to be revised from time to time. -It is needless to add the careful thought should be given before drawing up the audit program. The different aspects of the transactions to be checked, should be carefully studied, so that all-important items receive due attention. The audit program thus drawn up enables the audit party to proceed with their work methodically. It has, however, to be noted that the audit program may have to be **revised quite often** during the progress of audit. In fact, it should never be allowed to become stereotyped or obsolete and it should be revised from time to time according to circumstances and should be continuously kept up-to-date.

5. Allocation of work amongst the assistants. -Since the work involved in the auditor of large institutions such as District Central Co-operative Banks, Urban Banks, Marketing societies, processing societies, Sugar Factories, Spinning Mills, etc., is voluminous, it is not possible for the Chief Auditor to attend to all the work himself. A major portion of routine checking and other work will have to be entrusted to the audit assistants. It is needless to add that important items of work should be attended to by the Chief Auditor himself and only routine checking and other work of lesser importance may be entrusted to the assistants. The following items of work will have to be attended to by the Chief Auditor himself : -

- 1) Vouching of the debit side of the cashbook, except minor payments and other fixed charges, which are being paid regularly. The Chief auditor may check vouchers on the sample basis.
- 2) Breaches of the provisions of the Act, Rules and byelaws.
- 3) Perusing the minutes of the general meeting, Board/managing committee and sub-committee meetings.
- 4) Verification and valuation of assets and liabilities including verification of cash, confirmation of bank balances, verification of share certificates, securities title deeds to immoveable properties, etc. Verification of collateral securities including government securities, shares certificates, insurance policies, gold and silver ornaments, inspection of godowns, periodical stock returns, insurance policies of godowns, etc.
- 5) Scrutiny of loan balances and other sundry debtors' balances, checking overdues statements and classification of overdues into good, doubtful and bad.
- 6) Adequacy of provisions made for doubtful debts (NPA's) and loans.
- 7) Scrutiny of control accounts, and agreements with schedules of balances and supporting lists.
- 8) Scrutiny of financial position of the society including scrutiny of balance sheet and profit and loss account.
- 9) Appropriation of profits, treatment of capital profits and provision for income.
- 10) Allocation of expenditure between capital and revenue, deferred revenue expenditure, etc.

- 11) Provision for outstanding liabilities and provision for overdue interest, depreciation, taxes, etc.
- 12) Reconciliation of bank accounts, accounts of branches and other balances.
- 13) Scrutiny of operational efficiency of processing and manufacturing units by application of normally accepted standard and norms. Reconciliation of cost accounts with financial accounts.
- 14) Scrutiny of reasons for losses, shortages, wastages, etc.
- 15) Observance of conditions in respect of borrowings from Government and financing agencies.
- 16) Proper utilization for financial assistance received from Government.
- 17) Scrutiny of terms and contracts entered into with various parties.
- 18) Scrutiny of store accounts, cost accounts, processing and production account, allocation of stores and wages and overdues.
- 19) Scrutiny of use of vehicles.
- 20) Physical counting of cash, securities and stores.

There might also be other items of work, which the Chief Auditor might consider to be sufficiently important to be attended to by him. The other items of work may be entrusted to his *assistants according to seniority, experience ad qualifications*. However, these would depend on the Circumstances of each case, considering the importance of the society, volume of its transactions and the qualifications and experience of the staff assisting the auditor. No matter, however, qualified and experienced of the staff assisting the auditor. No matter, however, qualified and experienced his assistants may be, the Chief ***Auditor should always bear in mind that the entire responsibility for the proper conduct of audit rests on him.*** He should, therefore not leave important items of work like those enumerated above, to his assistants, but should pay his ***personal attention*** to them. He should also exercise proper control and supervision over the work of his subordinates.

The Registrar has issued a number of circulars specifying the various items of work, which should be attended to by the Chief auditor himself. Such instructions have been issued in respect of audit of urban and central banks, salary earners societies, sugar factories, etc. [Please see circulars No. ADM/243 dated 3-6-54, No. ADM/Sugar factories dated 26-11-69 and No. ADM/243 (CFAs.) dated 7-11-67]. The instructions issued by the Registrar should be carefully studied and in view of their special importance, these items of work should not be left to audit assistants. Whatever work is entrusted to the audit assistants clear instructions should be given, orally or in writing where necessary, so that they may have a ***clear idea as to what is to be done, how it is to be done, what points are to be noted*** in connection therewith, etc. The various processes and procedures for conducting audit, the types of tests to be applied should be explained to them in detail and they should also be aware of the types of irregularities they are likely to come across. After the audit assistants have carried out their part of the work, it should be test checked to see if any important points are missed. In this way, the auditors are encouraged to gain self-confidence and encouraged to become active partners in all that pertains to performance of efficient audit.

6. Method of working and training of audit assistants - Auditors are ordinarily expected to work in batches of two, one senior and the other junior, the more mechanical part of audit work like vouching, posting, calling over, etc. being shared both by the auditor or his senior assistant and the assistant. This should ensure that the junior members of the staff are given ample opportunities for acquiring knowledge and experience in the various branches of audit work. The division of work in the offices of Chief Auditors in no doubt a matter of internal organization, but it should be so arranged as to give a thorough insight

and experience to the junior members in the difficult and more complicated part of audit. The need for training the clerks and assistants so as to get an adequate output of work consistent with efficiency is all the more in case of Chief Auditors as it is practically impossible for them to pay adequate attention to all the work. In order that the work is not carried out in a mechanical way, and the audit clerks and other subordinates in charge *do not loose their sense of responsibility*, it should be impressed upon all the members of the staff that the programs set out for them is the basis upon which the audit has to be conducted and that they must use their intelligence while carrying it out. They must be encouraged to think out for themselves and make surprise checks outside the audit programs and suggest additions and improvements in the scheme. ***Experience has shown that serious discrepancies are generally revealed by surprise investigation and intelligent enquiries***, which fact should always be borne in mind? In order to give time to the Secretary or the Accountant to bring the books upto-date and also to draw up the information required for audit, the order of the various items of work to be carried out, specified in the audit program, may stably be changed. Thus, for example, vouching the payments side of the cashbook might have to be postponed in order to give time to the Secretary to attend the payment vouchers so that the time of the auditor in tracing the supporting vouchers will not be wasted. Similarly, if the personal ledger balances are not extracted and agreed with the total accounts in the general ledger, other items of work remaining from the audit program like scrutiny of the minute books, checking of the members' register etc., will have to be taken up.

7. Responsibility of Auditor for proper conduct of audit. - As we have seen, Auditors in charge of large and important societies are given audit assistants to assist them in their audit, as it is not practicable for them to attend personally to all the work connected with audit. The extent of work, which the Auditor would do personally, and work, which is to be entrusted to his assistants, will have to be decided by him. *However, the Auditor alone will be responsible for the proper conduct of audit even though much of the audit work will have to be carried out actually by his assistants.* It is, therefore, necessary that the progress of audit work should be kept under careful watch in order to ensure that it is proceeding on right lines and according to the program prepared by him. Auditors should see that the audit assistants assisting them have properly understood the nature of their work, the manner in which it has to be carried out and the departs and irregularities which are likely to exist and have to be noted by them.

8) Control of the quality of audit work: The Institute of Chartered Accountants of India has issued guidelines, regarding quality of work in general and procedures to be followed when work is delegated to assistants in and individual audit. The guidelines suggest that the quality work is maintained if the following objectives are achieved.

- 1) **Personal qualities:** The auditor should follow the principles of integrity, objectivity, independence and confidentiality.
- 2) **Skill and Competence:** The auditor has attained and maintains requisite skills and competence.
- 3) **Assignment:** Audit work should be assigned to personnel who have the degree of technical training and proficiency required in the circumstances.
- 4) **Directions and supervision:** There should be adequate direction and supervision of work at all levels.

9. Maintenance of worksheets. - Separate worksheets mentioning details of work done in respect of every society audited should be maintained by each member of the audit staff

(including the Auditor himself), taking part in the audit. Worksheets will be of two types, one will contain details of work done from day-to-day and the other will be regarding total checking and other work done, i.e. consolidated audit program. As already suggested, before commencement of actual audit, a detailed consolidated audit program should be prepared on the lines of the model audit program. As soon as a particular item of work is completed, by a particular member of the audit party or by a batch of two assistants, his or their signatures should be obtained against that item. The audit program should cover all the items to be covered during audit although the various items of work will be distributed amongst the different members of the staff according to their seniority and experience. From the work sheets maintained by the different members of the audit staff, the consolidated audit program will be filled in. The worksheets and the consolidated audit notes, query sheets, statements, final accounts and other routine papers relating to the audit of the society.

The Registrar in his circular No. ADM/243 dated 12-6-59 has directed that all audit assistants should maintain their worksheets, showing details of work done by them in the following form: -

Daily Worksheet of Shri.....audit assistants

Name of the Society


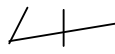



Period of audit: From:.....To.....

Date	Serial No. of the item in the audit program	Particulars of work done	With whom done name of the other member of the batch	Period covered from - to	Other details regarding vouchers, specific books, files, etc.	Initials	Initial of the officer
1	2	3	4	5	6	7	8

The last three columns in the consolidated audit programs should be filled in the form as worksheet.

10. Technique of audit. - Use of ticks or check marks. - While carrying out the routine checking for the mechanical part of the audit, the auditor has to make “**ticks**” or “**checkmarks**” for every entry in an account book or register examined by him and also initial or cancel vouchers by means of rubber stamp. Every receipt or voucher, invoice, bill, statement or other supporting documents initialed or signed by him is an evidence of his having been satisfied about the genuineness of the documents and the correctness of entry passed by him in his audit. The making of these ticks or check marks is quite necessary as they serve as an evidence of an Auditor having checked and compared the entry with the particulars mentioned in the supporting Documents, statements, or other records and passed it in his audit. The tick or the check-mark and the initials of the auditor also serves as an evidence of cancellation of the supporting document after having served its purpose, viz., serving as evidence of the correctness of the entry made in the books so as to prevent its production once again in support of another subsequent entry. The ticks or check marks should, therefore, be clear enough so that they can be recognized at any time. The use of these ticks and check-marks, their size, length, angle and other peculiarities are not uniform and every auditor is, therefore, free to have his own method of ticking or marking an entry in the books as evidence of his having “**passed**” it in his audit. Most of the professional auditors use rubber stamp bearing the names of their firms for canceling receipts, vouchers and other supporting documents signed by them.

11. Type of “ticks” or “check marks”. - The following are the usual ticks or check marks which are supposed to be used by the Auditors to indicate the different processes and procedures of audit carried out by them. If some auditors are using different tick or check marks, they should use following ticks or check marks for items of audit work shown against them with a view to have uniformity in this respect: -

Work	Area	Types of ticks
Posting	On the right hand side of the figure close to the last digit.	\ Or /
Casting or totaling	On the left hand side of the figure checked	
Carry forward	Same as above with an additional posting tick across the tick like	
Calling over or comparing	At the bottom of the figure.	
Vouching	On the left side of the figure, the horizontal line covering a part of the figure. Some time, the tick is put on either side of the figure.	
Bank pass books or statements	The posting tick on the right hand side unticked items; i. E. items appearing in reconciliation would have the letter “R” place on the right hand side.	R 
Contras or transfers	On the right hand side.	C

These ticks or check marks should also be distinctive and should be indicative of the particular process or procedure carried out or the test applied for. Particular care should be taken to see that the staff of the society whose accounts are being audited does not know the significance of these ticks. While carrying out different processes and procedures which form part of routine checking, distinctive ticks or check-marks should be made so that every member of the audit party including the principal should always be able to recognize his own ticks and state definitely what books and registers have been seen by him and what portion thereof or what type of entries have been checked by him.

12. Use of coloured pencils. - For marking the ticks or check marks, the auditors are required to use coloured pencils. Auditors of the Cooperative Societies are required to use **green pencils** and their audit assistants are required to use **blue pencils**. The staff of the society should be requested not to make use of these pencils for their internal checking.

13. Calling out figures and description. - While calling out the figures, audit assistants should be careful to speak out clearly or otherwise mistakes may be easily passed. For example, while calling out figures, “Twenty”, “Thirty”, “Sixty”, etc., the ‘**ty**’ should be emphasized and called out as twenty (twentie), thirty (thirtie), sixty (sixtie) etc., the ‘**ty**’ being called out as **tie**. Rs. 20.06 should be called out as twenty zero six or Twenty Rupees and six paise. As already explained, audit staff work in batches of two, the mechanical part of audit work like vouching, posting, calling over, etc. being carried out by two persons, one calling out the figures and description of the entry from the cashbook or other register and the other person tallying the particulars with the figures and description in the voucher or other document or entry in another book.

14. Corrections and overwriting in accounts. -While carrying out this audit, *the auditor should be careful not to make any alternations in the figures originally entered. He should not also make any entry in the books or statements himself or make any notes in the vouchers, statements or other documents which he is checking, if the figure appearing in any book or register is not distinct or appears to have been corrected or overwritten, it should be very carefully examined in order to see whether the correction made is authentic or deliberate.* Use of erase or knife for scoring out or earnings figures should be discouraged. If many corrections are required to be made, the original figure should be dislodged. If many figure should be entered distinctly on the top of the original figure or along side. *The Accountant or any other responsible officer in charge of accounts should be asked to make the corrections and the Auditor should not make any corrections himself.* All corrections should be invariably supported by initials of the officer authorizing them. If any figure is illegible or the auditor is not clear about it, he may encircle the figures with his coloured pencil and write the correct figure distinctly in the margin or along side the original figure so as to assist him to recollect the figure. In any case, it should be seen that the figure checked while vouching is taken both in totaling and posting.

15. Entries in Pencil to be got inked before checking. -Many times, the auditor comes across entries made in pencil. *It should be noted that entries made in pencil, particularly figures written in pencil, can be very easily altered and hence no auditor should accept entries in pencil. He should immediately ask the accountant or any other officer of the society to ink out the figures and initial them.* Many times, totals and balances are entered in pencil. Although totals or balances might be correct, still, it is necessary that they should be inked out and the Auditor should *take particular care* to see that all entries passed by him in his audit are inked out before he puts his tick or check mark on them.

16. Account books to be got written up completely before commencement of audit. -As far as possible, the auditor should not commence checking up of an account book until it has been written up completely for the period for which the audit has been taken up. On no account should he check figures in pencil even though he is assured that the figure would be inked out in due course. Each stage of work should be completed at one sitting, if possible. For example, while checking cashbook vouchers, for a month or other specific period, the whole should be checked and notes made of missing vouchers and irregular payments. Similarly, each part of the other work like checking of loan bonds, posting, calling over, etc. should be completely checked and record made in the *“Daily Work Sheet”* maintained by the auditor and his assistances of the exact stage upto which the checking has been carried out. These suggestions are of special importance to the auditors who are in charge of audit of certain types of societies.

CHAPTER V

V-1 ROUTINE CHECKING AND HIGHER AUDIT

1. General: As we know, the work of audit consists of carrying out certain processes and procedures and applying certain tests, which would enable the auditor to satisfy himself about the reliability of the accounts and the correctness of the profit and loss account and the balance sheet. It is therefore, needless to add that the auditor should be fully acquainted with the nature and significance of the various processes and procedures that are required to be carried out and also be able to determine the appropriate tests for

ascertaining the reliability of the accounts. Further, since he has to express his opinion on the balance sheet and profit and loss account, he must do all that he deems necessary to form an opinion thereon and report to the management of the society and the Registrar. Audit work may, therefore, be divided into the following parts.-

(i) Preparation: A close and complete study of the system of internal control, with a view to find out deficiencies and loopholes and its effectiveness in practice, the desirable features of a sound system of internal control have already been discussed

(ii) Routine checking: An exhaustive examination of the routine transactions, the extent of which would depend upon the auditor's assessment of the soundness of the system of internal control and its effectiveness in practice. In case of most of the smaller and medium size co-operative societies, however since a satisfactory system of internal control cannot be introduced for want of adequate paid staff, the transactions will have to be checked on a cent percent basis. The method of checking routine transactions and points to be noted during the course of checking, have been discussed in the following paragraphs.

(iii) Review or higher audit: Checking of profit and loss account: The principles governing preparation of the profit and loss account and certain specific items which call for special attention, such as allocation of expenditure between capital and revenue, depreciation, provision for bad debts and losses, etc., and also allocation of the net profits will be discussed in the following chapter.

(iv) Checking of the balance sheet, verification and valuation of the various items of asset, verification of liabilities, etc. These would be discussed in another chapter.

These are fundamentals upon which adequate time and attention should be devoted by the auditor and his staff. Routine checking or mechanical checking also forms an important part of audit work and has to be carried out diligently and intelligently. In fact, routine checking forms the very base of audit work as many of the tests to be applied and the extent of their application would depend upon the results of routine checking. The educative value of routine checking also assumes considerable importance in the audit of the smaller societies since it is only by observing how the auditor conducts his audit and noticing what types of defects he has pointed out, that the management becomes aware of their mistakes and how they could be avoided in future. It has also to be remembered that the auditor has also to act as an advise and thus to function as an aid to management. In order to discharge this function properly, he has to examine a number of documents and call for additional information, which the professional auditor is not normally required to do.

2. Importance of Routine checking- As regards the mechanical part of audit, routine checking as it is generally called, different processes and procedures are known by different names such as vouching, posting, casting, tracing, balancing, calling over, etc. In the following paragraphs, attempts will be made to explain the meaning and the significance of these processes and the manner in which they are to be carried out.

At the outset it may be observed that routine checking will disclose merely clerical errors and very simple frauds and will seldom, if ever, reveal errors of principle or clever frauds. In order to discover these, the auditor must go behind the books of accounts, examine the original records and make intelligent enquiries. In fact, he will be required to trace the entries to their very source. He has always to remain watchful bearing in mind the weak spots in the system of book keeping in respect of which errors or frauds are

likely to occur. This routine checking or “tick work” as it is sometimes referred to, is of course, important and must be carried out thoroughly *with care and diligence*: but, unless other higher and more important matters enumerated above have also been properly attended to, only clerical errors are likely to be discovered. Routine checking is apt to become monotonous and consequently is likely to be done in a mechanical fashion. However, it is the very basis of audit and is required to be carried out *thoroughly and intelligently*. This part of audit mostly devolves on junior members of the staff. They should be encouraged to think out for themselves and understand exactly what part of the checking they are doing, plays in the whole plan of audit, what are the likely frauds or errors that might take place and how they could be detected by their checking. In this way, the work will become quite interesting and an intelligent junior will soon be able to grasp the entire principles of practical auditing.

Some of the frauds that can be found out by the routine checking are detailed below.

A) Cash: While checking totalling the Cash in inner column less credited can be searched out, as well as the credit side total will reveal the short credit and at debit side the excess debited cash will be found out. Totalling of cash receipt at inner side of cashbook and receipt would be revealed for short credit of cash. The total of vouchers at inner side of debit side of cashbook will show the excess debited cash in cashbook

B) Stock: totalling of stock register will understated for purchases and overstated for sales, however, the amount does not commensurate with the quantity and amount. The totals of sale register are understated by which the amount of sale is not properly credited, and amount is misappropriated.

C) Ledgers: The personal ledger is credited for sum received, however the same amount is not credited to the cashbook. And the General ledgers is over or under summed for cancellations of entries that are passed in personal ledgers, and not credited to cashbook. Most professional auditors are now of the opinion that in the past far too great proportion of time was devoted to detailed checking. The modern view is that an audit is made much more effective by devoting a greater proportion of time to the more advanced part of the audit programme in case of bigger institutions. It has also to be remembered that if the auditor confines himself to the entries as they appear in the books and does not go deep enough, his information will be incomplete and he may pass over matters of importance which affect the accounts materially.

3. Vouching: The term “*vouching*” is used to describe the examination of a document or a series of documents for the purpose of verifying a transaction which is recorded in the book and in appropriate cases ensuring that the system of internal control relating to the transaction has been duly followed. *Vouching is the very essence of auditing and the whole success of an audit depends upon this intelligence and thoroughness with which this part of audit work is carried out.* It has, however, to be understood that vouching does not mean merely comparing receipts and vouchers with the cashbook. During the course of vouching, the auditor has to examine a whole set of documents such as receipts, vouchers, bills, invoices, statements of accounts, minutes of meetings and such other documents on the basis of which the entries in the cashbook and other books of prime entry have been made. A careful comparison of the entries in the cashbook, journal and other books of prime entry with the supporting documents would ensure:-

As regards receipt:-

- (i) that all moneys due to or receivable by the business have been duly brought into account and there has been no impropriety or irregularity in the realisation of moneys due to the business.
- (ii) All moneys received by the business have been properly accounted for and credited to their proper heads of account.

As regards payment:-

- (iii) that all payments made and liabilities incurred are regular, properly authorised and payable out of the funds of the business and have been shown under correct heads of accounts distinguishing between revenue and capital expenditure and in particular that the expenditure incurred and liabilities contracted were necessary and incidental to the business of the society.
- (iv) No fraudulent or unauthorised payments have been debited which reduce the cash balance of the and

- (v) The daily closing balances have been correctly extracted and carried forward.

In the examination of transactions, it should be noted that neither the entries in the books of account nor the documents from which the entries have been made are to be **blindly** accepted at their face value, but have to be relied upon after applying due tests which are described in detail in the following paragraphs. It is also necessary that the auditor should apply to the audit his knowledge of the conditions, under which the society conducts its business. Thus, for example, in agricultural credit societies, loans to members are to be made only in accordance with the credits sanctioned to individual members in the Normal Credit Statement / Kisan Credit Cards finally approved by the financing agency. In case of marketing societies, period for payment of sale proceeds, scales of commission and expenses and other matters are governed by the rules of the Market Committee or by custom. In co-operative sugar factories, payment of cane prices and advances to members and sales of sugar are regulated by policy decisions taken by the State and Central Governments. It is, therefore, necessary that the auditor before commencement of his audit should familiarise himself with:

(a) the nature of the business conducted by the society.

(b) The account books maintained and the method of bookkeeping adopted. And

(c) the system of internal control in force and the nature and extent of external supervision and control over its operations.

4. Vouching of cash transactions-control over cash- Since a majority of frauds are in connection with cash, it is important that an adequate and scientific system of internal check should have been in operation as regards receipt and disbursement of cash, remittances of cash and for the custody of the cash balance. Where cashier is appointed, he alone should attend to the receipts and disbursement of cash and remittances to and from bank and preparing cheques. The “Day Book” or the “main Cashbook” should be written by the accountant and not by the cashier who should maintain only a rough cashbook or cash diary and cash summary book.

5. Vouching of receipt- Internal control over receipts. - It has to be noted that vouching receipts is always more difficult than vouching payment, since, in many cases, no direct evidence as regards regularity and correctness of the amount received, would be available.

The system of internal check should be carefully enquired into and special attention should be paid to any part that is considered inadequate.

To ensure proper control over receipts, the following arrangement are necessary:

(i) All incoming letter should be opened by the Manager or other responsible officer. All cheques, drafts, postal orders, registered letters, etc. Should be specially crossed to the Bank account and entered in a separate register along with other remittances in currency notes and coins received under insured covers or by money orders before being passed on to the cashier. At the close of the day, entries in this book should be compared with the entries in the Cash Diary or Rough Cashbook maintained by the cashier.

(ii) All remittance should be invariably acknowledged. Specially printed receipt books with duplicate serially numbered receipts to facilitate retention of the carbon copy in the book itself, should have been issued for acknowledging all remittances whether received in cash or by cheques, drafts or by money orders. Counterfoils are required to be written up separately and it is likely that an unscrupulous employee might enter different amount in the counter foil and the outer form. No acknowledgements should be made on the invoices, bills, or statements issued to the customers. The employees should be strictly forbidden acknowledging remittances on the ledger account of the society kept by the customer or on the copy of the invoice or bill sent to him. This practice followed by some the marketing societies, should be discouraged. Notice should be given to all members and customers that no receipt would be valid unless issued from the printed receipt book of the society and countersigned by the authorised person. All receipts in a receipt book should have been pre-numbered and the serial numbers should be examined before a new receipt book is brought into use.

(iii) Spoiled and cancelled receipts should not be destroyed, but should be pinned to the carbon copy as evidence of what has taken place. Cancellation should be made under initials of the officers authorised to sign the receipts. While checking receipts, it should be seen that the serial numbers run consecutively and that no receipts are missing.

(iv) Where there is a system of issuing temporary or katcha receipts on plain paper or recording acknowledgements on the books of the customer by recovery clerks, salesmen or representatives, the constituents should have been duly notified that such receipts or acknowledgements are merely temporary acknowledgements and that they must insist on obtaining official receipts. The practice of issuing temporary receipts should be discouraged. Wherever possible all temporary receipts should be called back at the time of issue of the official receipts. Where necessary, specific mention should be made in the official receipt about the cancellation of the “katcha” or temporary receipt already issued for the same remittance.

(v) Where remittances are received in cash, signature of the person paying in the amount should be obtained on the receipt itself in the space provided for it or at the back of the receipt as evidence of the delivery of the receipt.

(vi) Any material alteration in the receipt, if necessary, should be made only under initials of the person or persons authorised to sign the receipts.

(vii) All unused receipt books should be kept in safe custody. An account of the receipt books received from the Printing Press and issued should be maintained and a fresh book should be issued only when the receipt book in use has been completely exhausted. When different receipt books are simultaneously in use for acknowledging different classes of

receipts or receipts under different heads, the receipt should be of different colours or sizes so as to be easily distinguished.

(viii) *The cashier should not be allowed to make any entry in the ledger and the ledger clerk should not be allowed to handle cash.*

(ix) In banks and other large concerns, all remittances are first entered in a scroll book by a clerk before they are paid over the counter to the cashier. The scroll clerk examines the chalans, paying in slips or other documents accompanying the remittance and makes entries in his scroll book. At the close of the day, entries in the scroll book are called over into the rough cashbook or cash diary maintained by the cashier which would ensure that all remittances are properly accounted for.

(x) Cash ,cheques and other remittances received either by post or from cash sales collections ,cash paid in by travelling salesman, recovery, clerks, etc. Cash remitted by disbursing officers (employers) in case of salary earners' societies and also canteen takings, cash takings of milling or grinding charges in societies, running rice mills ,flour mills and rendering other services should be banked intact daily except where the collections are too small and allowed to accumulate until a substantial amount is collected to justify remittance to bank .However as far as possible no payments should be made out of cash takings.

6. *Nature of documentary evidence available for checking receipts:* Counterfoil or carbon copies of receipts issued to the remitters should be available for checking the following types of remittances:-

- (i) Shares and entrance fees
- (ii) Deposits (Except in banks where the persons paying the amounts are required to prepare pay-in- slips or chalans explained in paragraph (3) above.
- (iii) Miscellaneous receipts such as hire charges of machinery and equipment's , fees and charges for services rendered, share transfer fees, copying charges, fees for issuing duplicate documents, etc.
- (iv) Repayment of loan by members, recovery of dues on account of credit sales and other outstanding dues.

In an Institution doing banking business and also in some other institutions, customers are required to fill in pay-in-slips or chalans for moneys paid by them. Similarly, for issue of drafts or transfer of funds and also for payment of hundies and release of railway receipts and other documents of title to goods, application forms which furnish full particulars of the amounts paid, are required to be filled in by customers and would be available to the auditor for his verifications. For such remittances, generally no separate receipts are issued.

7. *Method of checking receipts:-* The entries in the cashbook should be compared with the office copy of the receipt issued to the party and it should be seen that the following particulars correspond:-

- (1) Date of receipt
- (2) Name of the person paying in the amount and name of the person on whom behalf are remittance is made.
- (3) The amount received should have been mentioned both in words and figures.

(4) Mode of remittance if received by cheque, name of the bank on which drawn should be specified. If received by money order, postal order, insured post etc., the mode of receipt should be specified.

(5) Head to which credited: Carbon copies of the receipts issued to the remitter retained in the Receipt Book only provides indirect evidence. There will also be different types of documents, which will have to be examined for verifying certain types of receipts. These will be discussed in the following paragraphs.

V-3 CHECKING OF DIFFERENT TYPES OF RECEIPTS

1. Share and entrance fees: Share certificates bearing distinctive numbers are required to be issued for all shares subscribed. Counterfoils of share certificates issued will also be available and information contained therein, will have to be checked with the entries in the share register, share ledger and the members' register. Byelaws of Cooperative Societies generally provide that allotment of additional shares should be made by the committee. Minutes of committee meetings will, therefore, have been seen.

Printed receipts are generally issued for acknowledging amounts received towards shares and entrance fees paid by members and prospective members. Since entrance fees and share money are required to be paid before admission to membership, pending approval by the committee, of the application for membership, ordinarily, the amount would be credited to a share suspense account in the first instance and subsequently adjusted to the share and entrance fee accounts after the resolution admitting the applicant to the membership of the society is passed. His name will thereafter be entered in the member register.

2. Recovery of shares by instalments. - Except in case of co-operative sugar factories, spinning mills, and a few other types of societies, where the value of a share has been kept high, the full value of the share is recovered in one lump sum. As such, except in case of the above types of societies, there is no system of making calls towards balance of share money due from subscribers to share capital. In case of salary earners' societies, monthly subscriptions at rate specified in the Byelaws are collected from the members along with other dues of the society and shares are allotted to them when the full amount of a share is received. In consumers societies, rebate or purchase bonus payable to non-member customers is also credited to their accounts and when the full amount of a share is collected, they are enrolled as member and the undisbursed bonus payable to them is credited to their share account.

3. Share Capital of newly registered societies: - Before a society is registered, the promoters of the proposed society are required to collect deposits from the prospective members towards initial share capital of the proposed society. No society is register until initial share capital considered adequate by the registering authority is collected and paid into the bank. The amounts collected from time to time by the promoters are required to be deposited with the head office or nearest branch of the district central bank of the district and Maharashtra state cooperative bank in Mumbai, or Urban Cooperative Bank or Postal Savings bank. An account is opened in the name of the proposed society to be operated jointly by the Chief Promoter and one or two other promoters. Not depositing the amount in the said manner is offence under section 146(d) of the M. C. Societies Act, and punishable for a fine of Rs. 5000 under Section 147(d) of the Act. No amount is normally allowed to be withdrawn from this account until the society is registered and the account transferred in the name of the registered society. If the society is not registered, the chief

promoter can withdraw the amount only on production of a letter signed by the registering authority stating that the society has not been registered and the promoters are permitted to withdraw the amount and refund to the prospective members of the proposed society, the initial capital contributed by them.

The newly registered society at its first general meeting is required to pass a resolution intimating the Bank that the society has been registered and requesting that the account opened in the name of the promoters should be transferred to the name of the society. Copies of the resolution along with account opening form duly filled in and signed by the authorised persons are sent to the bank. After the account is transferred in the name of society the amounts paid in by the promoters and other applicants for membership of the society are credited to their respective share accounts and the entrance fee account

3-A) Treatment of Deemed members shares:- Section 23 1-A provides for deemed membership. If the society refuses to accept the application from an eligible person for admission as a member, or the payment made by him in respect of membership, such person may tender an application in such form as may be prescribed together with payment in respect of membership, if any to the Registrar. The Registrar shall forward the application and the amount, if any so paid, to the society concerned within thirty days. From the receipt of such application and the amount and thereupon, if the society fails to communicate any decision to the applicant within sixty days from the date of receipt of such application and amount by the society, the applicant shall be deemed to be member of a such society. From this provision it is clear that, until the period of sixty days from the receipt of amount and application he is not become the member of the society, during this period the amount so deposited by the person shall be credited to the share suspense account. After the completion of legal procedure if accepted by the society or become a deemed member the amount of share suspense account should be transferred to the respective entrance fees and Share Capital account.

4. Audit of accounts of societies prior to their registration: Promoters of cooperative societies are required to maintain proper accounts of all amounts received and payments made by them prior to the registration of the society. If the transactions prior to the registration of the society merely relate to collection of share capital and incurring normal expenditure for getting the society registered, such as expenditure over postage, reasonable conveyance charges, printing of receipts and books, typing of Byelaws etc. They are generally entered in the cashbook of society and should be checked by the auditor. However, if the promoters have already started business in the name of society and considerable period has elapsed before the society has been registered, the auditor should obtain a statement of receipts and disbursement made by the promoters on behalf of the society and the transactions should be checked in detail. *If the auditor is of opinion that he will be required to spend considerable time over checking the transactions prior to registration of the society, he should seek instructions from the Registrar whether the accounts should be audited by him or the society should be asked to get the accounts audited by a another auditor appointed by the society for this purpose.* In either case, it should be seen that the statement of Receipts and disbursement prepared by promoters and duly signed by the Chief Promoter is considered and adopted at the First General meeting of the society.

5. Checking of members register: Entries in the Members' register will be checked with applications for membership, resolutions of the committee and entries in the cashbook

relating to receipt of entrance fee and share money. As regards deletion of names from the Member's register, remarks regarding cessation and also the date of cessation and reason for deletion of name from membership should be recorded in the remarks column. If the society does not comply to remove the name of the person who has ceased to be member, the Registrar shall be competent to direct the society the name of such person and the direction is binding on the Society, as per Section 25 A of the M.S.C. Act.

5-A) Refund of shares:

i) In case of resignation or transfer of entire shares holding, resolution of the committee accepting the resignation and approving refund or transfer of the shares held should be seen and it should be seen that the restrictive provision in the Act, rules and the Byelaws regarding refund of share capital are duly observed. It should also be seen that the resigning member has repaid all his outstanding dues to the society and has also discharged his liability as surety. The main restrictions regards share refunds are

ii) The shares should be refunded at the value of the last years balance sheet as certified by the auditor in his audit memo, however, the value of refunding share should not exceeds the face value of the share. In other words the value is less than the face value of share the less value should be refunded and if it more than the face value, the refund should be restricted to the face value. This will not apply to the refund of shares by way of transfer. (MCS Rule No. 23)

iii) In case of liquidation societies shares should not be adjusted through recovery dues form the member. (MCS Rule No. 23)

iv) The limit of refund of share in the year in which refunded is 1/10th of the share amount outstanding in the last year's balance sheet. (MCS Rule No. 23)

v) **The method of valuation of share :** The method is prescribed in the Rule 23 as "amount arrived at by a valuation of shares by dividing net worth of the society by number of shares" this means the net worth of the society shall be calculated by the auditor and then he has to arrive at the valuation of the share, and to see the refund of share is made accordingly.

vi) **Net worth:** under the rule 23, explanation is given for net worth as, ' for the purpose of this rule, net worth means paid up share capital plus free reserves (Reserve fund, unutilized building fund, dividend equalisation fund , carried forward balance of net profit , any other fund which is not marked specifically for any liability) minus accumulated losses.

vii) **Calculation of Net Worth:** from the above explanation the calculation of Net worth can be arrived at as-

Sr. No.	+ or -	Particulars of funds and capital	Amount in Rs.
1		paid up share Capital	
2		Free Reserves	
a	+	Reserve Fund	
b	+	Building fund – (Utilised portion of the building fund)	
c	+	Dividend Equalisation fund	
d	+	any other fund (which is not marked specifically for any liability.)	
e	+	carried forward balance of net profit	
f		Total of a to e	
		Total Funds 9 (Total of 1+2)	
3	-	Accumulated losses	
4	=	Net worth	

viii) **Free Reserves:** Except the funds mentioned above in a, b, c, the other funds are required to be explained. Free reserves are those reserves which are created from the distribution of net profit and having no charge on them. It explained in rule as 'which is not marked specifically for any liability'. The auditor shall keep in mind while calculating the net worth, free reserves shall comply two conditions, one that it shall be appropriated from the net profit and another it shall not be created against any liability. Hence the funds created for member welfare fund, employees welfare fund or such funds shall not form the part of Net worth. As well as funds created from debiting profit and loss account such as Bad and doubtful fund, investment fluctuation fund, Investment amortisation fund and as such will not form part for calculation of the Net worth.

ix) **Net worth by NABARD/ RBI** _ For District Central Cooperative Banks, State Cooperative Banks, and Urban cooperative Banks the inspectors of RBI/NABARD calculates net worth according to the provisions of the Banking Regulation Act 1948, is explained elsewhere.

x) **Another method of calculation of net worth:** The net worth is concept wherein as on a specific date the assets are realised at their releasable value, after paying all the liabilities, the amount of balance is Net Worth. It can be calculated as given in the following table.

Sr. No.	+ or -	Particulars of Assets with their realisable value	Amount in Rs.
1	+	Liquid Assets (Comprising of cash, bank balances, and investments for less than 1 years duration) - losses not provided for on these assets	
2	+	Current Assets (Comprising of stock in trade, vehicles, and assets which are of current assets nature) - losses not provided for on these assets	
3	+	Fixed assets (Comprising of building, sheds, godowns, Plant and machinery, etc. attached to the earth) - losses not provided for on these assets	
4		Total of All Assets	
5	+ or -	All receivables – All payables	
6		Net of Assets (Net Worth) (4-5)	

6. Admission of new member: points to be noted. - While checking applications for membership, compliance by the prospective members of the requirements of the relevant provisions of the Act, Rules and Byelaws of the society will, also have to be seen. Some of them are mentioned below: -

- 1) Declaration in form 'K' to be furnished by applicants for admission to membership of a credit society, who are members of more than one credit society specifying the society from which alone they would borrow.
- 2) Declaration under section 48 to be furnished by members of agricultural credit, multipurpose and service societies, creating charge on agricultural lands held by them, or their interest in the lands cultivated by them in form 'M'
- 3) Undertaking under Section 49 to be furnished by members of salary earners societies, authorising their employees to deduct from their salaries or wages, dues of the society as communicated by the society.

- 4) Undertaking to be furnished by members of cooperative farming societies authorising the society to borrow on moneys on the security of lands pooled by them.
- 5) Undertakings furnished by members of co-operative sugar factories, spinning mills, ginning and pressing factories, oil mills, rice mills and other processing societies to deliver to the society their entire sugarcane, cotton, groundnut, etc. Grown by them.
- 6) Declarations furnished by members of housing societies regarding buildings plots, houses, or tenements already owned by them

Compliance of the provisions of the Byelaws regarding purchase of shares in proportion to acreage under specified crops held, loans borrowed, cost of tenements to be constructed, etc. will also have to be seen.

7. Receipt of Government share capital, loan and subsidy: Receipt of Government share capital- this has been dealt with separately elsewhere.

As regards receipt of Government loan and subsidy, copy of the order sanctioning the loan or subsidy should be inspected and it should be seen that the **terms and conditions** subject to which the loan/subsidy has been sanctioned are duly complied with. The auditor, during the course of his audit, should watch over the proper utilization of the loan and / or subsidy and point out in his report non-compliance of any of the conditions. Joint Registrar, District Deputy Registrars and other officers sanctioning loans and subsidies are directed by the Registrar to forward to the auditor concerned a copy of their order sanctioning loan and / or subsidy. (Registrar's circular NO. ADM-6/20-ADT, dated 10.8.69). Where loans and subsidies are sanctioned by other Department of Government (Industries Department, Fisheries Department, Social Welfare Department, etc.) Or by the Central Government or other authorities (NCDC), Maharashtra Small Industries Development Corporation, Finance Corporation etc. The Divisional Joint Registrar or the District Deputy Registrar to whom a copy of the order sanctioning the loan or subsidy is addressed should invariably supply a copy of the order to the auditor concerned to enable him to note compliance of the conditions of the loan or subsidy. Even though the auditor receives no copy, he should ascertain the terms and conditions from the copy of the order received by the society and point out non-compliance of any of the conditions, if noticed by him.

Institutions acquiring permanent and semi - permanent assets wholly or mainly out of grant- in-aid received from the state or central government, are required to maintain a register of such assets in the form prescribed by Govt. in Government Resolution, Finance Department, No. G. I. A. /7161/7942-VII, dated 18-6-1962. They are also required to furnish an undertaking to the sanctioning authority not to dispose of, encumber or utilise for other purpose such assets without prior concurrence of Government. Auditors during the course of their audit should verify the proper maintenance of the prescribed register and also see that the condition laid down are adhered to by the grantee institutions. (Registrar's circular No. SBY/ACT , dated 3-10-1962)

8. Accounting of subsidies granted by Government - Subsidies granted by Govt. towards capital cost of the scheme should invariably taken to the reserve fund of society. Subsidies received towards secretarial cost or other management expenses may be taken to profits except cases where specific instructions are to be given for its treatment. Where any conditions are have been laid down or special instructions are have been issued by the Registrar for the utilisation of Govt. Assistance, it should be seen that these condition or instructions are complied with.

In case of co-operative consumer societies, special instructions have been issued for the accountings of subsidies vide circular No. E/cons/FA/ACT dated 29 -1- 72. The

circular lays down that if there are adequate profits to enable the society to declare the dividend, the amount of subsidy received should be directly credited to Reserve Fund and is not available for distribution as dividend.

Subsidies granted by Govt towards capital cost of a scheme, should invariably be taken to the Reserve Fund of society.

Under Govt Resolution, Finance Department, No. CIA/7161/7942-VII dated 18-6-1962, all societies receiving grants -in-aid required to furnish an undertaking agreeing to abide by the conditions attached to the grant -in-aid. The grantee institutions are also required to maintain a register, in the proforma, prescribed by Govt., of permanent or semi permanent assets acquired wholly or mainly out of Govt grants and not to dispose of encumber, or utilise them for other purpose without prior concurrence of Govt.

In case of certain type of institutions like fishery societies, dairy societies and other societies, which receive loan or subsidy under special scheme of development of these societies and providing them financial assistance, the orders of Govt. Sanctioning the loan or subsidy contain specific instructions as regards treatment in accounts of subsidies granted to them. The provisions of these orders should be carefully studied by the auditors and their compliance noted.

9. Indian Accounting Standard for Government Grants: The Institute of Chartered Accounts of India has issued a accounting standard *AS 12* on accounting of the Government grants which is described below.

1) Government grants should included in accounts on after receipt of them and no accrual basis should be adopted.

2) Government grants received for acquiring specific purpose should be treated in the following manner.

2-a) The grants may be shown in the balance sheet as a deduction from the gross value of the relevant fixed asset (It may be noted that this method is also in conformity with the provisions of the Income tax Act 1961)

2-b) Secondly, the original total cost and the related depreciation may be left undisturbed and the grant treated as deferred income which should be recognised in the profit and loss statement by allocating the income over the periods and in proportions in which depreciation on the asset concerned is charge. If however, the grant relates to a non-depreciable asset, it should be credited to capital reserve under this method except where the grant relating to non-depreciable asset, it should be requires the fulfilment of certain obligation. In the latter case, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income balance should be disclosed separately in the balance sheet.

3) Sometime, a grant or subsidy is given as a compensation for the extra costs associated with the operations on a systematic basis in the profit and loss statement over periods necessary to match them with the related costs, which they are intended. Such grants should either be shown separately under “other income” or deducted in reporting the related expense.

4) Sometime, government grants have the characteristics similar to those of promoters’ contribution. For example, grants may be given with reference to the total investment in an undertaking or by way of contribution toward its total capital outlay (as in the case of Central Investment subsidy scheme). Such grants should be credited to capital reserve and treated as part of shareholders’ fund.

5) Government grants in the form of non-monetary assets, given at a concessional rate, should be accounted for on the basis of their acquisition cost. In case a non-monetary, asset is given free of cost, it should be recorded at a nominal value.

6) Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be recognised in the profit and loss statement of the period in which they are receivable and disclosed as an extraordinary item, if appropriate.

7) In case of government grants become refundable, the resultant debit should first be adjusted with reference to the relevant item in the balance sheet, e.g., in the case of a refund of a grants in the nature of the promoters' contribution, the refund should be set off against the capital reserve. The balance, which cannot be so adjusted, should be charged to the profit and loss account

8) The following should be disclosed.

A) The accounting policy adopted for government grants, including the method of presentation in the financial statement.

B) The nature and extent of government grants recognised in the financial statement, including grants of non-monetary asset given at a concessional rate or free of cost.

10. Related provisions of Cooperative Societies Act related to Government grants:

Section 62 describes various aids given to Cooperative Societies such as

- 1) loans
- 2) Guarantee for payment of principal of debentures issued by the society
- 3) guarantee for repayment of loans given by a bank to the society.
- 4) Guarantee for repayment of principal and interest for loans and advances given by the RBI /NABARD /IFCI or other financial Institute
- 5) financial assistance, in other form (including subsidies).

For state partnership to societies towards share capital is covered under section 51 to 60 of the act. Which is described elsewhere.

The major kinds of subsidies provided by the department are managerial subsidy for tribal vivid karykari societies, which is compensation of their expenses for management. Loans are sanctioned with some subsidy to various types of societies, for construction of godowns, storages facility, and for other purposes.

Auditors should observe the terms and conditions of sanction order, and accordingly the accounting policy has been opted by the society or not.

11. Deposits- For fixed and call deposits, printed receipts from counter- foil receipts books specifying the terms and conditions of the deposits such as rate of interest, period, due date etc., are issued to depositors. Counter- foils of the receipts and retained in the receipt book should be compared with the entries in the cashbook and the Fixed Deposits Register.

In Co-operative Banks and societies accepting saving deposits, pay- in -slips or chalans, as they are called, which are filled in by the remitters, would be available for amounts credited to their respective accounts. The Reserve Bank of India has issued various guidelines for accepting the deposits, their repayment, opening of accounts, their renewal, premature repayment, are described in another chapter in this manual elsewhere.

12. Receipts of loans from central banks and other financing agency -- Receipts of bank loans will be checked with the advice of the bank and correspondence with the bank regarding sanction of the loan and entry in passbook crediting the proceeds of loans. Duplicate copy of loan bond or agreement and promissory note copies of the application for loan and resolution of the committee on the record of the society should also be seen. The auditor should verify the terms and conditions laid down by the central financing

agency for repayment of loan, rate of interest, verification of assets created from the loan, insurance required to be taken, mortgage of property deeds and other relevant records.

13. Repayment of loans by members: For acknowledging repayment of loans (principal / interest and other expenses) made by member, printed receipt from the official receipt book are generally issued. Entries in the cashbook should be checked with the carbon copies of the receipts contained in the receipt book. Passbooks are also issued to borrowers. During the course of audit, a certain number of pass books should be called and compared with the account in the ledger

14. Special Receipts: Sale proceeds of Government securities and other investments: since purchases and sales of Government securities and other investments are made through broker or bank, broker's "sold notes" or "bankers' memoranda would be available for checking the correctness of the amounts received. The Reserve Bank of India has issued detailed instructions regarding sale purchases of Govt. Securities in his circulars, the details of these circulars is given in Urban Banks and DCC Banks section of this manual. Auditors are required to study this circulars carefully and verify the securities transactions, its valuation method, auditing procedure and its reporting method, CSGL/SGL accounts, limitations with business through brokers, etc. It will have to be seen that necessary adjustments are made for interest and premium amounts included in sale and purchase transactions and verify them accordingly. The Reserve Bank of India issues master circular on 1st July of every year regarding different aspects of banking business. The auditor should see that the banks have complied with such circulars. These master circulars are available on Reserve Bank of India's website i.e. www.rbi.org.in

15. Capital Receipts: Sale of immovable property and other fixed assets. Resolution of the committee / Board will have to be seen for agreement of the sale. If sales were made by private negotiations, the agreement for the sale and the sale deed and other correspondence would be available for ascertaining the price realised. If sold by public auction, the auctioneer's report would be available. Where fixed assets are disposed of, it is the duty of the auditor to see by reference to the sale agreement and other correspondence that the prices realised are reasonable. It has also to be noted that under Rule 57((1) (b) of the MSC Rules, no officer of the society can have any interest directly or indirectly in any property sold or purchased by the society. (Indian Accounting Standard **AS 10**)

16. Disposal of fixed assets: Sales or scrapings of fixed assets should be authorised by the committee or by a responsible officer. Where fixed assets are sold or scrapped, the value of which they are shown in the books should be alienated from balance sheet. Where a register of a fixed assets is maintained, the accumulated depreciation pertaining to the items disposed of should be ascertained and written off against the original cost of the items and the remaining net book value, if any, should be charged against the proceeds of the sale. If the sale proceeds received are in excess of the net book value of the assets shown in the balance sheet, the surplus should not be taken to the profit and loss account, but, should be credited to a "**special capital reserve** " or similar other fund. Any deficit remaining after adjusting the sale proceeds against the net book valued should be written off against the profit and loss account. (Indian Accounting Standard **AS 10**) The profits or losses incurred on disposal of the fixed assets should be clearly disclosed in the accounts. Where fixed assets are disposed off, it is the duty of the auditor to see by a reference to the sale agreement and other correspondence that the prices realised, are reasonable. This

should be particularly seen when fixed assets are sold to parties who occupy a fiduciary position as regards the society. Thus, for example, where a motorcar is sold to a relative or friend of a director or an employee of the society and the price released is below the market rate, further investigation is called for.

17. Replacement of Machinery: In Processing societies like Sugar Factories, Spinning mills, the machinery is partly replaced. While recording the transactions of purchase the auditor should verify that the machinery replaced is properly capitalised and the replaced machinery with its scrap value is properly charged to the fixed assets account and delated from it in the balance sheet and recorded in the machinery register. (Indian Accounting Standard **AS 10**)

18. Income received- Cash sales: - Cash memos, showing particulars of goods sold such as quantity rate, etc., and amounts received would be available for checking cash sales entered in the Daily Sales Register. The procedure for checking cash sales has been discussed elsewhere.

19. Interest Received on loans and advances: Interest received on loans and advances to members will be checked from the printed receipts issued to them. Interest calculation will have to be checked while checking posting into the loan ledger. The quantum of checking will be according to instruction issued by the Department in this behalf.

20. Interest received- Interest received in amounts deposited with bank will be checked from the entries in the passbook. As regards interest on fixed deposits with bank and other investment, since the rates can be ascertained from the deposit receipts and the securities, the amount of interest received can be verified by checking the calculations on the amounts of the deposits or the nominal value of the securities. In case of dividend on shares, the counterfoils of the dividend on warrants will have to be seen. Where the number of investments is large, it will be convenient to have a separate investment Register, or ledger. At the top of each account, a full description of the investment should be given together with the date or dates on which the interest or dividend falls due.

21. Rents received from properties: Agreements executed by tenants should be seen. It should be seen that all rent received has been duly brought into account and received. Enquiries should be made into arrears and action taken for recovery should be ascertained. Housing societies, Industrial estates and other societies, which hold large properties, should maintain a “*property Register*” prescribed in the form X-1 under Rule 65. It is also necessary to maintain a register showing full particulars of the tenement, names of tenants to whom they have been let out and the monthly rent, compensation, service charges and other charges recoverable from them. The registrar has prescribed various rates and issued instructions regards service charges to be charged and recovered in respect of housing societies, auditor are required to study these circulars and verify accordingly. Non occupancy charges on service charges are fixed by the Government by its No. Cooperation and Textile / sagruyo/ 1094/15165/ pra kra/ 317 14-C dated 1.8.2001.A “Demand Register” showing current demand and arrears of previous month, amounts collected and balance due should also be maintained. Receipts issued to the tenants should be traced to the Rent Register. Enquiries should be made into arrears outstanding for a long time and action taken for recovery ascertained. Similarly, where properties or tenements are shown as assets, enquiries should be made as to why and how long they are vacant.

22. Hire charges of trucks, tractors and other vehicles and machines: - Societies which own trucks, tractors and other costly machinery and equipment are required to maintain log books for each transport vehicle or other machinery owned by them showing particulars of the journeys performed, works or jobs executed or other services rendered. Where these are hired out to member, applications should be obtained from the hirers regarding the nature of service required or job to be executed, period for which the transport vehicle or other equipment would be required, etc. Rates of hire charges should be fixed by the committee. A hire register is required to be maintained and printed receipts are required to be issued for hire charges received. Where the number of such vehicles or machinery is large, daily reports should be obtained from the officer-in-charge.

23. Miscellaneous Receipts Occasional receipts such as sale proceeds of fixed assets, scraps, unused stores and spare parts, discarded material, waste papers, etc., and also receipts from insurance companies and from railways in respect of claims, should be vouched from the receipts issued, correspondence, minutes and relevant documents.

V-4 VOUCHING PAYMENTS:

1. General considerations: It is the duty of the auditor to see that *all payments made are genuine, correct, duly authorised and properly payable out of the funds of the society*. In order to satisfy himself on these points, he has to examine the entry in the cashbook and compare it with whatever documentary evidence is available in support of the payment made. The most important document is the voucher, which not only contains the acknowledgement of the payee receiving the amount, but also other evidence which should satisfy the auditor about the *regularity, correctness and propriety* of the payment made. Since most of the frauds perpetrated in cooperative societies are connected with cash and commonest method adopted by the culprit to conceal the fraud or misappropriation committed by him, is to keep on record a bogus or fabricated document as voucher, this part of routine checking viz. Vouching debit side of the cashbook has to be done very carefully.

In addition to the regular voucher containing acknowledgement of the payee, the auditor will have to examine a number of other document, minutes, notes, memoranda, correspondence etc., which are known as supporting documents. It has to be noted that for checking different types of payments, different types of document, such as official receipts issued by the payee, acquittance on payrolls or payment registers, debit slips, receipted chalang, counterfoils of pay-in-slips, debit notes, advices etc., would be available. It is, therefore, necessary that the auditor before commencing vouching should familiarise himself with the nature of the supporting evidence that would be available to him and the type of document that he will have to examine which, as we know, would be different according to the nature of the transaction and the practice followed by the **business**.

2. Control over payments - Payment by cheque all payments other than those made out of petty cash should have been made by cheques. Where no petty cash is maintained separately, a maximum limit for payment in cash should be fixed. Byelaws of some of the societies specify that all payments in excess of a specific amount should be made by cheques. Where there is no provision in the Byelaws, the auditor should insist that the management should pass a resolution prescribing a limit for payments to be made in cash. Where large payments are made in cash, reasons therefore should be ascertained. It has to be noted in this connection that Rule 107 D of the MSC Rules lays down that all payments should be made by cheque as provision of the Income Tax Act 1961. The Income Tax Act

also provides the limit of Rs. 20000 for cash payment, laying some exceptions. The auditor should study this provision carefully.

Cheques should only be drawn against properly authenticated documents, which should be presented to the officers who are authorised to sign them along with the cheques. These supporting documents may be invoices, payrolls, bills, etc., duly checked and passed for payment or reimbursement of petty cash or may consist of other evidence such as requisition for issue of cheques, a remittance, advices, etc., which contain necessary evidence that, the payments are to be made in respect of transactions which have been checked with the relevant documents and the payment duly sanctioned.

In case of very large societies, which have set up a separate “Accounts Department”, officer, who are authorised to sign cheques, should be different from those who have approved the voucher for payment. The clerk who prepares cheques should not have taken part in the approval of the voucher.

Before signing the cheques, the officers signing the cheques should see by reference to the supporting documents that the cheques are made out in the name of correct payee. All cheques should be crossed “ *Accounts Payee*”, “ *Not negotiable*”. Under no circumstance, ***bearer cheques*** should be issued. Banks generally supply chequebooks, containing cheques with printed crossing when demanded. Where the cheques is required to be signed by two officer, signature of one of the signatories, mostly honorary office bears, viz. Chairman, Treasurer or other committee member, is obtained in advance on a number of blank cheques under the plea that he may not be available when urgent payments are to be made. This practice is fraught with danger and the auditor should bring this pointedly to the notice of the Committee. When two or more cheques books are simultaneously in use, their issue should be properly controlled and all number should be accounted for. This is ensured by maintaining a “ **Cheque Issue Register**” in which all cheques are entered before they are put up for signature. All supporting documents, accompanying the cheques should be cancelled either at the time of signing or after issue of the cheques. This may done by means of a special “**Paid**” rubber stamp which should also have a provision for entering the date of payment and the cheque number.

As far as possible, payments should be made in full and promptly so as to avail of the cash discounts admissible. Where part payments or payments on accounts are made, enquiries should be made as to why payments are not made in full. It should be noted that part payment on account affords opportunities for errors and frauds. The auditor should note that, the cheques above Rs. 50000/- are required to be quoted with PAN number of concern persons, receiving the cheque, by way of crossed or transfer by NRTS. RTGS system of payment through banks.

3. Nature of documentary evidence available- In vouching payments, acknowledgments of the payees and other documents containing evidence of payment will be available. However, in order to be satisfied about the priority, authenticity and correctness of the payment made, a number of supporting documents like bill, invoices, statements of accounts, etc., and also entries in other books and registers and minutes, correspondence and other papers will also have to be seen. Thus, although the official receipt issued by the payee would be sufficient evidence of the genuineness of the payment made, still, in order to ascertain the propriety and correctness of the amounts paid, the transactions will have to be traced back to its source. Thus, in the case of payment for purchases, it will be necessary to commence from the issue of purchase order, issued to the supplier. In the course of such an examination, which is known in the professional auditors as “ **examination in depth**”, a whole series of document, such delivery chals, goods inward notes, inspection reports, suppliers’ invoices, goods returned notes, statement of accounts,

credit notes, etc., will have to be carefully examined in an orderly sequence. This process of “auditing in depth” will have to be carried out in respect of as many transactions as possible.

4. Checking payments: points to be noted - The following points are required to be borne in mind while vouching the payment side of the cashbook

- (i) The voucher should have been addressed **to the society itself** and not in the individual name of the managing director, chairman, secretary or other officer. The nature of the **transaction to which it relates should be one, which the society can be normally expected to carry on**. For example, a society engaged in supplying seeds and manure's is not expected to buy jewellery or cloth.
- (ii) Where it is known as **official receipts, i.e. printed receipts bearing the name of payee are generally issued for acknowledging remittances; no other receipts or acknowledgement should be accepted** as sufficient evidence of payment made.
- (iii) All vouchers should have **been properly authenticated by the authorised officers** of the society. This may be done by them either signing the original vouchers or preparing home vouchers, which should have an approval column. This will ensure genuineness of the vouchers produced for audit
- (iv) Where actual payment has been made to a person than the payee himself, a **letter of authority from the payee authorising the person to receive the payment on his behalf** should have been obtained.
- (v) When payment has been made to a person in his official capacity, it should be seen that **rubber stamp of the institution showing the designation of the officer is duly affixed** below the signature of the officer
- (vi) If the signature of the payee is not in English or in a language known to the auditor, it should have been translated into English or the language known to the auditor. All **thumb impressions should have been properly described and attested**.
- (vii) Where the amount paid is in excess of Rs. 5000 the voucher should have been duly stamped.
- (viii) Where the **large amounts** are paid in cash, the **payment should be witnessed and the payee properly identified**.
- (ix) The vouchers should have been properly checked as regards the **arithmetical accuracy of the amount and the propriety of the payment** by the chief accountant or other responsible officer of society. All usual discounts **and special discount** agreed upon should have been deducted.
- (x) All vouchers should be **cancelled by the auditor as soon as he checks them and pass the entries in his audit in order to prevent their production once again in support of a subsequent fraudulent or fictitious payment**. Either a **rubber stamp** bearing his name should be used for the purpose or voucher should be **initialled** by the auditor in a prominent place, preferably in the middle.

5. Sanction for payments: It is necessary that all payments should have been regularly **sanctioned by the committees or an officer properly authorised** to do so, such as Secretary, Manager, Managing Director, etc. Where the Secretary, Manager or other officer has been authorised to sanction payments, it should be seen that the **extent of the authority** has been fixed and that he has not exceeded his authority.

In order to be satisfied that all payments have been properly sanctioned, orders of the Chairman, Managing Director, Manager or other responsible officer, competent to sanction payments should be seen. Where the Managing Director, Manager or Secretary is authorised to sanction payments or incur expenditure, it should be seen that these officers

do not exceed their authority. Resolution of the Managing Committee, Board of Directors or of the general body will have to be seen in case of payment, which are beyond the powers of the Chairman, Managing Director, or other officers. All extra ordinary expenses and expenses which are not incidental to the business of the concern or connected with any of its activities, should have been ***sanctioned by the general body***. Even in such cases, their legality and propriety will have to be further examined. ***Similarly, all purchases of immovable property and investment of funds outside the business of the society, which the Board/Committee is not competent to sanction, should have been sanctioned by the general body.***

Where the Secretary, Managing Director or the Manager is authorised to incur the expenditure or disburse amount upto a specified limit, all expenditure incurred by him and all disbursements made by him should be placed before the committee or Board periodically and its approval should be obtained.

6. Petty Cashbook: Control over petty cash: - For recording small payments made in cash, it is convenient to maintain a petty cashbook. Only payments upto a specified limit should be made from petty cash and all payments exceeding the amount should be made; by cheque.

Petty cash should be kept ***on the imprest system*** and the ***fixed float with the petty cashier*** should normally cover his payments for a ***period of fortnight or one month***. The petty cashbook along with the vouchers should be produced to the officers authorised to issue cheques for reimbursement by way of a fresh cheque. He should sign the petty cashbook as evidence of having checked and approved the payments made. This arrangement provides an automatic and regular scrutiny of the petty cash expenses every time a reimbursement check is signed. It will also render difficult any manipulation of accounts or entering of fictitious or double payment by the petty cashier.

For all payments made from petty cash, proper vouchers should be obtained. These should be duly cancelled at the time of reimbursement of petty cash so as to prevent their further production in support of a fictitious payment. All vouchers should be serially numbers at the time they are recorded in the petty cashbook. All supporting documents such as bill, sub-voucher, cash memos, etc., should have been attached to the debit slip or home voucher.

The petty cash balance should be kept as low as possible. I owe you (I.O.U.) or unauthorised petty advances with or without vouchers should not be made from petty cash. The petty cashbook should be regularly examined and surprise verification of the cash balance made by a senior officer at frequent but regular intervals. The only receipts entered in the petty cashbook should be proceeds of cheques cashed for petty cash purposes. The method applied as already stated for reimbursement should be that of the imprest system, with the ***amount of the float being specified by a resolution of the committee***. Where employees are allowed to cash cheques, limits upto which cheques can be cashed by them should be laid down.

7. Method of checking petty cashbook- (1) Cheques from the cashbook to the petty cashbook should be checked and it should be verified that all cheques drawn for petty cash have been entered in the petty cashbook.

(2) Payment voucher should be checked and ***list prepared of all missing vouchers***. All petty cash payments should have been *properly authorised*,

(3) ***Totals and cross totals*** of the petty cashbook should be checked. Totals of the different columns should be called over into the main cashbook. It should be seen that proper double entry system is being operated with an imprest as the balance.

(4) Where no contra entries are passed in the main cashbook (or the daybook) postings into the general ledger should be seen.

8. Payment of advances: Advances are required to be made to the members of the staff and officers of the society for various purposes, such as for making purchases or payments to be made to creditors, for meeting expenses connected with purchases and also for meeting their personal expenses such as travelling expenses, conveyance charges, etc. Many time, advance payments have to be made or deposits kept for purchases or for services to be rendered. Advances are also required to be made against works to be executed or supplies to be made etc. There can be no objection for payment of such advances provided the *purpose is genuine, and payment of advances is necessary in the normal course of business* of the society. The reasons for the payments of advances or the *purpose, for which the advance has been paid, should have been specifically mentioned in the body of the voucher and the advances should have been adjusted within a reasonable time.* Thus, if advances are taken for making purchases or for meeting travelling and other expenses they should be cleared as soon as the officer returns to headquarters. Where advances have been made against supplies to be received or services to be rendered or against running bill, these should have been adjusted in the invoices or final bills. However, where *advances have been given for no specific purpose or consideration, they should be objected to and where such advances are subsequently credited back in cash. After some time, it should be noted, that this would amount to misapplication of funds of the society.* All such misuse of the funds of the society by its office-bearers by taking unauthorised advances themselves or giving advances to other persons, should be pointed out by the auditors.

A list of all outstanding advances on the date of audit should be obtained and it should be seen that only temporary advances recently granted for specific purposes are outstanding. Where advances have been outstanding for a long time, the reasons for not recovering the advances or adjusting them should be ascertained.

9. Anamat or Tasalmat: In some societies the advances are paid in the name of “*Anamat*” or “*Tasalmat*”, the auditor should check these *anamats* as stated in the above said paragraphs. *In some societies the anamats are credited for fictitious payments made, as there is no cash balance in cashbook to pay the expenses, which are in the nature of fictitious. Such entries are required to check very carefully by the auditor.*

10. Procedure for checking payment voucher- While examining the documentary evidence in support of a transaction, the auditor should satisfy himself that the system of internal control in the business provides for such evidence to be properly checked before presenting it to the official approving the transaction. The transaction should have been properly authorised in accordance with the system of internal control. Thus, for example purchases should have been made against orders for supply of goods signed by a responsible officer. The terms of the transaction should also be *prima facie* reasonable. For example purchase or sale of a motorcar at a figure well above or below the market price should put the auditor on further inquiry.

While examining **documentary evidence** in support of a transaction. Particulars entered in the cashbook and those mentioned in the body of the voucher or other document should correspond in respect of the following: -

- (i) Date of payment
- (ii) Name of the payee

- (iii) Name of the person receiving payment on behalf of the payee, in case the payment is made to a person other than the payee against his letter of authority.
- (iv) Supporting documents like invoices, statements of accounts, cash memos, bill for expenses, service charges, etc., should have been attached to the voucher or reference to such document made therein.
- (v) Amount paid should have been mentioned both in figures and words.
- (vi) *Head of the account to which debited.* If the amount paid has been debited under different heads of account, an analysis should have been prepared. This should be checked by the auditor and the total agreed.
- (vii) Mode of payment- Whether the payment has been made in cash or by cheque or whether the amount has been remitted to the payee by bank draft postal order, National Electronic Funds Transfer System (NEFTS), Real Time Gross Settlement System (RTGS), money order or insured post or the payee's account with the society has been credited and a credit note issued in his favour.

Besides comparing the particulars entered in the cashbook and those mentioned in the voucher, the following additional points will have to be examined.

- (a) Signature or thumb impression of the payee or the person authorised to receive payment on his behalf and the letter of authority of the payee.
- (b) Whether the voucher is duly stamped in cases of where the amount exceeds Rs. 5000 and is free from other defects such as want of authority to receive payment, want of sanction, irregular payment etc.
- (c) Whether the voucher has been properly checked and payments authorised by a competent authority.

11. Notes to be taken of usual and irregular items. - While checking voucher, *careful notes should be taken of all unusual items or items requiring further clarification or explanation* and also of items which call for additional information or authority or where further evidence such as inspection of the minutes, contracts, lease-deeds, agreements, orders, etc., is necessary. Notes should also be taken of all payments, which required to be apportioned or adjusted. *A list of all missing vouchers should be drawn up and explanation as to the circumstances of their loss or non-availability of reasons for failure to obtain* regular vouchers at the time of making payments should be ascertained. All subsidiary evidence in support of the payment, such as entry in the statement of accounts confirmed by the party, reference in correspondence etc., should be seen with a view to be satisfied about its ***genuineness and correctness***. In a number of cases, it will be noticed that only the debit slips or "home voucher" have been kept on record without the payment having been actually acknowledged by the payee. Sometime, it might be explained that the amounts have been merely adjusted or credited to the payee's account and, hence, no regular voucher was necessary. The auditor should carefully examine all such contra entries and insist that in all case, payee's acknowledgements should be obtained. There are instances to creating bogus liabilities, by making adjusting entries in book of accounts and then after paying it in cash, which result in misappropriation of the funds of the society. Hence, the auditors should have to verify mare entries without supporting vouchers, and take note accordingly, also call explanations and supporting documents to avoid misappropriations and verification of genuineness and correctness of the transactions.

12. Vouching different types of payment. - The more important types of payments that are ordinarily met with in cooperative are discussed below: -

Refund of shares: Refund of shares has to be made as provided for in the Byelaws of the society. It has to be seen that the conditions prescribed in sub-section (3) of Section 29 of the MSC Act and Byelaws of the society have been duly fulfilled. Where shares are to be refunded, the share certificates issued to the member should be called back, duly cancelled and attached to the voucher itself or kept in a separate file, unless it is intended to reissue the shares or transfer them to other allottees. Resignations submitted by the member and resolutions of the committee accepting the resignation and sanctioning refund of the share capital should be seen. Remarks about the cancellation of the share certificates should also be made on the counterfoils and also in the share register and the members' register (*Section 25 A of M.S.C. Act*).

In case of the societies which value of share is less than the face value, the auditors should check that the value refunded accordingly the value assessed by the auditor in the last audit report. The method of valuation of share should be based on the net realisable assets of the society, is explained earlier in this manual.

Refund of fixed deposit: The original fixed deposit receipts should have been called back and got discharged. In cases where no separate receipts are issued for fixed deposits, the original receipts issued for the deposits should be called back and a separate voucher obtained from the depositor for refund of the amount of the deposit and payment of interest thereon. The original deposit receipt called back from the depositor *dully cancelled* should be kept attached to the voucher. The RBI has issued detail guidelines in her various circulars regarding care to taken while refunding fixed deposits which is explained elsewhere in this manual. Auditors should have to study them.

13. Payments of savings deposits: Although under the provisions of the Byelaws of agricultural credit societies, these societies are permitted to accept saving deposits from members, very few societies have been conducting deposit business. As regards other types of societies, they cannot accept such deposits in view of the provisions of the Banking Regulation Act, 1949 (AACS). Withdrawal forms should be supplied to the depositor and his signature obtained thereon in the presence of the Chairman or a member of committee. If this is not feasible, the payment made should be got attested by an independent witness. The urban banks and district central banks are governed by Banking Regulation Act, 1949 (AACS), and they have to frame rules for saving deposits and transact business accordingly. Auditors should study the rules framed by the bank, and guidelines issued by the RBI while checking deposits. ***It should be remembered that Urban credit and Rural credit societies are collecting deposits, as provided in their Byelaws, from their members only. They are prohibited to collect deposits from the non members and general public.***

14. Payment of interest on deposits and loans - The deposits receipts itself generally contains provision for recording payment of interest on the deposit and also for obtaining acknowledgement of the depositor. If interest is paid separately, regular voucher mentioning full particulars of the deposits, interest accrued, period in respect of which interest is paid etc., should have been obtained from the depositor. Interest on saving bank account would generally be credited to the account of the depositor and added to the deposit. As such, no separate voucher would be necessary. Amount of interest paid should be checked with particulars furnished in the deposit ledger.

As regards interest paid on other borrowings, interest on bank loan or cash credit would normally be debited to the account of the society half yearly on 30th September and 31st March. When the loan or cash credit is fully repaid, interest *upto the date of closing of*

the loan or cash credit account will be debited and the entire balance including interest charged would be recovered. Advices regarding debiting of interest and other charges, such as godown rent, insurance charges etc., would be generally sent by the bank. These advices and entries in the Bank Pass Book should be seen.

15. Payment of dividend and bonus - The discharged dividend or bonus payable should be checked with the entries in the dividend or bonus paid register. If dividend or bonus warrants are not issued, separate vouchers specifying the number of shares held, the rate and amount of dividend or bonus should have been obtained. As regards payment of bonus or rebate on purchases from or sales made through the society, a register showing particulars of purchases made from the society or sales made through it by members and the rate at which bonus or rebate is paid and total amount of rebate or bonus earned should be maintained. If acquittances of the shareholders or constituents are obtained on the dividend /bonus paid register itself, the individual items will have to be called over in the cashbook.

16. Refund of suspense amounts. - Refund of amounts credited to suspense or to “**sundry creditors account**” should be supported by regular vouchers specifying and the particulars the amount of deposits refunded or paid. Where official receipts have been issued, the original receipts issued to the parties should be called back, cancelled and attached to the voucher itself. In lieu of separate vouchers, the original receipts obtained back duly discharged would also serve as voucher. Where these amounts are adjusted, contra entry should be seen. It should be seen that the amount has been credited to the proper head of account.

17. Repayment of bank loan, cash credit and overdraft -Repayment of bank loan would be checked with counterfoils of paying -in-slips receipts issued by the bank which would also show separately the amounts credited to principal and interest account. Entries in the passbook should be seen. Advices received from the bank in cases where amounts are paid directly for credit to the account of the society and entries in the passbook should be seen. Cheques operate some cash credit and overdraft accounts, repayment of cash credit, overdraft and other advances obtained from bank would be checked with the counterfoils of the paying-in-slips issued by the bank and entries in the pass book or the statement of account.

18. Management expenses:- Payment of sitting fees and travelling expenses to members of the committee- The members of the committee and other office-bearers of cooperative are honorary workers and their services so long used to be gratuitous. However, there is a growing tendency to pay on a liberal scale, allowances and fees particularly in the larger societies. Section 160 A and B have been incorporated in the MCS Act and in the rule number 107 A, wherein, the rates are fixed for travelling allowance and sitting fees by the Government by notification issued in this respect, time to time. The rule provides that, ‘**no member of a committee of any society class of societies shall be entitled to receive from the society travelling allowance, daily allowance and sitting fees, which are paid to the members for attending meeting of its committees, or for performing any other function as such members entrusted to them by the society at the rates higher than the rates notified by the government from time to time, and all societies or the societies concerned, as the case may be, shall be bound to comply with such rates.**’ Auditors are required to study these provisions, and verify the payments are made accordingly.

Since fees to the committee members are payable for attending meeting, it is necessary that Director's attendance book showing attendance of director at each meeting should be maintained. The fees and travelling expenses paid to the directors should be checked from this book. Regular bills showing particulars of journeys performed and expenses claimed should have been obtained in support of travelling expenses paid. Attendance of each member should be verified from the attendance Book.

19. Payment of Conveyance charges.- A number of co-operative societies now maintain motorcars and jeeps. It should be seen that when the vehicles belonging to the society are used, no conveyance charges are paid either to the committee members or members of the staff for whose use the vehicles have been purchased.

20. Travelling Expenses of staff. - Rules should be framed regulating payment to staff of travelling expenses, daily allowance and other charges and allowances. Where advances have been paid for meeting these expenses, it should be seen that travelling allowance bills are obtained promptly and the advances recovered or adjusted. Enquiries should be made into outstanding debit balances.

21. Expenses over maintenance of vehicles.- "Where motor cars or jeeps have been purchased from out of the funds of the society, it should be seen whether the investment is proper and necessary (Please see Registrar's circular No. ADT/ 184(ii) dated 17.9.63). Rules should be framed regarding use of the vehicles. A log book should be maintained for each vehicle and times of departure and arrival of the vehicle noted therein. For each journey, duty slip should be issued to the driver of vehicle and signatures of the committee members or member of the staff, who has travelled, should be obtained on the log book or the duty slip. The rules framed should also provide recovery of charges for private use of the vehicles. It should be seen that all journeys not on the business of the society are charged and the charges recovered from the persons making use of the vehicles. The specific purpose of the journey should invariably be noted in the logbook. It is not sufficient to mention merely "*official purpose*", "*office work*", or some such vague expression. Details of office work should be specified.

Separate accounts should be maintained for each vehicle for recording expenses over its maintenance and repairs. The total expenditure incurred should not exceed the provisions made in the annual budget. Monthly statements of expenditure incurred over petrol, repairs, renewals, etc. Should be submitted to the committee or Board and its approval obtained.

A register of unserviceable parts like tyres, tubes, etc. Returned when they are replaced by new ones, should be maintained. It should be seen that sale proceeds of unserviceable parts and other scraps are duly credited.

For control over vehicle expenses and its verification auditor should suggest the conservative measures to the society. For obtaining the information on vehicle various forms should be prepared and get filled from the society.

22. Expenses over maintenance of guest house:- A number of cooperative societies particularly sugar factories, spinning mills and other large marketing, processing and industrial societies and also some of the central and urban banks maintain guest houses primarily for the convenience of their directors and distinguished visitors, who visit the institutions. Many time, directors of the institutions, senior members of the staff and their relatives and friends are also permitted to make use of the guest houses. It should be seen that rules governing use of the guest houses have been framed and charges recovered from

such of the persons who cannot be considered as guests of the society. A register showing names of visitors, dates of their visit, times of arrival and departure and charges recovered from them if any should be maintained. It should be seen that the expenditure incurred over the maintenance of the guest houses is not excessive and does not exceed the budget provisions made under this head.

23. Payment of Honorarium:- Payment of honorarium or allowances to the chairman or honorary Managing Director is governed by provisions contained in Section 65(2) of the MCS Act and **can be paid only out of profits by way of appropriation of the net profits by the general meeting and cannot be charged to the profit and loss account.** There should also be a specific provision in the Byelaws permitting payment of such allowance or honorarium and also the scales of their payment. These are to be fixed by the general meetings specific resolution of the general body should have been passed. (Please see Registrar's circulars No. ADT / 243, audit memo, dated 8.1.64 and No. ADT / 665, dated 29.7.1964 and 24.4.1965).

24. Payment of salaries:- Cooperative Banks, marketing societies and other institutions, which employ a large salaried staff, should have evolved a scientific system of internal control over recruitment, promotions, transfer, retirement, dismissals, etc., of the salaried staff. In the case of new employees regular orders should be issued stating the salary, the scales of pay and other allowances admissible, and the category in which the employee is to be engaged.

In case of staff, which has been in continuous service, authorisation for drawing increased salary, payment of periodical increments earned or the promotion to a higher grade, should be seen. Total payments of salary paid during a month should be compared with the amount paid in the preceding months. Reasons for any increase or decrease in the total amount disbursed should be enquired into.

Acknowledgements of all employees should have been obtained on the salary book itself. All deductions made should have been credited to the respective accounts.

Deductions made from salaries should have been properly authorised. Deductions made on account of provident fund, income-tax, dues of employees' societies and other amounts payable to outside parties like Provident Fund Commissioner, Cooperative society, Canteen, etc., should be paid over promptly. It should be seen that various registers and service records are kept regarding leave, increments, punishments given etc.

25. Payment of donations and charities.- It should be seen that provisions of Section 69 of Maharashtra Cooperative Societies Act are being scrupulously observed. It should be noted that no donations or contributions for any charitable purpose can be made ***except from out of the Charity fund*** created for the purpose. All payments made should have been duly approved by the Maharashtra State Co-operative Union, which has been declared Federal society for purposes of this Section (Please see Registrar's circulars No. ADM/6 ADT dated 18.4.1961, ADM/184-Gen dated 20.7.1971, ADM/184 (59) 24.4.1963, and 10.8.63, and ADT/243(A.M.) Dated 1.7.64). **The tendency to debit as current or trade expenses payment of donation needs to be strongly objected to by the auditors.** Such payments will have to be made out of charity fund and debited to charities or donations paid account and not to the profit and loss account. If there is no charity fund, these amount should be debited to suspense or sundry debtors account in first instance and shown as recoverable and subsequently written off against charity fund when created out of net profits. (vide Registrar's circular ADM/184-Gen dated 20.7.1971).

The Registrar in his circular No. ADM/6-adt dated 19.4.1961 has directed that auditors should invariably point out in their audit memos, all payments made in contravention of Section 69. A special report should also be submitted to the District Deputy Registrar pointing out specific instances of such irregular payments.

26. Contingencies.- Payment of Rent, rates and Taxes, _ Payment of land revenue or ground rent and other fees and taxes paid to Government and local authorities should be checked with the receipts issued by the officers of the Revenue Department or other officers who are authorised to receive cash and issue receipts. However, if payments are to be made into Government Treasury or the State Bank of India, the receipted chalans would be available.

Ground rent paid to landlord where land is held on lease should be checked with the lease deed and the receipt issued by the landlord. It should be seen that all the terms and conditions of the lease deed are properly complied with. Society having more than one lease hold properties, the lease register maintained by the society, should be checked, and to see that, required provision for lease rent payable is made, as well as lease rent paid in terms of premium, should be written off as per duration of the lease.

Payment of rates and taxes including water charges paid to the municipality or other local authority and electricity charges would be checked with the demand notices and / or monthly, quarterly or yearly bill received from them and receipts for payment made to them.

Payment for rent of office premises, godowns and other buildings hired will be checked with the receipts issued by the landlord will have to be seen for ascertaining the amount or rent or compensation payable and other terms. Hiring of premises and approval of rent or compensation should have been sanctioned by the Committee. If any deposits or advances towards rent or compensation have been paid, they should have been sanctioned by the committee and the terms of their repayment or adjustment should be seen. If any expenditure is incurred towards repairs and maintenance of premises, the amount spent should be got recouped from the rent payable.

27. Payment of electricity and water charges. - Payment of electricity charges would be checked with the monthly bills issued by the State Electricity Board or the Electricity providing Company as the case may be. The receipted bills themselves would serve as voucher as no other receipts are ordinarily issued. It should be seen that the rebate for prompt payment, wherever admissible, has been obtained. Where rebate has not been obtained and penalty for late payment has been made, inquiries should be made. Where water charges are to be paid separately and included in the municipal taxes, bills received from the municipality should be seen.

28. Telephone Charges:- Telephone charges paid would be checked with the monthly or quarterly bills received from the Accounts Office of the Telephone section of the Posts and Telegraphs Department or telephone company. In case of landline phones a Register of calls booked will have to be maintained for each phone and bills for calls received should be checked from the entries in this book. Charges for private calls should be recovered from the parties making the calls. In case of mobile phones provided to the officers and office bearers of the society, it shall be seen that they are used for society's work. If the limit has been prescribed for such phones excess amount over the sanction limit of the bill should be recovered from the officers concerned. Mobile phones are purchased and provided by the society to the officers, it should be seen that adequate provision for depreciation has been made, considering the provision of Income Tax Act,

for such machinery and or considering the life of such phones and policy adopted by the society for charging depreciation on such phones.

29. Postage and telegram charges. - Amounts of postage stamps purchased should be traced on the credit side of the postage account. The balance of postage stamps on hand on the date of audit should be counted. For a payment of telegram charges, receipt (lower perforated portion of the telegram form) which mentions the value of postal stamps affixed or charges paid and bearing the date stamp of the post office, would be available. A copy of the telegram/ fax sent should have been attached to the voucher from which it could be verified that the telegram was sent for the purposes of the society. For payment of postage on under paid or not-paid envelope and letter, the envelope or other cover or wrapper on which is entered the amount of underpaid charges to be recovered , should be seen. Similarly, for payment of V.P.P. Charges, the original wrapping or envelope on which the amount is mentioned, should be seen. For payment of registration charges for articles sent by registered post, the post office issues separate receipts. It should be seen that the cost of revenue stamps purchased is not included inn postage and telegram charges. Society has availed fax facility, it should be seen that the fax receipts generated from the machine are zeroxed and attached with the voucher, as the writing on these receipts vanishes after some period. Society who have contracted for courier services, the contract deed and payment made and receipt provided by the agency should be seen accordingly.

30. Stationary and Printing charges .- Where large quantities of stationery articles are to be purchased or printing work on a substantial scale is to be got executed, it should be seen that before making purchases of stationery or placing orders for printing, the normal canons of financial propriety, such as calling for tenders, inviting quotations and acceptance of lowest tenderer or quotations , are being duly observed. If lowest tender are not accepted, reasons for the same need be recorded. It should be seen that large advances are not to be given to the printers before any printing work is executed. Payments should be made only against completed jobs and delivery of printing material, for payment of printing charges for printing forms, letter heads, register, notes, reports, etc., bills received from the printing press specifying the printing work executed, quantities, rates, dates of delivery, etc., should be seen. Proper account of receipts and issues of all forms, letter pads, books, ledgers, registers and other printed material should have been maintained. It is necessary to maintain an inward register for receipt of printing and stationery. The stock register may be posted from this inward register. Issues and consumption of stationery articles should have been properly controlled. Quantity account of stationery articles and printed materials should have been maintained and checked by a responsible officer at frequent intervals.

31.Payment of insurance premium.- Receipts issued by the insurance company acknowledging payment of premia due should be seen. The amounts of premium to be paid should be ascertained from the Insurance policy or temporary cover note issued by the Insurance Company. A “Register of insurance policies” should be maintained showing particulars of assets insured, risk cover, policy number, period, date of expiry, premium paid, claims preferred , etc. Government has established a Insurance Fund and societies are directed to insure there assets with the fund. Various circulars are issued in this regard by the Registrar, Government, and Director of Sugar, and other officers of the Department. Auditors should study the circulars and insure that the instructions are followed by the societies. In case of Banking societies the Reserve bank and Nabard has issued circulars to pay the premium to Deposit Insurance and Credit Guarantee Corporation within stipulated

time for safe guarding interest of the depositors, the auditor should see that the premiums required in proportionate to the deposits collected is paid within time limit, and the information as such is disclosed in the annual report of the society/ Bank.

32. Advertising charges.- A newspaper cutting of the advertisement and the bill received from the newspaper should have been attached to the voucher. The date or dates on which the advertisement has appeared as mentioned in the bill should be checked with the copy of the issue supplied by the press. Auditors should verify that there are no donations in kind of advertisement, as well as the Registrar has issued circular , prohibiting societies to advertise for well wishing advertises, anniversaries and well come advertises. ***The auditors are advised to make special report for such advertisement.*** This circular contains some financial limits for advertisement expenses, auditors should verify that the limits are adhered to.

33. Miscellaneous.- Trade expenses, general charges, office expenses, expenses on meetings and ceremonials, etc. - In case of fixed charges payable at regular intervals, the scales will have to be fixed and mentioned by the committee. In case of other expenditure it should be seen that the expenditure incurred in incidental to the business of the society. It should not also be disproportionately high having due regard to the size and importance of the society, the importance of the occasion, nature of the business conducted by the society, need for publicity and similar other considerations.

34. Observation of budgetary provisions: It would be desirable to have annual budget prepared and maximum amounts sanctioned for expenditure to be incurred over different items and under different heads. Section 75 of the Act provides that, the annual budget should be presented to the Annual general meeting and its approval obtained. It should be seen that the expenditure incurred under different heads shall be within the provisions made for them in the annual budget Expenditure over ceremonials, celebrations, general meeting and other meetings , visits of importing persons (V.I.P.'s) etc., should not be more than what should ordinarily be necessary. Expenditure over publicity, propaganda and advertisement should have some relation to the expected increase in the volume of sales or business of the society, in a particular line or general expansion of business or attraction of new members and customers. If there is excess expenditure on certain items of the budgets a re-appropriation statement will have to be prepared and kept before the next general meeting for its approval. The society should establish committee for observation of provisions of budget on periodical basis, headed by the Chief Executive Officer of the Institute and members of the committee, and the heads of various departments of the society. The allocation to the various departments should be made on the basis of the demands received by them at the time of preparations of budget. It should be seen that the budget should be prepared before the commencement of the year. And also should be approved before commencement of the year, otherwise the purpose will not be served. The budget should be in two parts for the capital Expenditure and receipts and revenue receipts and expenditure. It should be seen that the capital expenditure should be met from the capital funds realised in the particular year or the carried forward balance of such funds, available with the society.

35. Expenses, which should be objected in audit.- The following expenditure, though duly sanctioned by the committee or other authority , should be objected to by the auditors-

- (i) Expenses which are not incidental to the business conducted by the society expenditure, incurred which cannot be said to be for the purpose of the society, e.g. *Personal expenses of the directors, officers or employees*. The Section 71(A) also prohibits for using societies funds for the defraying the costs of any proceedings filled or taken by or against any officer of the society, in personal capacity. The auditor should strongly object this expenditure as the legal responsibility has been rested upon auditor under section 81 (2) (vi) of the M.S.C. Act.
- (ii) Expenses, which are not necessary and should in ordinary course have been avoided.
- (iii) Expenses, which are considered heavy or disproportionate, considering the size of the institution and importance of the occasion.
- (iv) Abnormal expenditure over publicity, propaganda and advertisement.
- (v) Unfruitful expenses, i.e. Expenses, which would yield no results.
- (vi) Fraudulent, false or fictitious expenses.
- (vii) Other irregular or improper expenses such as illegal commission or allowance, payment of on money, pagree, black money, etc.
- (viii) loans and advances made by the society have been shown as deposits.
- (ix) Expenditure not in furtherance of the objects of the society.
- (x) financial assistance received from the Government or Government undertakings or financial Institutions granted for which purpose is utilised for that purpose only.

Detailed notes of all objectionable expenses should be taken. These should be discussed with the management and suggestions made to recover the amount involved from the persons responsible. If no action is taken, specific mention thereof should be made in the audit report. A list of all expenses, which have been objected to and which, in the opinion of the auditor, should not have been paid from out of the funds of the society, should be contained in the schedules to be attached to the audit memo.

36. Checking of Journal.- When transfer entries are passed through the cashbook itself, both the credit and debit entries should be seen simultaneously. Such contra entries should be marked with a special tick in order to distinguish them from other entries, which involve passing of cash. ***All contras or transfer entries should be checked very carefully. Because these contra entries do not affect the cash on hand and no cash actually passes hands, there is tendency to pass these entries without proper scrutiny. However, since contras also create monetary obligations, they are as important as cash transactions and should, therefore, receive due attention.***

While vouching entries in the journal or in the cashbook, the auditor should see that not only there is ***sufficient evidence*** in support of the entry, but also that the ***entry itself correctly records the transaction***. It should further be seen that ***all transfers from one account to another account in the general ledger or from one personal account to another should be passed through the journal or through the cashbook and no posting into the ledger should be made directly in the ledgers***. The following are the types of entries, which are ordinarily passed through the journal,

- (1) Transfers from one account to another
- (2) Adjusting entries
- (3) Rectifying entries
- (4) Entries relating to depreciation, writing off of losses, bad debts, preliminary expenses, deferred revenue expenses etc.
- (5) Making provisions, carrying over amounts to reserves.
- (6) Appropriation of profits.
- (7) Allocation of expenses between capital and revenue and amongst the various departments of business.

- (8) Bringing into account outstanding creditors, income receivable, expenses payable, prepaid expenses, income received in advance, etc.
- (9) Closing of nominal accounts.
- (10) Opening and closing entries.

The narration below the entry or contained in the transfer vouchers (both credit and debit) should be gone through carefully and it should be seen that the entry has been correctly passed. ***Most care should be taken while passing the adjusting and rectifying entries and entries passed for transfers from one account to another.*** As these entries may result in fraudulent or fictitious entries. While checking rectifying entries it should be confirmed by the auditor that, the original entry requires rectification and the entry passed for rectification really rectifies the original entry. Necessary documents and records must be verified in these cases.

V-6 VOUCHING TRADING TRANSACTIONS:

1. Purchase: 1. Internal control over purchases: - The basic objective of the purchases is to buy the Goods in ***Reasonable price and of required quality***. The system of internal control relating to purchases should be very carefully evaluated. Proper ordering procedures are necessary to ensure that purchases are made ***only on terms and conditions acceptable to the society***, that they are in respect of goods and services that are necessary for the business and that they are made from approved suppliers, a list of whom should be maintained and always brought up-to-date. Proper buying procedures require that there is a clear-cut definition of functions and authority between (a) requisition of supplies, (b) placing of order, (c) inspection and recording of goods when received (d) checking and recording of invoices and (e) payments to suppliers and other creditors. For Sugar Factories the Director of Sugar has issued a circular describing detail procedure for purchase for sugar factories, auditor should go through the circular and verify that the procedure has been adhered to. Only the storekeeper , Chief Engineer, or other specified officer/ heads of departments, should be authorised to issue requisitions. The buying department should then take steps to invite tenders or quotations. A comparative table of quotations received should be prepared and normally the lowest quotations should be approved. The comparative table should contain (1) descriptions of supplies (2) rates (3) technical norms specified in the enquiry floated/ advertisement calling tenders (4) Taxes (5) terms of destination. If required the comparative table for technical specifications and financial terms may be separately prepared. When lowest quotations or tenders are not accepted, reasons for the same should be recorded. Where , on account of small value of the purchase to be made, non-availability of the goods in the open market or other reasons, regular quotations cannot be obtained, proper enquiries as regards rate should have been made, before placing an order. All orders for purchases should be issued from the printed order book, which should contain all the terms and conditions subject to which supplies are to be made. In particular, prices and terms of delivery and payment should have been specifically mentioned. In case of the bigger societies, it would be desirable to have a separate “Buying/ Purchase Department” headed by a senior officer with expert ***knowledge of markets***. The officers authorised to issue purchases orders should be clearly specified and the extent of their authority defined. As far as possible, official, who are required to submit requisitions for supplies, should not themselves issue purchase orders.

Goods when received should be immediately inspected as regards quality, quantities, conditions , taxes etc. Goods received should be entered into the “Goods Inward Register”. The storekeeper should also prepare a “ Goods Received Note” (GRN), copies of which should be sent to the Buying /Purchase Department and Accounts

Department. The goods received note should be issued from the printed goods received notebook with pre-numbered folios.

2. Purchase returns.- Goods which are damaged and are not according to the samples or otherwise not satisfactory, should be returned to the suppliers immediately, along with a *Goods Returned Note*. Copies of the Goods Returned Note should be sent to buying department and accounts department. The suppliers should be requested to send their credit notes immediately. It should be seen that credit notes from suppliers are received for all goods returned or the amount deducted from the total amount of the invoice.

3. Checking of invoices.- Invoices when received should be checked both by the buying department as regards, prices, quantities, discount allowed, terms of payment etc., and also by the accounts department as regards their arithmetical accuracy. It should also be seen that the invoices received are according to the orders of the buying department. Where more than one copy of the invoice has been received, all other copies should be stamped to indicate that they are duplicates. All invoices and credit notes should be consecutively numbered on receipt and entered in an “ *Invoice Register*”. Outstanding items should be investigated.

Invoices after being checked by the Accounts Department should be passed for payment by the respective officers. These officers should be independent of the Buying/Purchase Department.

All persons taking part in the checking of invoices should have initialled invoices in appropriate places. During the course of their audit, auditors should see that the procedure prescribed for making purchases and payments to creditors is strictly followed, as can be seen from the initials appearing on invoices. They should also check the arithmetical accuracy of the invoices. The entries in the Purchase Journal or Register should be checked with invoices and the Goods Received Note or materials received certificates stamped on the invoices. They should also check postings into stock ledgers. Casts and cross-casts of the invoices and the Purchase Journal should be checked and agreed with the amounts posted in the General Ledger.

4. Allocation.- Allocation of charges and credits to nominal accounts and cost accounts should be done by proper authority. ***The basis for allocation should have been shown on the invoices of the credit notes themselves.***

The procedure prescribed for purchase of capital items should be ascertained. Resolution of the Board /Committee sanctioning acquisition of or additions to fixed assets should be seen.

The Auditor should see that proper arrangements to ensure that all liabilities relating to goods received during the accounting period, have been duly brought into account.

Where statements of accounts are received from suppliers, these should be checked with respective ledger accounts. Wherever necessary, direct verification with suppliers should be made.

The control account in the general ledger should be frequently checked by an independent officer with the balances in the suppliers' accounts.

5. Method of checking invoices - While checking invoices, the following points should be noted -

(i) The invoices should be ***addressed to the society and not to any individual*** director or officer of the society. All invoices should have been compared with the

original requisitions and copy of the order issued by the Buying /Purchase Department

(ii) The goods purchased should be such as are being dealt in by society in the course of its trading transactions or are required for manufacturing processes.

(iii) Quantities and rates should confirm with the purchase orders . Where these are not mentioned in the purchase orders, they should be verified from the agreements, tenders accepted , Suppliers price lists or catalogues or other evidence that may be available

(iv) Certificates as regards receipt of goods should have been recorded by the storekeeper on the invoice itself or mention made of the serial number of the goods received note under initials of the storekeeper .

(v) All calculations, extensions and additions should have been checked and signed by the authorised person in token of having complied with the above requirement

(vi) ***Terms of payment*** - Where credit is allowed , it should be seen that payment is made before the expiry of the credit period .

All trade discounts normally allowed should have been deducted from the amount of the invoice . Cash discount , if allowed, should have been availed of by making prompt payment.

6. Inventory control- Organisation of the Purchase Department - In case of processing or manufacturing units , auditors will have to also to acquire sufficient ***knowledge of the modern inventory management methods***. They will have to know how the Purchase Departments are to be organised on sound lines and made to function.

The following points will have to be borne in mind. It may be seen whether,-

- (1) A qualified and competent purchase officer is appointed ,
- (2) Minimum, re-order and maximum levels are fixed ,
- (3) Proper material planning is done ,
- (4) Economic order quantities are fixed , and
- (5) Procurement time is contracted properly .

It is necessary to see that a follow-up register is kept in the purchase department. An up-to-date register will be very helpful in following the pending orders ,evaluating vendors , to find out the total cost of purchases, to find out total procurement time ,etc. It is also necessary to evaluate vendors before any order is placed. The most common method by which vendors are evaluated is by considering quotations received and placing orders with the **lowest cost suppliers. It may also be borne in mind that the lowest cost may not be the best quality products always.**

Hence, whenever the lowest prices are not accepted, the reasons must be recorded by the expert, or the head of the department who has demanded the goods , that ***why the lowest should not be accepted***. Evaluation of vendors should be done every six months. It will not only assure procurement time, but will also assure quality and hence ultimately low cost of purchase optimised inventories. While evaluating vendors, Marks will have to be given against various factors like procurement time ,quality, and cost after sale service and general conditions of the suppliers .

7. Organisation of the store section - The auditors will have to see whether the store section has been organised on proper lines. He should see that there is ***no tendency to stock materials in excess of requirements*** . The auditors must be able to suggest remedies against excess stocking by providing or using modernised inventories management techniques . Thus , if re-order level is fixed , orders will

have to be placed automatically and goods will be readily available in the stores. Naturally, the usual complaint that *“the intimation was short”* will not hold good if the re-order level is fixed properly. If vendor' evaluation is done and if the purchase system is simplified, the procurement time will be reduced. If the imprest system is employed for low priced items, excess stocking in them will be reduced. If the levels for the season and off-season are different, there will be no excess stocking in the off-season. There are various principles underlying optimisation of inventories. The most commonly system is the system of **ABC analysis**. It is the system of arranging the items in the inventory according to their importance. The objectives of this analysis are briefly as follows:-

- (1) To determine the importance of each and every item in the stores.
- (2) To fix the levels of stock based on the above ranking.
- (3) Ultimately to optimise the stock.

Such a division facilitates maximum control over the inventory with minimum effort. Thus, the principle under ABC analysis states, **“Control most which is important most.”**

According to this analysis **“A”** items will be as under:-

- (1) High value items, (2) Highly used, (3) Scarce (4) Not very difficult to get, (5) Less control, (6) Near to optimum, (7) Periodical checking

“B” items:- (1) Medium value items, (2) Used not very highly, (3) Not very difficult to get, (4) Less control, (5) Near to optimum, (6) Periodical checking.

“C” Items:- (1) Low value, (2) Seldom used, (3) Readily available, (4) No control, (5) Less checking.

The **objects** of fixing the levels are:-

- (1) To lay down a minimum to be maintained in stock. This must be maintained to run the factory.
- (2) To lay down when to place an order for goods in such a way that the goods are readily available in stock and yet without stocking them in excess.
- (3) To lay down a maximum above which stocks should not rise in the interest of the organisation.
- (4) Ultimately to optimise the inventories, thereby reducing the idle investment to the minimum.

Thus, there are three levels, -

(1) Minimum level (2) Reorder level, (3) Maximum level.

Just as the stores can be divided according to their importance, they can also be divided according to their movement. Thus, they can be fast moving, slow moving or non-moving. If any item has not moved to the extent of its inventory, it is slow moving. If the item has not moved at all, it is non-moving and the rest of the items are fast moving. There should be study at society level for these levels based on consumptions for the last 3 years related with production.

8. Auditors responsibility for proper organization of the store.- Auditors should be able to trace out slow moving or non-moving items and they can thus advice the management suitably to dispose off such items. If the non-moving items are idle **for 3 years continuously**, they should be disposed off immediately. If the **items have moved at least once in these three years, the items are slow moving**, the difference between the existing stock and the maximum level should be calculated. If this difference is more than 10 per cent of the maximum level, the inventory making the difference should be immediately disposed off. Thus, the auditor should see that the first steps with regard to **ABC analysis** are taken.

The second step would be to fix the levels as suggested above and then there would be a question of optimisation of the stores .

The auditors will have also to make suitable suggestions regarding classification and modification of stores. The Cardex system will have to be introduced instead of the old system of keeping bin cards in the bins or tagged to the bins, where there is every possibility of getting them spoiled . The ***system of taking perpetual inventory in some of the A and B class items will have to be suggested.*** The auditors should apply their minds to all the problems as suggested above and make suitable suggestion (vide Registrar, C. S's circular No ADT/MISC, dated 12-11-1970).

9. Store accounting - The auditor should see that proper control over stores and works-in-progress comprising of reliable stocks and/or cost records are maintained. These records should either form part of the financial accounts , or if separately kept, they should be reconciled with the financial books. To ensure proper control over stores, the storekeeper should have full control the stock material lying in the stores. He should be responsible for receiving the stores and also issuing materials. Issue of materials should be only against properly authorised requisitions or indents signed by the foreman and sanctioned by the Factory Manager or other responsible officer. The storekeeper should personally maintain quantity accounts on bin cards of raw materials, stores and finished goods. Wherever possible, the Cardex system should be introduced instead of maintaining quantity accounts on bin cards, tagged to the bin or other containers. Accounts may be kept both in quantities and values in Accounts Department. Financial control accounts should be maintained in the Accounts Department against which the individual balances should be periodically proved . Where quantity accounts are not maintained in the Accounts Department, the accuracy of the accounts should be checked physically by continuous stock taking and also by periodical evaluations of the detailed quantity balances and reconciling them with the corresponding financial control accounts. Under this system , the need for duplicate maintenance of accounts in the Accounts Department and in the stores Department is avoided. However, where a second record is maintained in the stores, this not only will provide a cross checking and ensure accuracy of the stores records, but listing of the balances for agreement with the control accounts maintained by financial books is facilitated . The auditor, during the course of his audit, should examine the system carefully. He should check the Goods Inward Register with the copies of the Delivery Chals, Goods Inwards Notes and the original invoices. The entries in the Issue Register should be checked with the requisitions or indents submitted by the Manufacturing and other departments. Where quantity accounts are maintained separately, the balances as per the books should be compared with the balances shown on the stock cards and discrepancies, if any , should be inquired into.

In modern computerised accounting system the store accounting as well as financial accounting is maintained simultaneously, which helps the management for immediate information of stores and about its consumption, balance and the cost of such stores. For such accounting special programming have been developed by the societies from the system supplier. Auditors should check the norms prescribed for the programme, and see that the norms are proper and correct and no manipulation is possible by the store accountants or the financial accountants.

The ***basis for allocation of costs for the stores issued should be ascertained.*** The procedure for charging labour and other direct costs and overheads

to works-in-progress should also ascertain. Transfer from work-in-progress to finished goods account or “Cost of Goods sold” accounts should also be checked. The cost accounts should either be integrated or periodically reconciled with the financial accounts.

10. Valuation of Inventories: The method of valuation of inventories should be verified by the auditor. Major changes in valuation mode will have more impact on the cost of production and profits. The auditor should see that the valuation is proper and accordingly standard accounting policies that are fixed by the Board. Policies as laid down as per the *Indian Accounting Standards AS 2*.

11. Sales- 1. Retail sales are mostly confined to consumers’ societies and other societies, which deal directly with customers. So far as consumers’ societies are concerned, the Byelaws require that sale should be for cash only or against deposits kept with the society by the customers. Where credit sales are made, it should be seen that *necessary provision for selling goods on credit is contained in the Byelaws*. It should also be seen that credit limits are fixed for individual customers and these are not exceeded.

2. Control over cash sales - A cash memo is issued for every sale. In a number of cash memos, names of customers may not have been mentioned. However, description of goods sold, quantities, rates, the amount and sales tax when charged, are invariably shown in the cash memos. The auditor should compare the entries in the Daily Sales Register with the cash memos issued. *The procedure for fixing selling prices should be ascertained*. The society should be advised to maintain a Price Register for showing details of calculations for fixation of selling rates. The rates mentioned in the cash memos should be checked with the Price Register.

3. Checking of cash memos and Daily Sales Register.- Calculations, extensions and totals should also be checked on a percentage basis. The auditor should carefully study the provisions of the sales tax Act with particular reference to the schedule in which the commodities dealt in by the society are contained. It should be seen that the rates of sales-tax charged are correct.

The total sales for the day according to the Daily Sales Register should be called over into the main Cash Book. The total sales according to the Sales Register should also be compared with the cash received by the cashier according to his Rough Cash Book or Cash Dairy. The accounts of sales tax collected should be maintained separately. The total amount of sales tax collected should be paid into Government treasury in the specified period along with the return of the sales for the period.

4. Sales in manufacturing and processing societies.- As regards sales in manufacturing and processing societies, *the procedure followed should be ascertained*. Where goods are manufactured against orders a register of orders received from customers should be maintained. The customers’ orders should be formally approved before they are accepted. Where credit sales are made to customers, credit limits should have been properly fixed and checked before orders are accepted. The procedure adopted by the society, should be ensured that, orders are accepted only on terms and conditions acceptable to the society. Where

special concessions in rates or terms of payments are shown, reasons therefore should be recorded.

A review of uncompleted orders should be taken be time to time and where the completion of orders is unduly delayed, reasons for the same should be ascertained . It should be seen that deliveries are made within the period agreed for the execution of orders. Where part deliveries are made, outstanding commitments should be ascertained and their terms and delivery period should be reviewed. *Such type of control is of particular importance in determining the liabilities or losses arising out of the outstanding orders and also in assessing the values of stocks on hand the works-in-progress.*

It should be seen that, sale invoices are prepared for all goods despatched or works completed. Invoices should be sent immediately on despatch of goods. Sale invoices should be checked with entries in the Sales Register or Sales Day Book. Acknowledgements of receipt of goods by customers such as receipted chalans, delivery notes, etc., should be attached to the office copies of the invoices .

Where goods are returned by the customer or claims made in respect of short deliveries, incorrect prices, damages in transit, etc., credit notes should be issued. Quantities sold as per sale invoices should be traced in the stock register and also compared with the issues of finished goods. Where there is a system of issuing pro-forma or provisional invoices before actual despatch of goods are vogue, the proforma invoices should be compared with sales orders and the goods despatched notes and also with the final sale invoices and receipts advice notes or delivery chalans. Sales invoices should be checked with the sale orders as regards prices and terms of payment and delivery. Calculations, and additions should also be checked. Credit notes issued for goods returned should be compared the Goods Inward Register and other evidence. Price calculations , extensions and additions should also be checked. All credit notes should have been properly authorised by a responsible officer, who is not concerned with the Sales Department or the Sales Ledger clerk.

12. Consignment accounts.- Where goods are consigned to out stations for sale, the *agency terms and conditions should be ascertained.* In particular, procedure for preparing invoices and recording sales should be ascertained. Separate accounts should be maintained in respect of each consignment. *Goods sent on consignment should be included in stocks on hand and not treated as sold until regular account sales are received from the consignee,* when consignment account should be debited, crediting sales. Certificates should be obtained from the consignee of all goods lying with him unsold. It should be seen that balances in the consignment account are not mixed up with the sundry debtors account.

13. Sales on approval or return.- Where goods are delivered for sale on approval or return basis or '*jangad*' sales as they are called, the goods sent, should be treated as stocks on hand and the sales account should not be credited until the customer has conveyed the acceptance of the goods or the period within which the goods, if not approved, should have been returned, has expired.

14. Goods lying with third parties.- In case of goods lying with third parties. The auditor should see that the certificates are obtained from holders of the goods for the stocks lying with them. These certificates should specifically state the goods are the property of the

society and that they are hold by the consignees or the agents on behalf of society. It should be ensured that these stocks have been periodically confirmed by such certificates.

15. Goods received on consignment.- Where goods are received from third parties for sale on consignment, it should be seen that these good and the sales of these goods are not mixed up with the stocks or sales of the society. The stocks belonging to the third parties should be excluded and the account of such sales should also be kept separately.

V-7 PAYMENT OF WAGES

1. Internal control over payment of wages:- In societies, which have undertaken manufacturing activities, such as Co-operative sugar Factories Spinning Mills, etc., a large number of workers are engaged in manufacturing activities, Wages, therefore, constitute a major item of manufacturing cost and should, therefore, receive a particular attention of the auditor. The system in force with regard of the compilation of the payrolls and payment of wages vary considerably with the size of the society and the nature of its activities. The procedures involved in evolving a satisfactory system of internal control over payment of wages can be grouped under the following broad categories:--

(a) Recruitment, promotions, transfer and dismissal of employees.

Written orders should have been issued for:-

- (i) Appointment,
- (ii) Rates of pay and other allowances,
- (iii) Retirement or dismissal,
- (iv) Promotions, increments , punishments, etc.

Rules should have been framed governing (a) service conditions including grant of leave, retirement benefits etc. and (b) provident fund . Approval of the Registrar should have been obtained where necessary.

History sheets should be maintained for all employees and all matters, such as appointments, promotions, rates of pay, retirement, dismissal, etc.. Should be recorded therein. The specimen signatures should also be obtained at the time of recruitment. These history sheets should be maintained by the Personnel Department.

All general increases in pay, deductions from wages, payment of advances against wages, etc., should have been properly authorised.

(b) Attendance and job recording: Where wages are paid on time basis, the auditor should ascertain the normal working hours and regulation regarding absentees.

(c) Compilation of sheets and analysis of wages.

(d) Disbursement of wages.

2. Principal features of Internal control- The principal features of sound internal system for controlling payment of wages are as follows:--

(a) Muster rolls should be maintained to record the attendance of all employees. Where clock are in use, it should be seen that all workers have been provided with cards and they gets their cards duly punched on arrival into the factory and when they go out. Arrangements for checking clocks cards and clocks should be ascertained and it should be seen that there is proper supervision over the punching of cards or marking attendance on muster roll. The timekeeper who responsible for the maintenance of the muster roll and also the attendance cards, should be an independent officer. Where the number of employee is large, a separate office should be set up.

(b) Where wages are paid on piece rate basis, the system of maintenance of job-cards and clock-cards and their agreements should be carefully studied, as also the methods adopted

for calculation of piece works and particulars of bonus scheme, if any. Arrangements made for checking and authorising of piecework and treatment of partly completed jobs should be examined.

Quantities produced by individual workers and entered on piece work, tickets or job-cards, should be checked with the Daily Production Report and entries in the Production Register or Finished Goods Register. It should be seen that all work is recorded as and when completed and not carried forward.

(c) Where there is large number of employees, a regular procedure should have been prescribed for periodical checking and testing of the records of the wages Department as regards names of employees, rates of pay, deductions to be made and other standard information. Such testing should be made by a person who does not take part in the preparation of wage sheets. The method of preparing wage sheets or payrolls should be examined. Attendance should be called over from clock cards or muster rolls and production should be compared with job cards, production reports and other piecework records.

(d) The system of notifying to the employees particulars of gross wages payable and deductions to be made there from should be examined. Slips containing necessary particulars are generally delivered to the workers in advance or are inserted in the pay envelopes. These should be checked on a percentage basis.

(e) In case the society has appointed workers on contract basis from the agency providing it, the auditor should see that, the workers possess required skill, the terms and conditions of contract, compensation for any accident, responsibility of necessary legal deductions from the wages, and other terms and conditions are included in the contract, and follow up of the terms and conditions by the contractor. Necessary documents of the workers, if required may be obtained from the contractors.

3. Method of checking pay rolls- (a) The auditor should have carefully examined the system of internal control in force by calling for the time office record (attendance cards and piece works cards, inspection reports, production reports, muster rolls from the contractor or maintained by the time department duly verified) and checking these with the entries in the pay roll or the wages sheets. He should also check calculations and additions of the payrolls and also acquittances of the employees acknowledging receipt of wages. He should also see that the payrolls have been initialled by all persons taking part in the various stages.

The totals of pay-sheets of the different sections to be called over into an abstract or summary sheets and the total wages paid should be traced in the cashbook.

(b) Deductions made from wages should have been duly authorised..

Deductions made on the account of provident fund, Employees' State Insurance, Income-tax, cooperative societies dues for repayment of loan etc. should be paid over to the Provident Fund Commissioner and authorities within the prescribed time. Dues of the employees' society, canteen dues and other amounts deducted from wages and payable to third parties should be paid within a reasonable time. Totals of all deductions made under various heads should be called over into the General Ledger.

(c) Wherever possible, the auditor should attend at the time of payment of wages and satisfy himself that, the prescribed procedures are being regularly followed. In order to test the various aspect of internal control, such as new appointments, increase in pay and allowances, transfers, dismissal or resignation, etc.. The auditor should scrutinise the wage sheets for a specific period with the information available in the history sheets and relevant orders.

(d) Where wages are paid on piece basis or additional wages are claimed under a scheme of enhanced hours, appropriate job cards, piece work or bonus cards, should be examined and it should be seen that these are duly signed by the foreman or the supervisor of the section and also by a responsible officer of the wages Department. Quantities produced mentioned in the job cards included over into the Daily Production Register.

4. Payment of overtime.- There should be a proper procedure for authorising overtime. Overtime should be allowed only against written requisition by the foreman or a senior supervisor of the section. Reasons for overtime should have also been mentioned. Payrolls for payment of overtime should be separately prepared. The auditor should ascertain the basis or payment of overtime, method of calculating overtime and rates of overtime wages. The authority authorising overtime should be independent of the wages Department. It should be seen that the provisions of the Factory Act and the Shops and Establishments Act are duly observed.

V-8 LOANS TO MEMBERS

1. Restrictions on lending by co-operative societies.- Under provisions of Rule 45(1) of the Maharashtra Co-operative Societies Rules, where a person is a member of more than one credit society, he has to furnish declaration in form “K” that he will borrow from one society only the name of which is specified in the declaration.

Under section 44(3) of Maharashtra Co-operative Societies Act, the state Government has been empowered to prohibit, restrict or regulate the lending of money by any society or class of societies on the security of any property. The Registrar has also been empowered to regulate further the extent, condition and the manner of making of loans. In case of cooperative credit structure societies, (primary agricultural societies, district central banks and state cooperative bank) this section does not apply, such societies have to adopt their own loan policy in conformity with the Reserve Bank of India/ national bank guidelines. Rules 42(1) empower the Registrar to *prescribe margins* to be maintained, with reference to different commodities, securities or classes of societies. In case of cooperative credit structure the societies have to follow the guidelines issued by the RBI/ Nabard(National bank) in this respect. Under Rule 42(2), he has power to specify the **multiple of owned funds** of the borrowing society up to which advances by way of cash credit may be sanctioned by the central bank, or the apex Bank. Under Rule 42(5), the Registrar has been empowered to prescribe condition for grant of loans to member including maximum amount to be advanced and period of repayment both in regard to total advances and also against different types of securities. In exercise of these powers, the Registrar has issued a number of orders regulating and restricting grant of loans by societies and banks. Auditors will have to study carefully the contents of these orders and watch their compliance during the course of their audit. The orders are mentioned in this manual elsewhere.

Section 21 of the banking Regulations Act (Applicable to co-operative societies) gives wide powers to the Reserve Bank, to regulate and control advances by co-operative banks. Rule 44(3) provides this for cooperative credit structure to follow the guidelines issued by RBI/ National bank.

Under section 44(1) of Maharashtra Co-operative societies Act, no loan can be given to a non-member or against the security of a non-member or on the security of its own shares, or on the security of any person who is not a member. However, loans may be made to non-member depositors against security of their deposit, to the extent prescribed in its loan policy as per directives of the RBI, the amount of the deposit and for a period,

which does not exceed the date of maturity of the deposit. Although inter-lending between societies has been prohibited, the Registrar may permit such inter lending in special circumstances, and the special sanction of the Registrar is necessary as per this section .

Although a borrowing member cannot offer shares in the society held by him as security of his loan, still, under Rule 43 (1), he is required to hold shares in proportion to the amount of the loan applied for by him.

2. Finance with Collaboration and partner ship: The societies can make collaboration with the prior approval of the State Government and subject to such terms and conditions as the State Government impose or prescribe. The collaboration under section 20 (A) should be for specific business or businesses, including industrial investment, financial aid or marketing and management expertise. For the societies to whom there is no Government aid of any kind need not requires prior approval of the Government.

Under section 20, the two or more societies can enter into partnership for carrying out any specific business or businesses. A prior approval of Registrar is necessary for partnership if the society has any financial assistance from the Government, in the form of share capital ,loan, or guarantee. The societies entering into partnership have to pass resolution in the General Meeting with three-fourths majority.

3. Restrictions on lending operation of certain type of society.- Different type of institutions have been set up to cater to the credit needs of different set of people and also according to the purposes of which finance has to be provided. Thus agricultural credit, multi-purpose and seva societies cater to the credit needs of agriculturists. In towns and cities, urban bank or people's bank urban credit societies, cater to the needs of the small traders and industrialists. Employees of Government Departments, large and small business concerns and industrial establishment have organised salary earners societies, which give them loans for purposes, such as medical attendance, education of children, housing etc. Societies have been set up for factory workers, teachers and other salary and wage earners, which advance loan for short and long periods to enable them to tide over their temporary difficulties. Land development banks (Agricultural and Rural development banks) have been organised for provision of long term credit for development of land, provision of irrigation facilities, purchase of tractors and other costly equipment which increase the productivity of land earnings of farmer, the DCCB's are also permitted to finance for these purposes. Although the main object of all the institutions is provision of credit, their constitution and operations are different. In the following paragraphs, an attempt would be made to explain the salient features of the operations of these institutions.

Under section 48 of the Act, every borrowing member of an agricultural credit society is required to execute a declaration creating a charge in favour of the society, on the lands held by him or his interest in the lands cultivated by him as tenant for the outstanding dues of the society.

Section 49(1) of the Act lies down that every member of a salary-earners employees society, while applying for a loan, shall execute an agreement authorising his employer to deduct from his wages or salaries, the dues of the society as communicated by the society. It is mandatory for the employer to deduct the amount as called by such societies, subject to the provisions of Payment of Wages Act.

4. Transactions with non-members: As regards credit transactions and advances to non-members, Section 45 of the Act lays down that transactions of a society with non-members shall be subject to such restrictions as may be prescribed. Rule 46(B) requires that credit

sales to non-members where permitted by the bye-laws can be made to only such tenders and other persons who give undertaking to the society to refer any dispute to the Cooperative Court for arbitration.

There are also restrictions on the loaning or credit operation of society, which are not permitted to undertake lending business. Under Rule 44(1) of the Maharashtra Co-operative Societies Rules, no society, ***the object of which do not include grant of loan or financial accommodations to its members, can grant loans for sanction credit to any member without the sanction of Registrar.*** However, a society which has as one of its objects, supply of goods or services required by members for production purposes, may supply goods or services on credit against sufficient security on condition that, the cost of the goods supplied or services provided shall be recoverable from the sale proceeds of agriculture produce or other goods produced by the member. Under provisions of sub-rule (2) of Rule 44, a consumer's society may sell goods on credit to its members and other customers up to the extent of deposits received from them.

These are important provisions and it is responsibility of the auditor to see that the transactions of credit as well as non-credit societies are conducted or regulated according to this provision. Besides these restrictions, byelaws of co-operative societies contain number of provisions regulating advances and loans, grant of credit to members. Purposes and periods for which and limits up to which loans can be sanctioned are generally specified in the byelaws.

5. Checking of loan operations- Procedure and appraisal: Bye-laws of most of the co-operative banks and credit societies provide that all loans to be made to members are to be sanctioned by the managing committee or the Board of Directors of the bank or society. However, in case of banks and salary-earners' societies, where the membership is large, the byelaws provide for the appointment of a loan subcommittee to consider and dispose of loan applications. In case of some of the banks and societies, the President, Chairman, Managing Director, Manager or other principal executive officer is also empowered to sanction loans up to a specified limit by the officer should be ascertained.

The Managing Director, Manager, Secretary or other principal officer required to verify the correctness of the information furnished in the loan application from the records of the bank or society and to see that all necessary certificates and documents accompany the loan application. He has also to record his recommendation or otherwise on the application. The amount to which the applicant is eligible and the amount which he recommends. During the course of his examination of loan transactions, the auditor should satisfy himself so far as is evidenced by initials of the clerks taking part in the scrutiny of loan applications that normal procedure has been properly observed.

It has to be seen that regular applications for loans in the prescribed form are obtained from all borrowers and duly considered and sanctioned by the Committee. The proceedings of the meetings of the committee will, therefore, have to be seen in order to ascertain whether all the loans have been duly considered and sanctioned by the committee. The resolution sanctioning loans should be specific and all the terms and conditions subject to which the loan has been sanctioned and the purpose for which it is to be utilised should be contained in the resolution.

Prior to sanction of loan the loan application is required to be scrutinised and appraisal of loan should be made, on the basis of need of loan amount, purpose of loan,

necessary qualification of the borrower, repaying capacity of the borrower, security offered by him, terms of loan, repayment period, and realisation of sales or revenue. The Nabard and RBI have issued several guidelines in this regards which should be acquainted by the auditors and see that the banks have complied with the same. For any failure by the bank to comply with such circulars, necessary qualification should be included in audit report.

In order to be satisfied that the *loan sanctioned is a genuine one and not a renewal of an existing loan or conversion of a debit balance or mere book adjustment entered as a fresh advance against repayment of an overdue loan* with a view merely to extend the period of its repayment, the date or dates of repayment of the previous loan and the date of remittance of the amount to bank will have to be ascertained and it will have to be seen that there is a sufficient time lag between the repayments of old loan and disbursement of fresh loan. It should also be seen that all repayments of loans made by members are promptly credited into bank intact and not kept on hand and utilised for giving fresh loans. Even if the society has not borrowed from the bank, all recoveries should first be credited to current account intact and cheques drawn for fresh loans.

6. Documents: It should be seen that all necessary documents such as application for loans, loan bonds or agreements, surety bonds or mortgage deeds and promissory notes wherever necessary are got *duly executed from the borrower and registered where ever necessary*. Although certain documents executed by members of co-operative societies are exempted from payment of stamp duty and registration fees, other documents have not been so exempted and it is the duty of the auditor to see that all documents, which have not been exempted from payment of stamp duty, have been properly stamped. However, so far as agricultural credit, multipurpose and seva societies are concerned, there are practically no documents, which are required to be stamped. In regards loans advanced by the urban banks, urban credit and rural credit societies, salary earners societies requires stamp duty to be paid.

The documents required for various types of loans are ascertained, specifically the documents related to security, continuing security, registration certificates, documents creating charge, transfer documents of property if required. Documents after creating a charge, insurance policies, are also taken or not should be verified. An annexure of documents to be taken loan wise is enclosed, it is not exhaustive, and may change as per requirement of the societies business.

7. Checking of loan bonds- Where a separate loan register is maintained, the entries in the loan register should be compared with particulars contained in the applications for loans and loan bonds and it should be seen that the following particulars correspond,-

- (i) Date of advance,
- (ii) Amount advanced,
- (iii) Name of the borrower,
- (iv) Names of the sureties and/or particulars of other security obtained,
- (v) Date fixed for repayment for loan or period of the loan and the terms for its repayment, viz., the number of instalments in which repayable, amount of each instalment, date on which instalment falls due.
- (vi) Rate of interest,
- (vii) Purpose for which the loan is sanctioned.

It should be seen that loans are sanctioned ***only for purposes provided for in the byelaws***. The amounts entered in the loan register should be called over in the cashbook. Where no loan register has been maintained, the above particulars should be mentioned in the loan bonds and application should be compared with entries in the loan ledger. While checking loan bonds, the following additional points should be noted:-

8. Additional points to be noted while checking loan bonds.- (i) The signature of the borrower and signatures of the sureties should be examined. All signatures should have been properly witnessed. Thumb impression should have been properly described and attested. The signatures of the borrower and sureties are required to be taken before the authorised officer of the society/ bank.

(i) Mode of disbursement.- Whether the amount of the loan has been paid in cash or by cheque, should be seen. If any deductions have been made on account of shares or compulsory deposits, it should be seen that the amounts deducted have been properly credited.

(iii) Disbursement of loans by cheques - The societies should disburse all the loans by Account Payee cheque only. Where the loans are disbursed by bearer cheques, it should be seen that the payees themselves present the cheques for encashment at the bank. Some societies disburse the loan by bearer cheque and the chairman and secretary encash all the cheques together, which is not a good practice and the auditor should report such practice in their audit report. This should be specifically checked in the case of Seva or Vikas Societies, where in this system is used for renewal of loans without keeping proper time lag as required by the policy of Nabard. Where loans are disbursed in cash, it is desirable that the borrower should be paid in the presence of the Chairman or a member of the committee, who should initial the bond or the voucher (if separately obtained) in token of the amount having been disbursed in his presence. In case of large societies where a separate cashier is appointed, it should be seen that adequate arrangements for control over cash disbursements have been made.

(iv) It should also be ascertained whether any portion of the loan is to be disbursed in kind i. e. in the form of seeds, fertilisers, insecticides, etc. or payment is to be made direct to the suppliers of machinery like engines, pumping sets, etc. If so the arrangements made for the supply of these requirements should be ascertained and it should be seen that purchases have been made only from approved parties.

(v) Disbursement of loans in instalments- It should also be seen whether the entire amount of the loan has been disbursed in one lump or in instalments as and when required according to the purposes for which the loan has been sanctioned.

9. Scrutiny and verification of loans and advances- Different kind of loans, advanced by Urban Banks and societies.- Loans are generally classified into two broad types- ***fixed loans and cash credits and overdrafts*** - the difference being in the nature of operation of the accounts. Fixed loans are generally drawn in lump sums in one or two instalments only; **whereas advances to members generally take the form of cash credits or overdrafts, are operated as if they are current accounts.** Although in agricultural credit societies and small urban banks and societies, advances to members generally take the form of fixed loans repayable in one lump sum or in suitable instalments, Central Co-operative Banks sanction what are known as maximum credits to their affiliated societies based on the loan requirements of their members. However, advances to other types of

societies, generally take the form of cash credits. Urban banks and also commercial banks ordinarily sanction cash credits and overdrafts. The difference between an overdraft account and a cash credit account, the cash credit account begins with a debit entry. Both cash credits and overdrafts are arrangements under which cheques drawn by the constituents up to the limit sanctioned, are honoured by the Bank. The arrangement is also for a fixed period, generally for a year and can be renewed for a further period. However, before being renewed, the entire outstanding balance is ordinarily required to be repaid and the account cleared. Interest is generally debited monthly rests. Generally, there is a minimum interest or half interest clause contained in the agreement and this amount is debited even if the accrued interest is less than the amount. Sometimes, the operations are also subject to certain restrictions such as crediting of entire sale proceeds of goods sold into the account, maintenance of minimum balance, etc. RBI/ Nabard banks guidelines are followed by the societies coming under preview of the Banking Regulation Act 1949(AACS).

Cash credits include hypothecation, pledge, clean cash credits and overdrafts , which are described else where in urban banks section in this manual.

10. Loans against different kinds of security.-- In banks and other institutions doing loaning business, loans are generally sanctioned against the following types of securities:-

- (i) Loans against fixed deposits.
- (ii) Loans against insurance policies.
- (iii) Loans against gold and silver ornaments.
- (iv) Loans against pledge of Government securities and other trustee securities, share bonds and debentures.
- (v) Loans against mortgage of immovable property .
- (vi) Loans and advances against pledge or hypothecation of agricultural produce or other goods.
- (vii) Book debts
- (viii) Housing Loans
- (ix) and loans specified in byelaws for the purposes specified.

We shall now proceed to consider the various points , which are required to be noted while checking different kinds of advances.

11. Loans against security of fixed deposits.- Loans against fixed deposits is an important facility available to the depositor, since he can always secure financial accommodation to tide over temporary difficulties without being compelled to ask for refund of his deposit or being required to furnish other security. Obtaining refund of deposit before maturity would involve considerable loss of interest as per rules and guidelines issued by the RBI in this respect, and policy decided by the concern bank or society. This is an important concession allowed to the depositors. From the point of view of the lending bank also, the security is most perfect since availing it would amount to extinguishing an existing liability. Although Co-operative societies have been debarred from advance loans to person who is not their members, an exception is made in the case of advance against the security of his deposit. Proviso below section (2) of section 44 of the Maharashtra Co-operative Societies Act permits a co-operative society to make a loan to a depositor against the security of his deposit. Thus, loans even to non-members are permissible if they are made against the security of the deposit , held by them by society. As per provision of Rule 45-A, loans against fixed deposit amount and the period for which the loan is granted should not extend beyond the date of maturity of

the deposit and the advance amount should not exceed 90 % of the deposit. As per Rule 45 A- 2 if the depositor does not repay the loan within the period for which it is granted, the fixed deposit amount may be adjusted towards repayment of the loan amount and interest thereon and only the balance, if any shall be paid by the society to the depositor on the date of maturity. However the Reserve Bank of India in its Directive directed the urban banks and DCCB's to decide the margin for advance against fixed deposit.

Since deposit receipts are not negotiable, they will have to be got discharged and assigned in favour of the lending society/bank before a loan can be made against the security of the deposit. Instead of the usual rate of lending, interest at one or two percent over the rate paid on the deposit is charged on such loans. Advance should have been made against the deposit receipts issued by the bank itself. If advances are to be made against the security of deposits with another bank the assignment of the deposit of the receipt in favour of the lending bank will have to be got registered with the branch issuing the receipt. The conditions subjects to which the deposit has been accepted will also have to be carefully examined in order to ascertain that advance by another bank on the security of the deposit of that bank and creating charge thereon are permissible. It has always to be noted that in case of co-operative societies, what section 44 of the Maharashtra Co-operative societies Act contemplates made by a societies against deposit with itself and not with another institution. and the RBI/ Nabard has also issued guidelines not to advance against the fixed deposit of another institution as possible as the bank can.

12. Loans on the security of Insurance Policies.- Ordinarily, insurance policies are accepted only as collateral security, Moreover, since loans are also granted by the LIC itself, there would be very few borrowers who would offer their life insurance policies as security. All the same. Where insurance policies have been offered as security, the following points will have to seen:-

- (i) It should be seen that the policy is in the name of the borrower himself.
- (ii) Receipt for the payment of the latest premium should have been attached to the policy. An undertaking should also have been taken from the borrower that he would pay all the future premia and keep the policy alive during the currency of the loans. In the case of failure by the assured to pay premia as and when they fall due, the bank should have authority to pay them and debit the amounts to the account of the borrower, along with other charges and expenses incurred by it.
- (iii) The policy should have been got assigned in favour of the bank or society, which has lent the money and the *assignment registered with LIC*.
- (iv) A certificate should have been obtained from the LIC for the *surrender value* of the policy. Advance should be limited to 80% of the surrender value. It should be ascertained whether the policy is subject to any charge encumbrance, etc.

13. Advances against gold and silver ornaments and gold silver bars etc., It is necessary that a *qualified appraiser* is appointed to test and value the ornament and other article offered as security. Resolution of the Board or the Committee regarding appointment of the appraiser, the terms and condition of his appointment his duties and responsibilities, remuneration payable to him ,etc., should be seen. A regular agreement should have been got executed and *adequate security* should also have been obtained from him. Every advance should be supported by a certificate of the appraiser containing a brief description of the articles pledged, their contents, gross weight, net weight, fineness, rate at which valued, market rate prevailing on the date of the certificate, total value of the articles and the amount recommended for being advanced. When the loan is repaid and the articles are sufficient to cover the balance of loan still

outstanding. It should also be seen that the gold and silver articles lying in the safe or strong room of the bank have been *fully insured*. It should be observed by auditor the procedure followed by the bank for keeping the ornaments in safe proper sealing is made to the bags, by the branch manager, borrower and the appraiser. Adequate *margin* should always have been maintained and if owing to fall in the market price return of some of the articles or other reasons, necessary margin is not maintained, notice should be issued to the borrower either to pay up the difference in cash or furnish additional security. *Rules governing* such advances should have been framed and it should be seen that these rules have been duly observed. The auditor should go through the rules carefully and satisfy himself that they generally confirm to the model rules framed by the Department for guidance of co-operative banks. As this business is risky, no advances should be made unless the fineness of the gold and its value is guaranteed by an expert goldsmith or dealer of high professional standing and unquestioned integrity. Actual inspection of the articles in possession of the bank should be carried out during the course of audit.

14. Advances against pledges of Government and other trustee securities, shares, bonds and debentures.- Particulars of the securities pledged, their markets-value etc., should be seen. Since it is difficult to ascertain the value of the shares and bonds, etc., which are not quoted in the market, advances should ordinarily be restricted to Government securities and other bonds, shares debentures, etc. For which market quotations are available. The valuation should be based as guidelines from RBI prevailing on the date of advance and should be obtained from FIMMADA. If the borrower himself has not purchased the securities, it should be seen that the last endorsement is in his name. It should also be seen that all interest warrants not due for payment are intact. Actual inspection of the securities if, in possession of the bank should be carried out during the course of audit. Since the Reserve Bank of India has prohibited physical possession of the securities, and only permitted to be in the form of *demat*, the certificate of bank/ depository, in which the securities are deposited, a certificate in that respect should be called from the bank for verification.

If the securities have not been endorsed in the name of the lending bank, a *letter of assignment* should be got executed along with *blank transfer forms* duly signed by the owner of the securities. Wherever necessary, the *charge created in favour of the lending bank should be got registered with the authority* issuing the bonds or certificates and with the depository. Restrictions on the transfer of some of the securities like rural debentures issued by the State Co-operative Land Mortgage Bank and certain other institutions should be noted. In view of the restrictions on the transfer of shares of co-operative societies and the right of set off available to the societies against shares held by their members, *shares of co-operative societies should not be accepted as security* for loans. It has also to be noted that the Co-operative Societies Act *forbids societies to advance loans on the security of the shares issued by himself*. Since seconds charges are not recognised in case of certain bonds and debentures, care should be taken to see that *prior encumbrances have not created* on such securities.

Securities carrying Government guarantee should be preferred. Quotations should always be obtained before making advances. Necessary margin always be insisted upon. Since securities not quoted in the market are not ordinarily in demand, it would be risky to make advances on the security of partly paid shares, the contingent liability in respect of the unpaid calls should be duly considered. RBI

has issued detail guidelines in this respect, the auditor should carefully study these circulars while checking this type of advances.

15. Advances against pledge of goods- Certificate of the Manager or other responsible officer for having taken possession of the goods should be seen. Every time additional goods are taken into custody, ***“intake notes”*** signed by the borrower should be obtained and certificate of receipt of goods by the Manager should be seen. Similarly, when goods are released, ***“delivery orders”*** signed by the Manager mentioning the amount credited and the quantity of goods to be released should be issued. ***Goods should have been released only against repayments and it should be seen that the market value of the remaining goods adequately covers the outstanding balance.***

The Advances Register maintained by Bank / Society should furnish full particulars of the goods pledged, their type or quality, period of production and if perishable goods are pledged, the perishable period, prevailing market rate, total value, amount advanced and margin required to be maintained and margin actually maintained. Agricultural produce or other goods pledge by different borrowers should have been ***stored separately***. All the goods should have been ***adequately insured*** and the insurance policies taken out in the name of the lending bank. If the godown in which the goods are stored is not owned by the bank, it should have been hired in its name. The lease agreement should be examined with a view to ascertain whether there are any restrictions on the use of the godown for storage of certain types of commodities. There must always be a ***signboard bearing the name of the lending bank***, hung over the main entrance. The locks should also bear these of the bank.

The produce or the goods should have been so arranged as to facilitated easy checking. The gunny bags or other containers in which the agricultural produce or the other goods are stored should have been neatly arranged in convenient rows so that they can be easily counted or taken out for measurement or for weighting. Where agricultural produce is stored in loose condition (that is in bulk or heaps) measurement will have to be taken to estimate the quantities. ***All the godowns may be visited and the goods actually verified and counted during the course of audit considering the internal control for the godowns.***

16. Advance against hypothecation of goods-- As regards advance against hypothecation of goods, it has to be noted that, although a charge exists against the goods hypothecated in favour of the lending bank, the possession of the goods continues to be with the borrower and he is free to dispose of the goods as he likes, provided, the remaining goods are sufficient to cover the outstanding balance as per terms stipulated in the agreement. In some of the agreement, the borrower binds himself to credit to his loan account all sale-proceeds of the goods sold by him.

The borrower is required to submit, as may be stipulated daily, weekly, fortnightly or monthly ***statements of stocks*** lying in the godown and hypothecated to the bank. The stock statements submitted by the borrower are required to be ***carefully examined*** and it has to be seen that the ***required margin*** is always maintained. The ***insurance policy*** is also required to be taken out in the name of the lending bank. The actual stocks should also have been inspected by the officers of the bank at frequent intervals. In addition to the periodical stock statements, monthly trial balances and other statements showing the financial position of the borrowing institution are required to be obtained. In case of the individual borrowers, ***confidential inquiries***

regarding their financial position and their dealings in the market should be made periodically

It has to be noted that several restrictions have been placed by the Reserve Bank of India on such type of advances. Although in the case of advances against pledge, advances up to sixty percent and in some cases, even up to seventy per cent of the value of goods pledged are generally allowed, the restrictions pledged by Reserve Bank of India advances against agricultural produce and in particular against food grains and industrial raw materials, such as cotton, oil seeds, etc., should also be taken into consideration and it should be seen that the directions issued by the Reserve Bank of India in this regard are being scrupulously observed. As already stated, Rule 42 empowers the Registrar to issue with the approval of the Apex Bank, directions regulating grant of loans by co-operative societies. The following are the more important orders issued by the Registrar in exercise of powers vesting in him:-

- (1) Registrar's Order No. BNK-110/Fin., dated 8-9-1964 regarding crop loan systems.
 - (2) Circular No BNK-110(Fin.) Dated 16-2-1963 regarding policy to be followed for financing defaulters.
 - (3) Circular No BNK-75(Fin), dated 12-10-1964, regarding crop loan system.
 - (4) Order No. BCB-110 (Fin), dated 18-10-1965, laying down conditions for acceptance of deposits and raising of loans.
 - (5) Order No.-75 (Fin), dated 17-12-1966, under Rule 42 (1), regarding regulation of loans.
 - (6) Order No. BCB-75 (Fin,) dated 17-12-1966, under Rule 42(2), regarding grant of cash credits.
 - (7) Order No. BCB-75 (Fin,) dated 17-12-1966, under Rule 42 (5), laying down conditions for different types of loans.
 - (8) Order No. BCB -75- (Fin) dated 2-2-67 regarding margins.
- The auditors should carefully study the above orders and circulars and see that they have been duly complied with.

MASTER CIRCULARS The Reserve Bank has issued various circulars in respect of hypothecation and pledge loans and advances, and has consolidated them in to master circulars in 2006 and are revised in July every year, auditors have to study them, from obtaining it from the website of the RBI.

17. Advance against mortgage of immovable property.- Title deeds such as sale deeds, or certificates issued by the Revenue Department or by the Civil courts showing title in the immovable property and the nature of tenure and other terms and condition subject to which lands or other immovable property has been held, Restrictions on its alienation or transfer and creating charges or encumbrances thereon, should have been carefully got examined and the *solicitor's or legal adviser's certificate* regarding title of the borrower and his right to mortgage the property should have been obtained. The documents should appear to be genuine and should refer to the particular property mortgage to the bank or society. Other evidence such as extracts from village record of rights (7/12), city survey records, index II, revenue account abstract from talathi, receipts issued by Revenue Officers acknowledging payment of land revenue or ground rent, notices and receipts issued by the local authorities for payment of taxes on the property should be examined in order to be satisfied that the property belongs to the borrower and continues to be in his possession. *Valuation report of the architect or the engineer* should also be seen in order to be satisfied about the adequacy of the security. The mortgaged property should have been insured for its full value and the policy assigned to the lending bank.

Since the lessee has no permanent interest in the land, recovery of loans made against mortgage of the lease hold property, will have to be before expiry of the period of the lease. Interest of co-parceners in property held by a Hindu Joint Family will have to be examined and it will have to be seen that purpose of the loan is one for which the joint family estate can be mortgaged for securing a loan.

It should be seen that the charges created on mortgaged property are registered with the competent authority, and registration certificates are obtained. In case of companies, to whom loans are provided on mortgage of property, charges should be registered with Registrar of Companies within stipulated period as per Companies Act 2013.

18. Discounting of bills and hundies.- Discounting of bills and is an extremely popular form of temporary accommodation granted by banks. In the co-operative sector, this business is mostly undertaken by urban banks. Cheques and hundies received from the customer are immediately credited to his account and he is allowed to draw cheques against unrealised bills up to the sanctioned limit. Since drawings are allowed before the bills received for collections are realised, the **risk of dishonour** of the bills or cheques is always there. As such, very careful inquiries should have been made about the financial position and integrity of the customers to whom this facility is allowed. In some of the banks, what are known as **time or usage bills** are also discounted and the bills are presented for payment and the amounts collected on due date. Bills or hundies may either be clean bills or documentary bills. In the latter case, they are accompanied by railway receipts or other documents showing title to the goods, which are to deliver to the drawee or consignee only against payment of the bills. Since the title to the goods consigned to the drawee continues to the vest in the drawer, discounting of such bills is quite a safe mode of investment of funds, provided due **care and caution** is exercised and the party is known to the bank. As regards clean bills, since in most cases, they are mere **accommodation bills or "kites"** as they are known, very careful inquiries are required to be made about the material assets possessed by the borrower, his integrity and reputation for honesty in his dealing and the status enjoyed by him in business circles. *The Reserve Bank of India has prohibited issuing such bills, cheques for misuse of banking channel, the auditors should carefully examine these types of transactions and advise the bank to stop such practices.*

Discounting of bills and hundies is one of the most remunerative modes the employment of funds short periods. However, the bills should have been purchased only from **approved parties, whose credit limits have been fixed** after making very careful inquiries about their financial dealings and their status and their credit in business circles. The movable and immovable properties held by them are also required to be considered. Limits should have been fixed separately for clean bills and other bills, which are accompanied by documents evidencing title to goods such as railway receipts, etc. While checking these transactions, the auditor should see whether the bills discounted are genuine trade bills or are mere accommodation bills. Cases of misuse of hundi limits discounting of hundies beyond the credit limit fixed, meeting of previous hundies already discounted and due for payment by drawing or accepting fresh hundies, frequent dishonour of bills or delay in honouring them, cases of reimbursement of dishonoured bills by accepting cash payment from the limit-holders, etc., **should receive particular**

attention of the auditor with a view to ascertaining whether this business of discounting of bills and hundies is being conducted on sound lines.

As regards payment of cheques received for collection before they are realised, it may be observed that collection of cheques on behalf of constituents is a very important service rendered by the banks. However, this does not mean that the amounts of the cheques should be paid or credited to the account of the constituents before they are realised. Upcountry cheques are required to be sent by post to collecting banks or the drawee bank and considerable delay occurs before the proceeds are realised and there would be considerable loss of interest. As such except in certain exceptional cases, proceeds of cheques are not credited to the account of the constituent before realisation. However there should be no objection for discounting them provided they have been received from approved parties to whom hundi limits have been sanctioned.

MASTER CIRCULARS The Reserve Bank has issued various circulars in respect of facility regarding bills discounting to be given to the customers, and has consolidated them in to master circulars in 2006 and are revised in July every year, auditors have to study them, from obtaining it from the website of the RBI.

V-9 INVESTMENT OF FUNDS

1. Investments in shares of co-operatives- Under Section 70 of the Maharashtra Co-operative Societies Act, societies are permitted to invest its funds in the shares of any other limited liability society. Federal societies have been set up to facilitate the operations of different classes of primary societies. Since membership of federations is compulsory, all primary societies are required to buy shares of their respective federal societies.

All societies- both agricultural and non-agricultural- are required to purchase shares of the District Central Co-operative Bank or other financing agency from which they borrow. Marketing and processing societies facilitate the operations of agricultural credit societies, by helping to link up credit with marketing and processing. Hence, agricultural credit societies have to purchase shares of the marketing and processing societies operating in the area. Primary marketing societies are required to be affiliated to their respective District Marketing Federations and also to the State Co-operative Marketing Federations. Dairy societies are required to be affiliated to their Milk Unions and buy their shares. Housing societies, if they want to borrow from the Maharashtra State Co-operative Housing Finance Society, have to become its members. All primary societies are thus required to invest certain portion of their funds in the shares of their federal societies.

2. Restrictions on investment in shares of other societies.- However, it should be seen that shares of only such institutions, which have been organised for the furtherance of the objects of the society or otherwise assist the society in its operations, are purchased. The amounts invested should also not be disproportionate and in no case should ***exceed a reasonable percentage*** of the paid-up share capital of the society.

Under Section 19 of the Banking Regulations Act, Co-operative Banks are not permitted to purchase shares of any society other than the Central Co-operative Bank and State Co-operative Bank except to the extent permitted by the Reserve Bank of India. It should be seen that if any co-operative bank has

invested its funds in the purchase of shares of any other co-operative society, it is permissible under that Act and also that the amount invested does not exceed the limit specified in the directive issued by the Reserve Bank.

3. Method of checking investments in shares.- Receipts or other acknowledgements, acknowledging receipts of the share money should be seen. Since payments are generally made by cheques or debited to current account, entry in the Pass-book will also provide supporting evidence. The share certificate issued by the bank or other society should also be inspected.

4. Investment in fixed or call deposit with Bank - Funds, which are not immediately required for the business of the society, are generally invested in fixed or call deposits with the Central Bank. The original fixed / call deposit receipts issued by the bank should be seen. If the deposits have been withdrawn, advices or credit notes and entries in the bank passbook will have to be seen. Call deposit and fixed deposit receipts, which have not matured, should be inspected. The Urban Cooperative Societies are prohibited to invest their funds in another cooperative urban credit societies, or urban banks without prior approval of Registrar. As well as the Urban Cooperative Banks are also prohibited to invest their funds in the Urban Credit Societies and are required to invest their funds in Central financing Agencies, by the Reserve Bank of India.

5. Purchase of national plan loans, saving certificates and other Government and trustee securities, bonds and debentures- If the purchases are made through the banks, the banks' memoranda of purchases or advice notes and entries in the bank passbook would be available. If purchases are made through brokers, the brokers' "*bought notes*", blank transfer forms or endorsements, etc., will have to be seen. As securities are placed in demat accounts, certificate issued by the depository should be seen. In case of bearer bonds, it will also have to be seen that all the interest coupons are intact. It should also be seen that the investment made is permissible under Section 70 of the Maharashtra Co-operative Society Act. If securities are pledged with bank for safe custody or as security against advances, certificates will have to be obtained from the bank and inspected by the auditor. The Reserve Bank of India has issued various guidelines and directives regarding purchase of securities, bonds and trust securities, PSU Bonds, the auditors should carefully study these, and physical verification should have to be done. The guidelines issued by the RBI are described elsewhere.

6. Purchase and sales of investments- In addition to contract notes issued by the broker, agreements and correspondence should also be seen to verify the correctness of the rates. All purchases and sales of investments should have been sanctioned by the committee or the committee appointed for this purpose. Resolutions of the committee should be seen. Rates at which purchases or sales have been made, should be compared with the market quotations prevailing on that date. It should also be seen that necessary adjustments on account of interest accrued and income tax deducted are properly made. Reserve Bank of India has issued various directives for purchase and sale business of investments by the urban banks, DCCB's which are covered under B.R. Act (AACs), are described elsewhere. If the securities are purchased or sold by the bank without the help of the broker, the auditor should see the deal slip for purchase and sale, with demat account and see that the

transactions are taken place with due care, and reasonable rate prevailing at the time of purchase or sale.

7. Purchases and sales of securities on behalf of customers.- Co-operative banks and other financing institutions which purchase and sell securities on behalf of their clients, should maintain separate demat or SGL accounts of the purchases and sales made on behalf of clients. It should be seen that the income, rights and other benefits relating to them are properly charged and credited to the accounts of the customer concerned. Reserve Bank of India has issued various directives for purchase and sale business of investments by the urban banks, DCCB's which are covered under B.R. Act (AACS) , are described elsewhere.

8. Investment in treasury bills - Some of the societies, particularly, urban banks, central banks, find a remunerative outlet for their surplus funds in treasury bills or other short-term investments , which are generally sold at a discount. The difference between the face value and the purchase price represent the return on the amount invested. Reserve Bank of India has issued various directives for purchase and sale business of investments by the urban banks, DCCB's which are covered under B.R. Act (AACS) , are described elsewhere.

9. Switching operations -- When certain investments are sold and the sale proceeds received are utilised for purchase of other investment, the operations are known as switching operations. The profit and loss realisation should be brought into the account and the new investment should be entered at its actual cost. Reserve Bank of India has issued various directives for purchase and sale business of investments by the urban banks, DCCB's which are covered under B.R. Act (AACS) , are described elsewhere

10. Badla transactions-- These are purely speculative transactions involving purchase and sales of securities not with view to investments, of funds, but merely to profit by the rise and fall in the prices of security and no delivery of securities purchased or sold, is necessary. Only the differences are paid or received on dates fixed for settlement ***Auditors should see that co-operative banks do not employ their funds for such transactions.*** Reserve Bank of India has issued various directives for purchase and sale business of investments by the urban banks, DCCB's which are covered under B.R. Act (AACS) , are described elsewhere.

V-10 INVESTMENT IN IMMOVABLE PROPERTY, PURCHASE OF LANDS AND BUILDINGS .

1. Purchase of lands buildings - Where lands buildings are purchased, agreement for sale and the sale-deed itself will have to be seen. Both the documents should have been properly stamped. The sale-deed should also have been registered. Title deeds showing title of the vendor to the property and also such other evidence like 7/12 extracts, 8A abstracts from village record-of-rights, city survey records, sanads granted etc., should be inspected. Receipt for payment of ground rent or land assessment, municipal taxes, etc., which show that the property continued to be in the possession of the vendor till the date of sale, should also be seen. The title deeds should have been carefully examined by legal advisers. They should appear to be genuine and refer to the particular

property to be purchased. The dates and sequences of the conveyance should be checked and it should be seen that, the last conveyance is in the name of vendor. The valuations of the building should also have been made by a competent architect or engineer. Stamp duty, registration charges and also legal charges and architect's fees may be allowed to be capitalised. If the building were purchased in an auction sale or through the Civil Court, the auctioneer's report, or certificate granted by the court would be available. If the building is sold under an order of a Civil Court, certificate granted of transfer of title to the property issued by the court will also be available. It should be seen that all the documents of title to the property are delivered and conveyance duly completed. Resolutions of the Board, Managing Committee or of the general body as may be seen. It should be seen that ***necessary permission of the Registrar*** as required under Section 70 of the Act for purchasing the building has been obtained. When buildings are purchased or constructed out of the Reserve Fund and other surpluses, permission of the Registrar for utilisation of the amounts for construction works will also have to be obtained in addition to the permission for investment of funds in immovable property as required under Sections 70 of the Maharashtra Co-operative Societies Act. In case of Banking institution, provision of Section 9 of the Banking Regulations Act 1949, will have to be observed regarding disposal of the non-banking assets. According to this section, no co-operative bank is to hold any immovable property, howsoever acquired, except such as is required for its own use for any period exceeding 7 years from the acquisition thereof or from the commencement of the said Act, whichever is later or within such extended period as is provided in the said Act, with permission from the RBI.

2. Investment of Reserve Fund in immovable property.- As regards investment of the Reserve Fund in immovable property, it has to be noted that under clause (iv) of sub-rule(i) of Rule 54 of the Maharashtra Co-operative Societies Rules, co-operative societies may utilise or invest their reserve fund in any immovable property specified by the Registrar by general or special order. Societies, which desire to withdraw any portion of their reserve fund for investment in immovable property, are required to obtain specific sanction of the Registrar. The Registrar in his Circular No.ADM/184(28), dated 16-8-1963 has directed that the following norms should be invariably followed while granting permission to any society for utilisation or investment of its reserve fund in immovable property:-

- (i) The amount to be invested in immovable property should not exceed half the total amount of the reserve fund.
- (ii) The society concerned should be of at least 5 years' standing.
- (iii) The society should be in 'A' or 'B' class.
- (iv) The society should agree to the creation of a first charge for the amount to be so invested on the profit which it would earn in subsequent years to make good the amount within a period which may not ordinarily exceed 10 years.
- (v) The land purchased or the building to be purchased or constructed should be advantageous to the society in the conduct of its business.

These conditions are generally specified in the order permitting investment of reserve fund in immovable property. Auditors should see that the conditions specified in the order are duly complied with. The committee has been constituted by the Registrar for permitting such investment, headed by the DDR, DJR and CRCS at

various levels, for specified amount. The auditors should verify the society has submitted his proposal for scrutiny and permission to these authorities.

3. Construction of buildings; approval of layout plans.- Before commencement of construction work in rural areas and in towns and cities outside municipal limits, permission for use of the land for non-agricultural purposes, should have been obtained. The layout plans and plans for building prepared by the architects, qualified engineers or engineers, should have been got approved from the municipal or other local authorities wherever necessary. Where godown or buildings are to be constructed out of loans sanctioned by the Government, it should be seen that the plans and layouts conform to standard pattern approved by the Government Engineer. All changes in the plans and layouts should also have been got duly approved from competent authorities.

4. Appointment of contractors.- Where construction of buildings is entrusted to contractors, it should be seen that the normally accepted canons of financial propriety, such as calling for tenders or obtaining quotation, comparison of rates and acceptance of the lowest tender, enquiries into financial position and past performance of the contractors, etc. are duly observed. If tenders are not called for and the contract is entered into by private negotiations or where the lowest tender is not accepted, reasons for not calling for tenders or for not accepting the lowest tender should be ascertained. The rates agreed upon should not be more than the prevailing rates for similar works. The following further points should be seen:--

(i) Whether tender deposits has been collected and regular agreement on stamped paper has been got executed in the form prescribed by the Institute of Chartered Architects.

(ii) The terms and conditions should be examined particularly in regard to (a) supply of materials and deduction of the cost thereof from the bills, (b) payment of advances, deduction of retention money from the amount of the bills, (c) payment of damages for delay in completion of works, appointment of subcontractors, etc.

(iii) Measurement books should be maintained by the building supervisor, clerk of the work or other employee of the society supervising over construction work. Measurements of all works executed should be taken at regular intervals under the direct supervision of the architect.

(iv) All running bills should be duly checked by the architect. ***Quantities shown in the bills should be checked from the measurement books and rates*** should be compared with rates specified in the tender form filled in by the contractor and accepted by the society.

5 Payments to contractors.- The agreement entered into with the contractors should be seen and it should be ascertained whether lump sums are to be paid on completion of specific stages of the work or advances are to be paid from time to time against running bills to be submitted according to progress of work. Advances to contractors during progress of work should only be made against progress reports and valuation of work as ***certified by the architect***. Running bills should have been submitted through the architect who should have checked them and initialled them, in token of (a) having compared quantities with the measurement books, (b) rates with those specified in the tender submitted by the

contractor and accepted by the society, and (c) having checked calculations, extensions and totals of the bills (d) the work completed by the contractor is of ***assured quality and quantity***. The valuation certificate should mention specific items of the work executed and value thereof, total value of the work executed so far, amounts paid to the contractors upto submission of the bill, amount to be deducted on account of supply of materials and retention money, necessary taxes and the net amount of advance recommended to be paid. If additional amounts are to be paid on account of materials purchased and stored at the site by contractor both quantities and rates at which different materials have been valued should be mentioned and the amount of advance paid against stocks of materials lying on the site should not ***exceed 75 per cent of the value of the materials***. All running bills should be serially numbered and filed along with the architect's certificates.

The running bills should also be checked by the accounts department as regard rates, quantities, etc. Calculations, extensions and totals should also be checked. Quantities mentioned should be compared with those mentioned in the immediately preceding bill and it should be seen that increases are shown only against items of works which are still in progress. In respect of completed items of work, as for example, excavation for foundation, filling in and construction upto plinth level, columns, slabs of lower floors, etc., the amounts shown against these items in previous bills should have been repeated, since in respect of these items, there would be no further progress.

6. Final bills and completion certificates.:- Final bills submitted by the contractor should have been duly checked as to quantities, rates, calculations extensions and totals, carry forwards and final total, by the architect who should also certify the completion of the building and correctness of the cost incurred over the construction. The architect also arranges to obtain the completion or occupation certificate from the municipal authorities without which the building cannot be occupied. Where buildings or godowns have been constructed out of Government loan, after completion of the building, a valuation certificate is also required to be obtained from the Executive Engineer of the State Government, or of the Zilla Parishad or other Engineer, as specified in the Government order sanctioning the loan. ***The actual expenditure incurred and quantities should be compared with the estimates originally prepared and the difference under different heads, if material, should be inquired into.***

7. Construction of buildings Departmental.- Where construction work is carried on departmentally, the society itself buying materials and engaging labour, the following points should be noted:--

- (a) Layout plans and estimates should have been prepared by the architect and approved by the general body.
- (b) A qualified Civil Engineer or overseer should be appointed to supervise over construction work. One or more mestries, works clerks or other assistants may be appointed where construction work of considerable value is undertaken.
- (c) Attendance of labourers should be checked with the muster rolls, job cards, job registers and supervisor's Daily Reports.
- (d) Payments of wages should be checked from the acquittance rolls, at the top of which particulars of the works or job executed should be mentioned
- (e) Purchases of building materials like bricks, cement, lime, iron and steel, timber, etc., should be checked from suppliers' bills, delivery notes, materials received

notes and entries in the materials received register, building materials, are stored in the open on the site. It is, therefore, necessary to appoint a watchman who will attend to the safeguarding of materials. However, cement and building stores like bolts and nuts, hinges, screws, nails, etc., should be stored in a godown or closed room and should be under the control of store keeper, Purchases should only be made against requisitions submitted by the Civil Engineer.

(f) A register showing receipts and issues of different kinds of building materials should be maintained. All entries in this register should have been checked and initialled by the Civil Engineer.

(g) Basis for allocation of wages, building materials and also supervision charges including salaries of the building supervisor and Civil Engineer to different buildings and other civil works should be ascertained.

8. Construction of godowns by co-operative societies.- In order to encourage agricultural credit societies, marketing and processing societies to construct godowns for storage of agricultural produce of members pending sale and also chemical fertiliser, insecticides and other agricultural requisites, both the Central and the State Governments have formulated special schemes for giving them financial assistance both by way of loans at concessional rates of interest and subsidies. During the course of audit, auditors will have to see that terms and conditions subject to which the loans and subsidies have been sanctioned, are complied with. It has also be noted that the amount of ***subsidy received is credited to the Reserve fund*** and the full cost of the construction including cost of the land should be shown on the assets side. If the actual cost of the godown exceeds the amount of loan and subsidy received from Government, permission of the Registrar for investments of additional funds in the construction of the godowns as required under Section 70 of the Maharashtra Co-operative Societies Act should be obtained

V-11 CAPITAL AND REVENUE EXPENDITURE

1. Treatment of capital expenditure.-- It is necessary that all capital expenditure incurred should have been properly authorised. The resolution of the managing committee / board or the order of the authorised officers sanctioning such expenditure should be seen. Similarly, all major repairs and maintenance charges, though not capitalised, should also have been sanctioned by the committee or the authorised officer.

The expenditure capitalised should be added to the cost of the assets and not for replacement, unless the asset itself is scrapped and a new asset acquired in which case the sale-proceeds of scrap received should be credited to the account of old assets and the cost of replacement debited to the account of the new assets. The difference between the value of the old assets and the sale-proceeds received should be adjusted to the profit and loss account. Where assets are not acquired from an outside agency, but, have been created by the concern itself by supplying materials and employing workers, it should be seen that the expenditure capitalised is limited to the actual cost of the work done, i.e. the cost of material and labour charges and only a reasonable portion of the factory overhead. Administrative overheads should not be capitalised and no profit margin should be charged.

2. Apportionment of expenditure between capital and Revenue.-- The distinction between capital and revenue is of vital importance as it directly affects the amount of profit or loss and the correctness of the balance sheet

Capital expenditure is all expenditure incurred for purpose of acquiring assets of a parent nature by means of which the business is carried on or for the purpose of increasing the earning capacity of the business.

Revenue expenditure is all expenditure incurred for carrying on the business and in maintaining the capital assets in a state of efficiency.

The allocation of expenditure between capital and revenue calls for the auditor's careful examination. Where the expenditure is directly incurred for capital purposes, it can be vouched during the course of examination of the cashbook or Purchases Register. However, in many cases, as for example, when an additional wing is constructed to the building, the expenditure incurred is first debited to the general revenue account such as wages, etc., and then transferred to capital. In such cases, precise particulars should be obtained as to number of men employed, nature of work, rates of pay, etc., and the portion thereof applicable to capital. The Works Manager and other officers concerned should certify such analysis.

As regards expenditure on materials, schedules of all goods taken from the store for such purposes, should be prepared by the store keeper and certified by the Works Manager, value being calculated at cost price.

3. Vouching of capital expenditure- All capital expenditure should be very carefully vouched, to ensure that payments are in order, have been properly authorised and are proper capital charges. The question as to what documents will have to be examined depends on nature of the payment. For example, where plant, machinery, furniture and fixtures, etc., have been newly acquired, invoices and receipts will be seen. Where adjustments have been made to revenue accounts in order to segregate capital expenditure, inquiries should be made in order to ascertain that the items to be capitalised are bona fide capital charges, have been properly authorised and no repairs and expenses of manufacture are added to the capital account. In addition to invoices price, carriage and other expenses connected with the purchase can be capitalised. In case of plant and machinery, cost of erection can also be properly added to the cost of machinery or shown separately under the heading "Machinery Foundation", or "Erection charges". As regards purchase of new buildings or addition made to existing buildings, the expenditure should be verified by inspecting agreement for purchases, architect's, engineer's certificates, supplier's invoices, wages sheets and other documentary evidence that may be presented to him for purposes of his audit. Where buildings are purchased the amount paid should not only be verified by a reference to the solicitor's statement, agreement and sale deed, but a certificate regarding reasonableness of the amount paid should be obtained from a qualified architect, qualified architect, qualified Engineer or Government Engineer. The title deed and conveyance or the lease should be examined. If the buildings are in course of erection, the auditor should examine the builder's account, his running bills and receipt and certificates of the architects or qualified engineers. Solicitor or architect's charges will be vouched from tier statements of accounts and theses expenses may be treated as being part of the capital cost.

In case of societies, which have undertaken development of land and constructions of building, viz., farming societies, housing societies, industrial estate, etc., the expenditure incurred over development of the property may be allowed to be capitalized. In case of farming societies, the entire expenditure incurred for developing land, levelling

and constructing bunds and providing irrigation facilities, should be capitalized. In case of housing societies and industrial estates, in addition to the cost of land, the expenditure incurred over the development of land including construction of roads, drainage, provision of electricity and water, division of land into plots and similar other expenses, may be capitalized. In the case of tenant Co-partnership housing societies, not only the cost of land, development charges and the cost of construction of the building, but also the expenditure incurred for supervision over construction work and reasonable administrative charges incurred during the period upto the date when the flats are ready for being let out to members, may be capitalized.

In case of newly established societies, all expenditure incurred upto the date of commencement of trading (i.e. Disposal of the first batch of finished goods) may be allowed to be capitalised. In cases of processing and manufacturing societies, the entire expenditure incurred including financial charges upto the date of commencement of manufacturing activities may be capitalized. However, the expenditure capitalized should be the net amount of the deficit after taking into account the income by way of interest on surplus funds invested, sale proceeds of scrap and unused material, etc.

It is the duty of the Auditor to verify additions to each type of fixed assets during the year. During the course of his audit, the auditor should make it a point to inspect any substantial capital addition to the assets, which have been made during the year covered by his audit. This is desirable for satisfying himself about the reasonableness of the expenditure, which has been capitalized. He would also be satisfied that the capital expenditure incurred is represented by some tangible assets and is not merely fictitious or replacement of an Old asset which has not been written off.

CHAPTER VI

VI-1 PREPARATION OF THE PROFIT AND LOSS ACCOUNT

1. Checking of posting into ledger: - while vouching the cashbook and the journal, the auditor has to see that not only there is sufficient evidence in support of the entry, but the entry itself correctly records the transaction. By careful vouching, the auditor will be able to discover the nature of the entries in the cashbook and the other books of prime entry. However, it should be noted that the ledger is the center of all accounts, since all the transactions affecting the business are posted therein and the profit and loss account and the balance sheet are prepared from the ledger. The auditor will, therefore, *have to trace carefully the entries from the cashbook and the journal into the ledgers and satisfy himself that they have been posted to the correct ledger accounts.* Ledgers are primarily divided into two classes personal ledger and impersonal or general ledger. Accounts relating to individuals are maintained in the personal ledgers and in the impersonal or the general ledger, as it is more commonly known, aspects of the transaction as they affect the business and not as they affect individual are recorded. The impersonal ledger is further divided into two sections, one containing real or property accounts which record assets and liabilities of the business and the other containing nominal accounts, which relate to the profit and loss account. The impersonal ledger will, therefore, contain all accounts, which record the operations of the business and at the close of the accounting period are summarized into the trading and profit and loss account and secondly all account which represent the assets and liabilities of the business. The auditor must, therefore, check the whole of the entries in the general ledger. In fact, he can verify the correctness of the personal account by agreeing their total with the balance of the concerned total or control account maintained in the general ledger. ***It need hardly be pointed out that one of the commonest methods of concealing manipulation in personal account is to make***

corresponding fictitious entries in the impersonal account either by opening a bogus account or by posting the amount of nominal or total account in the general ledger. For example the secretary of PACS has credited principle of loan in personal ledger, of amount for which he has received actual cash, for canceling this entry, he has passed the entry in general ledger, without recording cashbook, crediting anamat account and debiting the principle of loan account.

Generally the expenses are debited by crediting Secretary or Chairman anamat or anamat on the name of member who is relative of these officers, in the General ledger; these entries are not recorded in the original books, i.e. cashbook or journal.

2. Checking of the General Ledger: *As already stated, the entries in the general ledger will all come from a book of prime entry, viz., the Cashbook or the journal.* In most societies, which do not maintain a separate journal, the cashbook is generally called the Daybook. The total of all subsidiary book, viz., Purchase journal, Sales Register, and other subsidiary cashbook are first entered in the Day Book and posted into the general ledger from the Day book, although in some societies, posting from the subsidiary book are directly made into general ledger. However, it is more usual to analyze the transactions recorded in the subsidiary books according to their classes and post the total into the Daybook under heads so classified and then posts them into the general ledger. In such case, viz., where total amount have been analyzed and classified under various heads, the auditor should check the analysis, reconcile the total amount and trace the individual items comprising it into the general ledger. ***It should further be seen that all transfers from one account in the general ledger to another account are passed either through the journal or the day book and no amounts are posted directly in the account in the general or personal ledgers without first being entered in the cashbook or the journal.*** The narration below the entry should fully explain the origin and nature of the transaction and the reasons for making the entry. Routine checking of posting is usually done by two clerks or assistants working together, on calling out the amount form the cashbook and the other repeating the amount after tracing the amount in the ledger account. Entries both in the cashbook and the ledger should be ticked simultaneously.

3. Calling over of opening balances from previous year's ledger: - After the whole of the posting into the ledger have been checked, the auditor should examine each accounts in the ledger in order to ensure that every item has been ticked. ***All the accounts in the ledgers should be scanned for unticked items and should there be any unticked item, it should be traced in the cashbook. The Cashbook and journal should also be scanned for the same purpose.*** Thereafter, totals of both sides of the ledger account should be checked and it should be seen that the closing balances have been correctly extracted. ***Opening balances in the ledgers should be called over from the previous year's ledgers.*** Since closing balances of all nominal accounts are transferred to the trading and profit and loss account and the accounts are closed at the close of the accounting period, there would be no balances of nominal account in the general ledger. However, there would be certain accounts relating to expenses and losses, which might not have, been completely written off. The balances not written off are brought forward under heading, such as deferred revenue expenditure, development charges, preliminary expenses etc. and are written off against profits of future years. The opening balances of all real or property account and all account in personal ledgers will, however, have to be called over from the previous years' ledgers.

The non-checking of the opening balance will results in: Canceling of any asset or liability, which is cancelled subsequently by creating fictitious assets or bogus liability.

4. Drawing up of the Trial Balance: After checking the posting into the general ledgers and extracting balances, all the closing balances are entered in a sheet separately according as they are debit or credit balances. This statement, which contains a classified summary or a list of all closing balances of general ledger, is known as the “**trial balance**”. Since the cashbook is also a ledger account (it being the cash account). The opening and closing cash balances are also entered in the trial balance and if the totals of the two sides of the trial balance agree, it signifies the arithmetical accuracy of the accounts. If the two sides of the trial balance do not agree, it means that either the postings have not been made correctly or the totals have been incorrectly taken. Hence, in order to trace the difference, the whole of the posting and total, both of the general ledger and the cashbook will have to be checked. However, in most cases, certain indication would be available after careful examination of the difference, which would assist in locating the difference.

Some indications are 1) if the difference is 1,100, 1000, 9, 99, 999 and so on the difference must be located by totaling, 2) the difference is of specific amount in odds there must be mistake of living the amount of the same amount. 3) If the difference of specific amount is there check in the trial balance the amount half of the same, which might have posted at wrong side.

The difference should be located and the trial balance agreed before drawing up the final accounts. However, the auditor should not proceed to prepare the final account unless he is presented with an agreed trial balance. In the smaller societies, particularly agricultural credit societies, instead of the trial balance, a receipt and disbursements statement is prepared from the cashbook, which serves the same purpose.

5. Checking of journal – When transfer entries are passed through the cashbook itself, both the credit and debit entries should be seen simultaneously. Such *contra entries* should be marked with a special tick in order to distinguish them from other entries, which involve passing of cash. ***All contra or transfer entries should be checked very carefully. Because these contra entries do not affect the cash on hand and no cash actually passes hands, there is a tendency to pass these entries without proper scrutiny. However, since contras also create monetary obligations, they are as important as cash transactions and should, therefore, receive due attention.***

There are adjustment entries, rectification entries, and routine entries of payments and receipts by transfer are recorded in the Journal. Auditors should take specific care while checking the rectifying entries to check that the original entry is really passed in the wrong manner. Adjusting entries are passed for provisions of expenses, prepaid expenses, and pre-received income, and for the goods received but no bills are received and needs to create payments entries. The entries are as follows.

Sr. No.	Particulars	Debited to	Credited to
1	Expenses due for the accounting period, but are not paid requires provision such as Salary, Audit fees, Interest, commission, cadre contribution, Education fund contribution etc.	Expenses account	Expenses payable account
2	Expenses paid are for the period of future accounting period requires to provide i.e. interest, Taxes paid, Insurance	Prepaid expenses account	Expenses account

	etc.		
3	Income for the period accounting period is not received but due to receive i. e. interest, Dividend, commission etc.	Income Receivable Account	Income Account
4	Income received for the future period requires to provide i.e. Rents, Taxes etc.	Income Account	Income pre received account.
5	Deductions made from salaries, commissions, Interest such as Income tax deducted at source, professions tax deducted, various deductions from salary etc.	Expenses account	Sundry payable account
6	Sales effected, but amounts are to be received	Sundry Debtors account	Sales accounts
7	Goods received, but payments are till to be made.	Purchase account	Sundry Creditors account.

While vouching entries in the journal or in the cashbook, the auditor should see that not only there is sufficient evidence in support of the entry, but also that ***the entry itself correctly records the transaction.*** *It should further be seen that all transfers from one account to another account in the general ledger from one personal account to another, should be passed through the journal or through the cashbook and no posting into the ledger should be made directly in the ledgers.*

The narration below the entry contained in the transfer vouchers (both credit and debit) should be gone through carefully and it should be seen that the entry has been correctly passed.

6. Closing of nominal account – Unlike the auditors of joint stock companies, the auditor of a co-operative society rarely finds that the books presented to him by smaller societies, are written up-to-date and duly balanced. In most of the cases, before the auditor proceeds to check the final accounts, he will find that necessary adjustments have not been made. In many cases, particularly, in case of the small and smaller societies, the auditor is called upon to advice balancing the books and making necessary adjusting entries for closing the accounts. He may tender necessary Advice in the capacity as an expert accountant. It is necessary to note that irrespective of the auditor advises to make adjusting and closing entries or merely checks them; he must satisfy himself that these entries are necessary and correct.

The closing entries for nominal accounts are

- 1) All expenses Credited and Debited to Profit and loss account and
- 2) All Incomes are debited and credited to Profit and loss account.

By these entries the balance of profit or loss is extracted and accordingly taken into balance sheet.

7. Adjustment of nominal accounts- In every society, there are bound to be transactions the results of which may not be known on the date of the balance sheet. In order to show correct position of the society, it is necessary that all such overlapping transactions should be taken into account and necessary adjustments made.

All nominal accounts must be checked carefully by the auditor so that he should be satisfied that all transactions of the business have been correctly classified and included in the final accounts. In this connection, the auditor should take particular care to see that all accrued income as well as the expenditure incurred, but not paid and income or revenue, in addition to examining the entries in the books, the auditor has to satisfy himself that all income, which should have been received, has been duly recorded in to. See that all sales effected, particularly, sales made during the last few days prior to the date of final accounts, to trace back the issue of dispatches of goods to the relative invoices or sales memos. Similarly, during the course of inspection of securities and securities and other investments, the auditor should ascertain whether all interest accrued due during the period has been received and all dividend declared is duly credited. Few such entries are shown in the Para 5 above

8. Adjustment of outstanding expenses - As regards outstanding payments, the auditor should examine the “ *Good Inward Book* ” or the “ *Invoice Register* ” for the last few weeks of the period and satisfy himself that all purchases made and included into stock have been duly brought into account and the amount of the unpaid invoices credited to the respective accounts of the suppliers of the goods. In addition to purchases not paid for, expenses incurred but not paid, are also required to be brought into account. Many times, bills for supplies made and service rendered are not received from the suppliers and other creditors. For example, the transport contractor might not have submitted his bills for goods transported during the last few days of the year. Similarly, solicitors and other consultant might not have submitted their bills for professional services rendered to the society during the period covered by the audit. In most of the societies, salaries and wages for March may not have been paid before the close of the year. All these items will have to be brought out as the outstanding expenses. Special attention should be given to the items discussed in the following paragraphs.

The society should be advised to maintain an *accrual ledger* in which the accounts of such outstanding items would be maintained. This would facilitate the comparison of the amounts provided during the current year with those of the previous years and the auditor’s attention should be drawn to any items, which might have been overlooked. Where no accrual ledger on the above lines has been maintained, the auditor should examine the last year’s journal and ascertain what adjustments in respect of outstanding items are required to be made.

9-(i) Interest payable- Interest on bank loan and other borrowings is generally debited to the account of the society. However, in case of deposits and other temporary borrowings, interest accrued upto the date of the balance sheet should be calculate and provided for. In particular, interest on fixed deposits accrued from the date of last payment of interest upto the date the balance sheet should be calculated.

(ii) Interest on saving Bank account- this is ordinarily calculated and credited to the accounts of the respective depositors, before the close of the year.

10. Outstanding expenses - All nominal accounts in the impersonal ledger should be examined to see that all expenses and charges pertaining to the period under review have been included. There may be, for example, outstanding bills for repairs, fuel charges, electricity charges, water charges, etc., and also transports charges, godown rent, subscriptions, advertisements etc. The auditor should further inspect the ledger account, any accrued and unpaid proportion from the date of last memo till the date of the balance sheet noticed during the inspection of these documents is provided for. The amounts paid

under these headings should be compared with those appraising the corresponding nominal accounts for the previous year so as to ensure that all rents, rates, taxes, etc., payable have been duly provided for.

11. Prepaid expenses - Just as there are outstanding liabilities on account of expenses, there may also be advance payments or prepaid expenses as they are called. Under this head. Will be included rents, rates and taxes, insurance premium, advertisement charges, subscriptions, membership fee, etc. paid for periods that extend beyond the date of balance sheet. The auditor should examine the nominal accounts and also the demand notices bills and receipts and sees that correct calculation has been made of the proportion the amounts relating to the un-expired periods.

12. Income receivable – There might be various amount due to the society for which credit will have to be taken. These will include interest on loans and other advances made by the society, interest or dividend on investments, rent receivable for premises hired out, royalties, commission, etc, receivable. Interest on loans and advance accrued upto the date of the balance sheet should be calculated and brought into account However, since dividend does not become due until it is declared, no credit should be taken for dividend on shares undeclared of dividend has already been made. Sometimes, rebates and bonus share also receivable. However, these should not be taken credit for unless the society has been informed that they have accrued and would be paid in due course. All items in the general ledger relating to income should be scanned carefully and inquiries should be made as to whether any amounts are receivable. However, no credit should be taken of amounts, receipt of which is considered doubtful, unless adequate provision is made therefore. As regards outstanding interest on loans and advances, this has been treated separately.

13. Deferred Revenue expenditure – Many times, heavy expenditure is incurred, the benefits derived from which would extend to periods beyond the date of the balance sheet. It is; therefore, equitable that the expenditure incurred should be spread over a period of years during which the benefits of the expenditure would be available. For example, heavy expenditure might have been incurred on advertisements the benefits of which would be derived in future years. Similarly, considerable expenditure might have been incurred over development and also expenditure over research and experiments, alteration to premises and equipment and heavy repairs might have been also made. The auditor should examine carefully the whole of the circumstances in order to satisfy himself that the carry forward of part of such expenditure is fully justified.

VI-2 DRAWING UP OF THE PROFIT AND LOSS ACCOUNT

1. Division of the Profit and Loss Account into three sections- In the case of co-operative banks and other institutions, the profit and loss account will contain all the items relating to the income and expenditure of the institution. However, in case of trading societies such as consumers' societies marketing societies etc. the Profit and Loss Account has to be divided into two sections, the first relating to trading operations and the second the Profit and Loss Account proper. In case of manufacturing and processing societies, there would be three sections, the first section being styled as manufacturing or production account, the second and third sections will be the trading and profit and loss account respectively. (as per note below 'N' form of profit and loss account) The basis upon which the manufacturing, trading and profit and loss account are prepared, is explained in the following paragraphs.

2. Manufacturing account – The object of the manufacturing account is to show the manufacturing cost of the goods produced. As such, the manufacturing or production account will contain only items relating to the manufacturing operations of the society. The main heads under the manufacturing expenses are shown as under

- (1) The work in progress or value of unfinished goods at the beginning of the year.
- (2) Raw materials used (opening stocks plus purchases *minus* closing stock)
- (3) Fuel, oil, electricity and other power charges.
- (4) Stores and spare parts consumed.
- (5) Direct or indirect labor.
- (6) Maintenance of factory building, plant and machinery tools and other equipment's.
- (7) Insurance of factory building, plants and machinery and tools stores, etc.
- (8) Depreciation of factory building plant, machinery loose tools and other equipment.
- (9) Factory heating lighting and water charges.
- (10) Rent, rates and taxes of the factory premises.
- (11) Salaries of the technical staff and officers including works manager, factory superintendents, etc,
- (12) General administrative expenses strictly pertaining to the factory.

Form the total of these items, i.e., the total of works in progress or unfinished goods in the beginning of the year and manufacturing expenses incurred during the year, the value of the work in progress at the end of the period is deducted and the results give the manufacturing cost of the goods produced during the period, which are available for sale. This figure is brought down to trading account-

3. Trading Account – In the trading account , the opening stock (value of finished goods at the beginning of the year) appears at the first item. The cost of goods purchased, which would also include all expenses connected with purchases, or manufactured appears as the next item and there after all trading expenses are debited to this account. In case of a manufacturing business, the cost of goods manufactured brought down from manufacturing account takes the place of purchases. This account is credited with the net sale proceeds received (total sales minus returns) and value of closing stock. The difference between the two sides, viz., net sale proceeds received minus cost of goods sold which would include selling expenses, will show gross profit. This gross profit is brought down to the credit of the profit and loss account. Whereas the object of manufacturing account is to show the manufacturing cost of goods produced during the year, which are available for sale, the object of the trading account is to determine the gross profit which is the difference between the sale proceeds received and the cost of goods sold. In the trading account of trading societies, in addition to the invoice price of the goods purchased, direct charges such as carriage and freight, insurance, godown rent and other expenses connected with the purchase and storage of goods are included. In some of the societies, particularly in consumers stores rent of shop premises and also salaries of salesman and other staff directly engaged for selling goods are also shown in the trading account. Adjustments, however, will have to be made for the value of opening and closing stocks before arriving at the figure of gross profits.

4. Profit and Loss account proper – The third section of the profit and loss account is the profit and loss account proper. This account is credited with the gross profit brought down from the trading account together with any miscellaneous income such as cash discount, interest rent, dividend, share transfer fees, commission, etc. On the debit side, the various items of expenditure are grouped usual under the following heads: -

- (i) Selling and distribution expenses.
- (ii) Administrative charges including audit fees, legal charges, etc.
- (iii) Financial charges.
- (i) **Selling expenses** – The selling and distribution expense include cost of packages and packing material used, labour employed for packing goods, carriage freight, insurance and other charges incurred for dispatch and delivery of goods to customers where these are not to be charged to the customer, home godown delivery expenses (in case of consumers' societies) expenditure incurred over advertisement and publicity, cost of samples, printing charge of catalogues, price and lists and other publicity material, salesmen's salaries and commission and their expenses, bad debts and sundry trade expenses are also shown under this heading.
- (ii) **Administrative expenses** - Administrative charges include overhead expenses such as –
 - (1) Clerical and accountancy charges.
 - (2) Printing and stationery.
 - (3) Postage telegrams and telephone charges.
 - (4) Office rent rates, insurance Office lighting and heating.
 - (5) Office lighting and heating
 - (6) Director's sitting fees and expenses.
 - (7) Managing Director, Manager's salary and cost of requisites and allowances.
 - (8) Audit fees and legal charges and other general expenses.
- (iii) Financial charges include –
 - (a) Cash discount.
 - (b) Interest on deposits, loans, bank overdraft and other borrowing.
 - (c) Bank charges including discount charged on bills collected or discounted.
 - (d) Provision made for payment of income – tax is also sometimes included in the profit and a loss account. However, this has been dealt with in a subsequent paragraph.
 - (e) Depreciation on office furniture and equipment. Also depreciation on building, godowns, etc. where these are owned by the society.

5. Revenue Account of Income and expenditure Account- In case of non-trading societies, such as co-operative societies, clubs and also federations, housing societies and similar other societies which do not undertake trading activities, it is common to term the “**Profit and Loss Account**” as “**Revenue Account**” or the “**Income and Expenditure Account**” However, the principles for preparing the Revenue Account or the Income and Expenditure Account are the same, the object being to disclose the excess of income over expenditure or the deficit incurred during the period.

5.A) Profit Appropriation Account: Section 65 and Rule 49 A and 51 provides the charges made to profit and loss account, and after arriving net profit how the appropriation of profit should be made is described in Rule 50. After arriving the net profit the profit should be appropriated as below.

Sr. No.	Section	Rule	Particulars
1	65,66		Reserve fund not less than 25 % of the net profits or as sanctioned by the Registrar, but not less than 10%
2	69		Fund created for charitable purposes including relief to the poor, education, medical relief, and advancement of any other general public utility, not exceeding 10 % of the net profits.
3	65		Dividend to its members

4	65		Bonus or honoraria to its members and honorary workers, other than employees.
5		50	Development fund, Dividend equalization fund and any other fund created under bye-laws

However in Joint stock companies the profit appropriation account is created for the purpose of adjusting the Expenses and Incomes, which are not related to the accounting period of the Company. Cooperative Societies does not prepare Profit Appropriation Accounts, the above appropriations are shown by the societies, in their annual report only. The auditors are required to guide the societies for preparing the profit appropriation accounts in relation to the Income and Expenses which are not related to the accounting period for which they are taking the audit, so that, the correct and fair position of the profit and loss account would be arrived.

6. Auditor's responsibilities as regard Profit and Loss Account. Scrutiny of Profit and Loss Account- Under sub-rule (3) of Rule 69, the auditor is required to state in his audit memorandum that the profit and loss account is ***in agreement with the books and gives a true and fair view of the profit or loss for the financial year.*** Thus, he has not only to certify that the profit or loss is not only correct according to the books, but also has been calculated according to normally accepted accounting principles. The auditor's responsibility in certifying the correctness of the profit and loss account is great. ***It is a fundamental concept of accounting that no dividend can be paid except out of profit and the profit must have been earned before paying a dividend. If, on the contrary, dividends are paid out of capital and if this is not reported by the auditor, the auditor would be held liable.*** It is possible that the profit of a business may not have been genuinely earned and the accounts might have been manipulated to show profit in order to declare dividend and keep the shareholders satisfied.

7. Principles governing preparation of profit and loss account – Following are the principles, which govern preparation of the profit and loss account: - Rule 49 A

- (1) Adequate provision should have been made for depreciation, bad debts and other losses,
- (2) Stocks should have been valued on a correct basis,
- (3) Interest overdue should not have been taken into account,
- (4) Provisions of the Byelaws relating to the creation of Capital Redemption Fund, Sinking Fund, Guarantee Fund and other funds should have been duly observed,
- (5) Conditions laid down by the Government and the financing agencies regarding creation and maintenance of these funds should have been complied with,
- (6) Interest payable on deposits, loans, debentures and other borrowings should have been calculated and brought into account.
- (7) Capital profits and other extraordinary receipts should not have been taken to profits,
- (8) All expenditure incurred, but not brought into account should have been provided for,
- (9) Transfers to profit and loss account from funds created out of past profits should not have been made.

These matters require careful attention and the auditor should look into above points before certifying the correctness of the profit and loss account.

8. Prior items or changes in accounting policies in respect of profit and loss account:

The Institute of Chartered Accountants of India has issued an Accounting Standard AS 5 regarding this.

The profit and loss account is prepared for a period on the basis of certain fundamental accounting assumptions and reflects the accrual of revenues and related costs for that period. In this context prior period or extraordinary items or those items, which arise due to changes in accounting policies and are generally non-recurring in nature, requires special consideration which effects on the true and fair position of the profit and loss account.

The prior period items are specified by the institute is, “material charges or credits which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more periods.” Such as the provisions required for prudential norms (NPA) not adequately provided, which effects in the next period of the profit and loss account.

Extraordinary items are gains or losses, which arise from events or transactions that are distinct from the ordinary activities of the business and which are both material. Such as the sugar factories or banking societies are made income tax applicable will effect the profitability of the society.

Disclosure of accounting policies (AS 1):- Generally the accounting policies are not decided by the cooperative societies, however the conventions of accounting regarding charging of depreciation, or providing expenses are followed by the societies till date, now the act provides for adopting the accounting policies by the societies. Changes in these policies makes material effect on the profit and loss account such as the society charging 10% depreciation on the computers changes the rate of depreciation at 33% will effect materially, in case of banking societies, which are running their business on computers. This will effect the profit and loss account.

Auditors are required to study the accounting standard and offer their comments accordingly in the audit report.

9. Guide lines issued by the institute of chartered accountants – The following guide lines issued by the Institute of Chartered Accountant of India in connection with the preparation of the profit and loss account should be noted :-

- (1) The profit and loss account should be made out as normally to disclose the result of the working of the society during the period covered by the accounts.
- (2) It should be clearly disclose every material feature including credits or receipts or debits or expenditure in-respect of non recurring transactions of an exceptional nature which should be separately
- (3) Profit and loss account should clearly set out the various items relating to income and expenditure of the society arranged under most convenient heads.

10. Form of the profit and loss account – The form of the profit and loss account is prescribed under the rules and is required to be drawn up in from “N” accompanying the rules. In the case of marketing societies consumers societies and other societies which have under taken trading activities the profit and loss account is required to be dividend into two parts showing separately the trading accounts and the profit and loss account proper. In case of producers societies processing societies forest labourers’ societies and other types of societies, which have under taken manufacturing activities, a separate manufacturing account is required to be prepared. However, the form in which the manufacturing account and the trading account are to be prepared, has not been prescribed.

Hence, these accounts should be prepared in accordance with the generally accepted principals. As already stated, the profit and loss account should clearly disclose the results of the working of the society during the year. ***Every material nature and also transactions of an exceptional nature are expected to be dealt within the report of the committee. However, if this is not done, it is the responsibility of the auditor to point out these in his report.*** (Please refer to Para 8)

Figures for the previous year are required to be shown in the profit and loss account. These serve, as guide for the general scrutiny of the current year's transactions. An independent scrutiny of the comparative figures would indicate the changes in the Business of the society. Enquiries should be made into the reasons for any material change and commented upon.

11. Amounts to be charged to profit – Sub-section (1) of section 65, and Rule 49 (A) which lays down the procedure for calculating net profit requires to be noted. The section prohibits inclusion of overdue interests, i.e. interest accrued and accruing in accounts in which the principle is overdue, in the amount of net profits. This means that only such portion of unrealized interest, which is not overdue, should be taken to profit. The section further lays down that a number of deductions should be made before arriving at the figures of net profits. Besides, interests and establishment charges and other working expenses including depreciation, provisions for a number of other outstanding are required to be made form out of gross profits. It should be seen that amount of net profit is calculated correctly strictly in accordance with the provisions contained in the sub-section.

It is the duty of the auditors to see that the net profits have been calculated strictly in accordance with the provision of section 65 and Rule 49 A (Registrar's Circular No. ADT/243(AM) dated the 3rd August 1964). It will be seen that the section prescribes not only the mode of calculation of profits, but also appropriation of profits.

Rule 49 A provides the amounts that are charged to profit and loss account before arriving of net profit are as under

- i) all interest accrued and accruing on amounts of overdue loans (excepting overdue amounts of loans against fixed deposit, gold, etc.)
- ii) Interest payable on loans and deposit;
- iii) Establishment charges;
- iv) Audit fees supervision fees, inspection fees;
- v) Working expenses including repairs and maintenance, rent and taxes;
- vi) Depreciation;
- vii) Bonus payable to employee under the Payment of Bonus Act, 1965;
- viii) Provision for payment of Income Tax;
- ix) Amount to be paid for contribution to the cooperative education and training fund, at the State Federal Society/ State Apex training institutes which may be notified by the State Government in this behalf;
- x) Provision for election fund for payment of election expenses;
- xi) Provision for bad and doubtful debts;
- xii) Provision for share capital redemption Fund;
- xiii) Provision for Investment Fluctuations fund;
- xiv) Provision for retirement benefits to the employees;
- xv) Provisions for any other claims admissible under any; other law;
- xvi) Provision for bad debts and revenue losses not adjusted against any fund created out of profits;
- xvii) expenses on advertisement, propaganda and publicity not exceeding than celling limit as specified y the Registrar or State Government from time to time

12. Rule 51: Further amounts to be charged to profit – Rule 51 and sub rule (2) of the Rule 49 A specifies further amounts to be deducted from profits before arriving at its net profits, in addition to the amounts already specified in Rule 49 A (2) . The following amounts are required to be deducted by a society from its profits.

- i)** Contributions to be made to sinking fund or guarantee fund constituted under the provisions of the Act, the rules or Byelaws of the society for ensuring due fulfillment of any guarantee given by Government in respect of loans raised by the society.
- ii)** Provision considered necessary for depreciation in the value of any security, bonds or shares, held by the society as part of its investments.
- iii)** Any provision required to be made for redemption of any share capital contributed by Government or federal society.

13. Form “ N ” : From a perusal of Form “ N “, it will be seen that in the form of profit and loss account prescribed under the Rules, all usual items have been included and the major items have been grouped together under appropriate heads so as to give a fair idea about the expenditure incurred over various items.

We shall now deal with the various items on the expenditure side of the profit and loss account and the manner in which they are to set out.

(i) **Interest payable** – *The amount to be debited to interest account will include interest actually paid as well interest payable on deposits, loans and other borrowings.* Interest payable has been specifically mentioned in order that the management may not fail to make adequate provision for interest payable on loans and deposits. The auditor will have to check all items of interest payable at the time of his audit.

(ii) **Bank charges** – These are charges debited by the Bank on account of exchange, commission, etc., charged for collection of cheques, remittances of funds, etc., cost of cheque books and pass books, postage and other charges for services rendered.

(iii) **Contribution to staff provident fund-** The auditor will have to verify with reference to the Staff Provident Fund Rules that employer’s contribution has been correctly made.

(iv) **Salaries and allowances of the Managing Director** – This point has been discussed elsewhere.

(v) **Traveling expenses and sitting fees paid to Directors/Managing committee members-** This has to be separately shown. The expenditure incurred under this head should include expenditure and allowances for journeys undertaken even outside the jurisdiction by the Directors/ managing committee members for the purposes of the society. It should be seen that rates of traveling allowance, daily allowance, etc., paid to members of committees do not exceed the maximum rates notified under Rule 107- A, which are binding on the societies.

(vi) **Traveling expenses of staff** – All amounts payable need to be brought into account.

(vii) **Rents, Rates and Taxes** – These should not only include amount paid, but also the amount payable.

(viii) **Postage telegrams and telephone charges.** - No comments are called for.

(ix) **Printing and stationery-** No comments are called for.

(x) **Audit fees.** - Audit fees paid to Government for statutory audit as well as fees paid to local auditors should be included under this head. However, if internal auditors are appointed from the staff of society its own, the expenditure incurred on the internal audit Department should be included under the heading “ salaries and staff ” and should not be shown under the heading “audit fees”

(xi) **Bad debts written off or provisions made for bad debts-** Bad debts actually written off during the year and also provision required to be made for bad debts or the contributions to be made to the Bad Debts Fund should be shown under this heading. However, if bad debts are actually written of should be shown as a deduction from the fund for the existing provisions and additional contribution made to the fund or provision made should be shown under this heading. For banks provisions are required to be made as per prudential norms issued by the Reserve Bank of India in this respect.

(xii) **Depreciation on fixed assets -** It is the duty of the auditor to see that adequate depreciation is charged on all wasting assets. If the considers that the depreciation charged is inadequate, he should state so in his report.

(xiii) **Land Income and expenditure –** If any agricultural lands are held by the society, assessment and other expenses connected with the land should be shown under this heading. Expenditure incurred over other property such as building plots, building, etc., should be shown under the heading “Property income and expenditure account “ and not under this head.

(xiv) **Other items –** All other items, which are not covered by the various heads shown above, should be shown under this heading. All unusual items such as contribution to sinking fund, depreciation in the value of investments, provision made for redemption of Government share capital and such other items may be shown separately under the appropriate heading and not under this head. Since every society, which employs 20 or more persons, is required to pay bonus irrespective of whether it earns a profit or incurs loss, this item will also appear in the profit and loss account on the debit side with an appropriate sub-heading Rule 49 A (vii).

14. Income side of the profit and loss account- The following comments are offered on the various items shown on the income side of the profit and loss account in N form:-

(i) **Interest received and receivable from loans and advances to members and interest received and receivable from investments –** These are required to be shown separately.

As regards interest receivable on loans, it should be noted that under provision of sub-Rule (i) of Rule 49 A, all interest accrued or accruing in amounts, which are overdue, is required to be excluded while calculating net profits for the year. As such, it is the responsibility of the auditor to see that where interest receivable as taken into account; adequate provision is made for overdue interest. Overdue interest may be shown either as a deduction from interest receivable, or shown under thee separates heading **of “provision for overdue interest ”** on the liability side. Either way, it has to be deducted from the total amount of interest received and receivable. If any portion of the overdue interest is realized during subsequent years, it may be included in the profits of that year.

(ii) **Overdue interest –** The following comments are offered in connection with the provision of overdue interest.

Interest account appearing in the profit and loss account includes both interest received and receivable. Interest received means interest actually realised during the year in respect of whether it has accrued during the year or in previous years. Hence, interest overdue, which was excluded from the profits of previous years, if realized during the year, may be included in the profits for the year, in which it has been realized.

As regards interest receivable, it has to be noted that interest receivable would include both interest accrued due and also interest accruing. Generally, recovery of interest is made along with the principal and as such, when the loan account is settled, full interest upto the date of repayment by the borrower is calculated and recovered along with the balance of principal outstanding. However, in the case of medium term and long term

loans, interest on the full amount has to be paid and any is recovered separately or along with the installment of principal. Thus, in loan account, interests would have accrued and would be accruing even when the principal has not become due for repayment. Hence, unrealized interest on loans outstanding would consist of (a) interest which has accrued and become due for payment and (b) interest which has been accruing but has not become due repayment. Where the date fixed for repayment of loan and interest extends beyond the date of balance sheet, the interest accrued during the period from the date on which interest has already been calculated to the date of the balance sheet is termed as “ interest accruing ” ***Both interest accrued and accruing may be taken to the profit and loss account, provided the accounts to which they relate are not overdue. An account is said to be overdue when the principal outstanding or the installment due has not been paid on due date.***

(iii) ***Interest on investment*** – As regards interest earned on investments, ordinarily only interest actually received is taken to profit and loss account and further interest, receivable up to the date of the balance sheet is not calculated and brought into account. Where income –tax is deducted from interest, the gross interest could be shown as income and amount of tax deducted should be shown as tax paid on receivable as the case may be. Societies, which are not liable to pay tax on their income, should obtain exemption certificate from the income-tax authorities.

(iv) ***Dividend received on shares-*** only dividend actually received should be shown Dividend declared, but not actually received may also be shown. However, since dividend does not become due until it is declared. No credit can be taken for anticipated income by way of dividend.

(v) ***Commission*** – Commission received on purchases and sales made on behalf of members, commission earned on insurance business and other commission may be shown under this head.

(vi) ***Miscellaneous income*** - Where the society has undertaken other activities, income received from these activities will be shown under appropriate heads. Thus, for example, if the society purchased and kept for hire costly agricultural machinery and equipment, such as oil engines, pumping sets, tractors, etc., hire charges received may be shown under this head. Similarly, rent received on property, refund of taxes and fees and other miscellaneous items may also be shown under this head. The various items of which are to be included under this heading have been enumerated in form “N”

(vii) ***Land Income and expenditure Account*** – Where the society has come into possession of agricultural land belonging to defaulters during the process of recovery of its dues, a separate account styled “ Land Income and expenditure Account ” has to be opened and all income received should be credited and all cultivation expenses including cost of seeds, fertilizers, etc., and also assessment, cess and other taxes and fees paid should be debited to this account. The net income received should be shown under this heading.

15. Income and expenditure not related to accounting year

The society should prepare the accounts taking into accounts, accounting standard no. 9 regarding income recognition and AS 5 regarding net profit or loss for the period, prior period items and changes in accounting policies. The auditor should see that the provisions made in both the standards are complied with and any material deviation from the standard should be qualified in his audit report.

CHAPTER VII

VII-1 PREPARATION OF BALANCE SHEET-VERIFICATION OF ASSETS AND LIABILITIES

1. Balance sheet – The balance sheet is not a statement of assets and liabilities as are considered by some of the auditors. It is merely a sheet showing the classified summary of all the balance appearing in the books after the nominal accounts have been closed by transfer to the profit and loss account and the balance of the profit and loss account. The profit and loss account, to which are transferred closing balances of all nominal accounts, is duly contained in the general ledger; but, there will be no such account styled as “**Balance Sheet**” in the general ledger. The balance sheet, no doubt, includes all the assets and liabilities of the business; but, in many cases, it includes items on both the sides, which are strictly speaking neither assets nor liabilities. Thus, for example, debit balance of the profit and loss account appears on the assets side, although it is not an asset. Similarly, expenses such as preliminary expense, deferred revenue expenditure, development expenditure, etc., are shown on the assets side until they are written off, to the profit and loss account over a period of years. These items also cannot be termed “assets” although they are shown on the assets side. Similarly, statutory reserve fund and other reserves, credit balance of the profit and loss account, or similar other items appearing on the liabilities side cannot be termed as “liabilities.” The balance sheet is expected to show a true and fair view of the financial position of the society and, in particular, it should show clearly the nature of all the assets and liabilities. However, since the balance sheet includes other items as well, which are neither assets nor liabilities, it is necessary that these items should be correctly described so that the whole position may be clear. It is the duty of the auditor to satisfy himself that the balance sheet is properly drawn up according to correct and consistent accounting principles. As we have seen, *the main object of preparing the balance sheet is to ascertain the financial position of the business as on the date on which it is prepared and also to see whether the proprietor’s capital is intact.* In case of a co-operative society, the balance sheet will show the share capital contributed by members and funds created out of past profits and how the entire capital, which belongs to the members, is invested. In case of a private business, the proprietor’s capital represents the excess of assets over liabilities. Similarly, in case of a co-operative society, the excess of assets over liabilities would represent the share capital of members and the retained profit.

2. Valuation of assets for purpose of Balance sheet – A comparison of the capital at the commencement of the year and at the close of the year, would, no doubt, show whether any profit has been made or loss incurred by the business. Where profit has been made, there should be an increase in the capital and where loss has been incurred, the proprietor’s capital would have been reduced. *The profit and loss account merely amplifies the information disclosed by the balance sheet and shows how this profit or loss has been arrived at.* Since the proprietor’s capital represents the surplus of assets over liabilities, any increase or decrease of such surplus represents the profit or loss made during the year. The ascertainment of the profit or loss will, therefore, depend entirely upon the value put on the various assets. It is always possible to ascertain the amount of liabilities exactly, except in case of contingent liabilities, such as claims under dispute, etc., However, although the assets belonging to the business can be ascertained, verified and valued, it is difficult in many cases to arrive at the correct amounts at which such assets should be stated in the balance sheet. It was all along common for an auditor to mention in his report that the various assets have been stated in the balance sheet as per the valuation made by

the directors. The term “ valuation ” however, has different meanings. To a layman, the term “value” would imply the amount, which the assets would realise, if sold or otherwise disposed of. It is, therefore, incorrect to say that the assets are stated in the balance sheet at a value in the above sense.

3. Meaning of Valuation – The term “ valuation ” in connection with the balance sheet can be differently interpreted as under :-

- (i) The value may be the estimated amount that the assets would realise, if sold for disposed off, in other words, realizable value.
- (ii) Value may mean the amount that is estimated the asset would cost to replace; in other words, the replacement values.
- (iii) The amount that an asset costs when purchased or acquired less the provisions made for depreciation, since its acquisition. In other words, written down value or going concern value.
- (iv) The balance of revenue expenditure, which is being written off over a period of years. This item will be shown under the heading “ deferred revenue expenditure ” or “ prepaid expenses ”

4. Going concern value – Although all the above basis for valuation may be used in connection with the various classes of assets appearing in the balance sheet, ordinarily, only the written down or going concern value is taken into consideration. It has, however, to be remembered that there can not be true profits unless the original capital together with the additions made thereto is intact. It is, therefore, imperative that where the asset in which part of the capital is invested, is of a wasting nature or consumed in the course of earning income, such wastage must be made good before true profit can be arrived at. For this purpose, it will be necessary to estimate the working life of fixed assets like buildings, plant and machinery etc., as already stated for purposes of preparing the balance sheet and the profit and loss account, certain accepted conventional rules are adopted. By making conservative provisions and by creating adequate reserves, well-conducted concerns leave sufficient margin to provide against errors in calculating the net profits or incorrect valuation of assets and also for unforeseen contingencies and undermined losses.

5. Verification : The Section 81 (2) casts the responsibility of verification of cash balance and securities and a valuation of assets and liabilities of the society. Verification mean the assets and liabilities are really in existence or not and they are conformity with the book of accounts maintained by the society on the date of balance sheet. The term “**Verification**” includes not only physical verification of the assets, but, it also includes comparing the ledger account with balance sheet, they are owned by the business, assets are acquired for the business, and they are properly valued.

6. Form of Balance Sheets Form “ N ” - Sub rule (2) of Rule 62 lays down that the audited balance sheet and the profit and loss account to be laid before the annual general meeting shall ordinarily be in form “ N ” accompanying the Rules. As we have seen, form “ N ” has been divided into two parts. The first part contains the form of the balance sheet and the second part contains the profit and loss account. The forms of the profit and loss account and the various items appearing therein have already been discussed in the previous chapter. In this chapter, we shall proceed to consider the form and contents of the balance sheet.

The sub-rule, however, states that the balance sheet and the profit and loss account should ordinarily be in form “N” which means that different types of societies may

prepare their accounts in a slightly modified form to suit their special requirements. The Registrar has also been empowered to permit a society or class of societies to adopt other forms as he may deem fit. However, the form should broadly confirm to form “N” and material changes will not be permitted. Co-operative banks coming within the purview of the Banking Regulation Act 1949 have been permitted by the Registrar to prepare their accounts in the form set out in the third schedule to that Act.

While preparing the accounts, specific instruction given as to how each item of asset or liability is to be made out, should be scrupulously followed. These instructions appear as **marginal notes** against the various items, these instructions are kind of disclosures. The various items of assets and liabilities have been classified and grouped under suitable heads. The assets appear in the order of their liquidity, viz., cash and bank balance, which are most liquid appearing first followed by investments and other current assets, fixed assets and fictitious assets appearing last. The liabilities, however, appear in the reverse order, share capital and reserves appearing first and liabilities and provisions for credit balance of profit and loss account appearing last.

7. Auditor’s responsibility regards form and contents of Balance Sheet- Since the auditor is required to report on the balance sheet and the profit and loss account, verification and valuation of the various assets and ascertaining the nature and amount of the liabilities constitutes one of the most important duties of the auditor. The various tests to be applied and the procedure to be adopted for verifying and valuing the various assets and liabilities normally adopted by auditors are explained in the following paragraphs:-

The management of the society is no doubt responsible for the form in which the balance sheet and the profit and loss account are to be prepared and the amounts at which the various items are to be shown. *The auditor has no authority to alter the form of the balance sheet or the values at which they are shown.* However, if the form for the balance sheet is materially different or the values shown are incorrect, the auditor should make necessary comments in his report.

With the various item in the balance sheet grouped in the manner specified in form “ N “, the salient aspects of the financial position of the society would be clearly brought out. It can be seen at a glance, what is the total capital of the society and what portion of it is invested in fixed assets and current assets and what portion thereof consists of intangible items. A ratio of owned capital to borrowed funds and also to the total working capital can be calculated which would indicate the financial stability of the society. Ratio of current assets to current liabilities and also total liabilities can be worked out to ascertain the ability of the society to meet its immediate and long-term commitments. Similarly, other ratios can also be worked out which make comparisons possible.

As already stated, certain generally accepted accounting policies are followed in arriving at the figures at which the various assets should be stated in the balance sheet. In case of some of the assets, technical knowledge and judgments are necessary to make the valuation. In most of the cases, an estimate plays an important part. No doubt, the responsibility for this lies on the management of the society and not upon the auditor. The auditor, however, is undoubtedly responsible to satisfy himself, so far as he reasonably can, that the various assets are fairly stated in the balance sheet. He must also make certain that the normally accepted *Standard accounting principles* have been adopted in preparing the balance sheet and these have been consistently applied from year to year.

8. Classification of Assets for purposes of valuation - The assets held by a society vary according to the type of the business conducted by it, since the auditor is required to certify that, the balance sheet shows a true and fair view of the financial position of the

society, it will be his duty to ***satisfy himself that the assets are not only in existence, but have also been valued correctly.*** There are certain accounting policies, which are required to be followed, for valuing the different kinds of assets, and the auditor has to see that these accounting policies are consistently followed by management. We shall now deal with the different kind of assets ordinarily held by co-operative societies and the methods adopted for their verification and valuation.

For purposes of valuation, all assets are broadly classified into fixed assets and current assets. There is also a third type of assets known as fictitious assets; i.e., assets which are not represented by any tangible assets, such as goodwill, deferred revenue expenditure, preliminary expenses, discount on issue of shares and debentures, etc. It is not always easy to classify an asset as a fixed asset or current asset, since what may be considered as fixed asset by one society may be considered as current asset by another; for example, in a processing or industrial society, machinery would be a fixed asset while a society, which manufactures or deals in machinery, it would be a current asset. The classification would thus depend on the use to which the particular asset is put. However, we may ordinarily consider those assets as fixed assets, which have been acquired for use in the business for the purpose of earning income and not intended for resale at a profit and conversion into cash in the normal course of business. For example, the plant and machinery of a factory are held with a view to manufacturing with them for the whole period of the working life of such plant. Current assets are those assets which are produced or acquired by a business in the course of or for the purpose of its trading and consist of cash, goods and such other assets as are held with a view to conversion into cash in the regular course of business. Examples of current assets are stock in trade, work in progress, debtors and other receivables, temporary investments and bank balance.

9.Verification of fixed assets. -Verification of fixed assets by the auditor would be carried out by examination of the documents relating to their acquisition. A schedule of fixed assets at the beginning of the year and fixed assets acquired during the course of the year should be obtained and checked with the fixed assets register. *It should be seen that all articles scrapped, destroyed or sold have been duly brought into account and their written down values adjusted.* As regards physical examination of plant and machinery and other fixed assets, the auditor should see that, this is carried out periodically. A certificate should also be obtained from the management that, all items scrapped, destroyed or sold have been duly recorded in the books.

10: Accounting standard for fixed assets (AS 10) :- The Institute of Chartered Accountants of India has issued a Standard regarding ***fixed assets***, which states that ,

The statement is applicable for the assets which are valued on the historical cost basis, and does not apply to forest , plantation and similar regenerative natural resources, wasting assets including mineral rights, expenditure for exploration or extraction of theses assets, and other not regenerative resources like oil, Gas, expenditure on real estate development and livestock, which are considered separately. The fixed assets is defined as, ‘ ***an asset held with the intention of being used for the purposed of production or providing goods or services and is not held for sale in the normal course of business.***”

11.Cost and valuation of Fixed assets: The cost of fixed assets is determined on the basis of purchase price and cost for acquiring the assets. The financial cost (deferred credit) or cost of borrowed fund attributed for acquiring or the completion of construction of the assets is also included in the total cost. The interest cost after use of assets should not be capitalized.

In case of self-constructed assets, the allocation to the cost should be the total costs that relates directly to the specific asset.

When the asset is replaced by another asset, the fair value of old assets should be deducted from the new asset.

The additions to the asset, if the addition increases the benefit from the existing assets beyond its previously assessed standard of performance, should be added in the book value of the concern asset.

The material realised for the asset replaced or discarded should be shown at the net book value that is netting of depreciation and wear and tears, and net of realisable value, which is less.

When the assets are discarded and are of no use, or beneficial for the business, the total value should be eliminated. Losses arising from the retirement or profit earned should be carried to the profit and loss account.

In case of hire purchase assets, while purchase value should be taken into account, and if it is not available it should be calculated on the basis of rate of interest charged for the assets while purchasing it.

The assets, which are jointly purchased by two or more societies, the prorata value should be accounted for.

Where several assets are purchased for a consolidated price, the value of each asset should be separated from the competent valuer and shown accordingly.

Goodwill should be recorded only if there is any consideration is paid for it.

In case if the society purchases whole business of another society, the net worth of the business and the value paid for the acquiring the business, the value is excessive of net worth the excessive value should be treated as goodwill.

In the case of patents direct cost incurred in developing the patents should be treated as the value of the asset.

The amount paid for the know-how for the plans, layout and designs of building and or design of the machinery should be directly added in the value of respective assets.

12.Revaluation of assets: The cooperative societies are not revaluing their assets, but some sugar factories have revaluated their assets with permission from the State Government. However, while revaluation the class of assets should be revaluated, or an asset should be selected on systematic basis. The basis of selection should be stated, in financial statement.

The revaluation value while revaluating the asset should not greater than its realisable value. while upgrading the revaluation the accumulated depreciation should not be credited to the profit and loss account on the date of valuation.

The credit balance after revaluation i. e. the differential value between book value and revaluation value on the date of valuation should be straight way credited to the “Revaluation Reserve account,” and there is decrease it should be charged to the profit and loss account.

At the time of disposal of revaluated asset, the difference between net disposal value and the net book value should be charged or credited to the profit and loss account, except, that to the extent such a loss is related to an increase which was previously recorded as a credit to the revaluation reserve and which has not been subsequently reversed or utilized, it may be charged to the profit and loss account directly.

13.Disclosure: The standard accounting policy requires to state the society gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements. Expenditure incurred on account

of fixed assets during the course of construction or acquiring and revalued amount substituted for historical costs of fixed asset, method of revaluation, basis used for revaluation, in which year the revaluation is made, and the nature of valuer.

14. Disclosure as per Cooperative Societies Act: As per Rule 62 the N form balance sheet' marginal notes states that there should be mention of to every asset that, " Under each head of the original cost and the additions thereto and deductions there from made during the year and the total depreciation written of or provided upto the end of the year should be stated."

15. Current assets : Classification of current assets- Current assets are ordinarily classified under the following main heads for purpose of balance sheet :-

- (1) Interest accrued on investment and loans.
- (2) Stock in trade in case of trading concerns.
- (3) (i) Stores and spare parts.
(ii) Loose tools.
(iii) Semi-finished goods work in progress and finished goods in case of manufacturing concerns.
- (4) Loans outstanding and sundry debtors
- (5) Cash and bank balances

Interest accrued on investments should be shown separately in the balance sheet and the basis of its computation should be ascertained. While computing interest receivable, overdue interest should have been made for the same. Physical verification of all stocks on hand and also work in progress will have to be carried out. For verification of loans outstanding and sundry debtors, ledger accounts and balance confirmations will have to be seen. Cash on hand should be counted and balance certificates will have to be obtained for all bank balances. The methods adopted for verification of different assets is explained in the following paragraphs: -

16. Fixed assets and depreciation - It has first of all to be noted that the value of fixed assets shown in the balance sheet does not indicate its realizable or replacement value, but represents the original cost of the asset which has not been charged to revenue in the year in which it was acquired, less amount written off to revenue by way of depreciation year after year. In other words, fixed assets appear in the balance sheet **at their historical cost less depreciation to date**. It is, therefore, the duty of the auditor to satisfy him that the amounts, which have been written off as depreciation, are adequate. There are various methods followed for providing depreciation, but the one most commonly followed by co-operative societies, is the straight line method under which the same amount is written off every year during the estimated life time of the asset (i.e. its usefulness to the business) at the end of which it is completely written off or appears at its scrap value in the books. Certain co-operative follow the " reducing balance " method under which the agreed annual rate is applied in the first year and thereafter to the written down value after deducting the depreciation provided in previous years. There is also a third method under which the assets are revalued every year.

17. Depreciation – Whether based on the historical cost or re-valuation, should be so calculated as to write off the assets over its expected normal useful life, irrespective of whether any allowance, initially or annually, granted by the income-tax authorities. The rates of depreciation, which should be applied, would depend upon the situation of the asset, its nature its expected life of usefulness its residual or scrap value, the degree of use

to which it is being put and risk of obsolescence. Where shift working is normal as in the case of sugar factories, spinning mills, etc., it would be necessary to increase the rates of depreciation. The main criteria for charging depreciation should however, be the expected life of the asset and its scrap value after the period of its useful life. Whatever method has been adopted for calculating depreciation it requires to be consistently followed and any departure there from will have to be pointed out by the auditor. Normal depreciation is a charge on profit and under Section 65 (1) and Rule 49 A (vi) of the Maharashtra Co-operative Societies Act, depreciation has to be debited before calculation net profits. ***Even where no profits have been made or the profits made are inadequate, normal depreciation must be charged so as to show the correct amount of loss incurred.***

If no provision is made for depreciation in respect of any fixed asset, the fact that no provision has been made will have to be stated by way of a note. ***Since adequate provision of depreciation on a consistent basis vitally affects the profit and loss account and the balance sheet, it is necessary that any departure from the normal practice should be inquired into if necessary, clearly brought out by way of a note or in the auditor's report.***

It may also be noted that whatever method is adopted for calculating depreciation, the income –tax authorities take into consideration the standard rates prescribed by them. Hence the balance sheet provided to that authorities, and submitted to Annual General body meeting may differ to that extent.

Byelaws of some of the societies contain specific provisions laying down rates at which depreciation should be charged on different assets. These rates may be applied where appropriate. However, where no provisions have been contained in the Byelaws, the rates admissible for income-tax purposes should be applied. Where rates have been specified in the Byelaws, but these are not considered adequate or otherwise unreasonable, the auditor should suggest suitable amendments to the Byelaws. It has, however, to be noted that the rates once applied should be continued. Where there is a change in the basis of providing depreciation or the rate applied, the auditor should mention it in his report.

18. Accounting standard - Depreciation accounting (AS 6): The Institute of Chartered Accountants of India has issued a Standard regarding depreciation, which states that , The statement is applicable for all the depreciable assets and does not apply to forest , plantation and similar regenerative natural resources, wasting assets including mineral rights, expenditure for exploration or extraction of theses assets, and other not regenerative resources like oil, Gas, expenditure on research and development, goodwill and livestock, which are considered separately. The standard also is not applicable to the lands except which not meant for the limited life i.e. lease hold lands. For this separate accounting standard has been issued by the Institute.

Various accounting policies are applied by the societies to charge the depreciation are already explained in the above Para 11.

19. Definitions: 1) **Depreciation:** The depreciation is defined by the Institute as, “ ***Depreciation is a measure of the searing out, consumption or other loss of value of a depreciable asset arising from use, efflux ion of time or obsolescence through technology and market changes.***

2) **Depreciable assets** are (a) assets which are expected to be used during more than one accounting period; and (b) have limited useful life, and (c) are held by the society for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business

3) **Useful life:** is either period over which a depreciable asset is expected to be used by the society; or the number of production or similar units expected to be obtained from the use of the asset.

4) **Depreciable amount** of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.

5) Accounting Standard:

Depreciation amount should be allocated to ***expected life on a systematic basis, by selected method and consistently for period to period.*** Change in the method should be disclosed in the financial statement, with there effect on the financial statements, i.e., Balance sheet and profit and loss account.

If a new method of depreciation is selected and charged accordingly, for requirement of statutory provisions, or other wise appropriate for the business, the result should be disclosed. Due to change in method, the unamortised depreciable amount of the asset should be charged to the profit and loss account for the remaining period of life of the asset, by applying new method.

The useful life of the asset should be considered on the basis of expected physical wear and tear; obsolescence; legal or other limits on the use of the asset. This should be reviewed periodically. After revision if it is found that, the estimated useful life of an asset the unamortised depreciable amount should be charged over the revised remaining useful life. This should be disclosed.

Extensions and additions are also charged depreciation for the remaining useful life of the asset , on the rate applied to that asset, to which the additions or extensions are made.

When the depreciable asset is revalued , the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful life of such asset.

6. Disclosure: The financial statement should state, (a) the historical cost or other amount added to that cost, of the such asset; (b) total depreciation charged to the asset or each class of assets; (c) related accumulated depreciation of such assets; (d) depreciation method used. (e) depreciation rates or the useful lives of the assets. (f) Basis of rates as per *statue or as per byelaws* of the society.

20. Valuation of different types of assets – We shall now proceed to consider the methods adopted for valuation of various types of assets-

(i) **Goodwill** – It is not common to find goodwill as an asset in any of the established co-operative societies. However, where a co-operative society is formed to take over an existing business owned by private parties, it may be necessary to pay some compensation by way of goodwill to the existing proprietors of the business. ***Thus, where the market value of the assets acquired is less than the amount paid to the vendors, the excess amount paid will have to be shown as goodwill in the balance sheet of the newly formed society.***

It may not be possible for the auditor to verify the correctness of goodwill, which is assumed to be capital value of extra profits, which an average business would earn on the capital, employed. The goodwill is thus an intangible asset although it may not be a fictitious asset inasmuch as its existence can be verified. From the Auditor's point of view, he will only have to see that its value is written down annually out of profits, in accordance with the resolutions passed by the annual general body or by the managing committee. Agreement with vendors of the business relating to purchase of the various assets consideration to be paid the form in which it is to be paid, etc., will have to be

inspected. Where the consideration paid exceeds the market value of the assets acquired, the excess amount paid will have to be treated as goodwill. Accounting standard regarding Goodwill has been explained above.

(ii) **Patents** – Such types of assets are not ordinarily possessed by co-operative societies. However, where they have been acquired, it should be seen that they are written off during the course of their expected life. It is also necessary for the auditor to see that annual renewal fees are paid every year. The auditor should study the provisions of Indian Patents and trademark Act. regarding the estimated life of the such asset.

(iii) **Trademarks** – Verification of trademarks can be made by inspection of the certificates of registration and / or any assignment of the trademarks.

(iv) **Copyrights** – These will be acquired only by co-operative publication, societies. The valuation should have regard to the prospect of the future sales, if the entire amount is not immediately written off. As far as possible, these assets should not appear in the balance sheet for a period longer than 2 or 3 years.

The above four assets are known as intangible Assets as they are not to be seen or touched. While examining these assets the auditors should take care that, what the basis on which such assets were originally valued. Which procedure for writing off of these assets is applied by the society. Whether they are presented fairly and adequately in the Balance sheet. There is proper control on income generated by these assets and it is accurate and completely taken in to accounts. The ownership of the assets should be verified. The assets are recorded consistent with accounting policies. These assets should be shown separately.

(v) **Freehold lands and building** – Verification is by way of inspection of title deeds. It should be seen that the title deeds are in order. The sequence of the conveyances should be examined to ensure that the last conveyance is in the name of the society. Also, extracts from the land records (update 7/12 extract, *khateutara*, index II etc.) , such as village record of rights or the city survey or the Municipal records should also be seen should be in the possession of the society. Unless the lands and buildings are mortgaged in which case a certificate to that effect should be obtained from the mortgagee.

As regards valuation, the cost of the lands and buildings can be ascertained from the sale deed or the architect's certificate. Contractor's account and the certificate of completion should also be seen where buildings are constructed by the society.

As regards expenditure incurred over construction of roads, digging of wells, planting trees, etc., the same should be verified from the vouchers. Expenditure incurred over the maintenance of roads, gardens, play grounds, etc., should be debited to revenue. Only the cost incurred over the original construction should have been capitalized.

As regards depreciation, it has to be noted that **freehold land does not generally depreciate in value.** As such, the question of charging depreciation to freehold lands does not arise.

As regards **leasehold lands**, the valuation can be ascertained from the lease deed, or the assignment thereof, which should be inspected by the auditor during the course of his audit. It should be seen that, all the terms and conditions laid down in the lease agreement such as insurance of property and payment of insurance property and payment of insurance premium, rent, rates and taxes, proper maintenance of the property, etc., are complied with. The valuation will be made with reference to the original cost so that every year and adequate amount is written off so as to bring the value to 'Nil' at the end of the life of the lease.

(vi) **Plant and machinery**- Purchase of new plants and machinery will be vouched during the course of audit. In addition to invoices and receipts, the correspondence regarding the purchase and also contracts with machinery manufactures and engineer's

certificates will have to be seen. As regards physical verification, where there are only a few machines, they should be personally inspected and identified by the auditor. However, where the number of machines is large and also where it is not possible to identify individual items of machinery, the auditor should obtain a schedule of plants and machinery. A certificate of their existence and efficient working should also be obtained from the Works Manager or other responsible technical officer. ***The mode of valuation should be the original cost less depreciation.*** Where the machinery or other equipment's is purchased under a hire purchase agreement or an agreement to pay by installments (deferred payments system) the depreciation should be calculated on the full cost price of the machinery and not on the amount of installments paid to date. (AS 10)

(vii) ***Loose tools and tackles-*** the expenditure incurred over additions will be verified from the vouchers. ***At the end of the year, fresh valuation of all the tools should be made every year and the difference between the opening balance plus additions during the year less closing balance should be written off as depreciation.*** The basis for valuation should not be the current or realizable value, but the estimated cost less an adequate allowance for wear and tear.

(viii) ***Dead stock, furniture and fixtures, installations, and fitting*** - Dead stock and furniture, including office equipment should be dealt with as in the case of plant and machinery and adequate depreciation should be written off every year, based on the working life of the different items. Items, such as safes, cupboards, tables, etc., have long working life, but fixtures and fittings, such as electrical installation, partitions, etc, have a short working life. In the case of fittings upon leasehold premises, the entire cost should be written off during the period of the lease or their estimated working life, whichever is shorter. A list of dead stock articles and office equipment should be obtained and the total agreed with the amount appearing against the item in the balance sheet.

(ix) ***Library books*** – Cost of newspapers, periodicals and even books is generally debited to the profit and loss account under the heading “trade expenses ” or “miscellaneous expenses” and do not appear as an asset in the balance sheet, unless the amount invested is considerable. However, purchase of costly books, particularly, reference books and technical books, may be capitalized and shown under the heading “Library books ”. A register of library books should be maintained irrespective of whether the cost of the books has been debited, to revenue account or capital account. The Register of library books should be inspected at regular intervals and the physical existence verified. A list of library books, the cost of which has been capitalized should be obtained and agreed with the amount appearing on the balance sheet. It should be seen that cost of old and outdated books, in particular, law books, is written off.

(x) ***Motor vehicles-*** the cost of new vehicles purchased should be vouched at the time of checking purchases. Registration books should be examined. All vehicles should be identified by their registration numbers in the accounts and in the list of motor vehicles, which should be necessarily obtained at the time of audit. Where a fleet of vehicles is owned by the society, it will be necessary to keep separate account of each vehicle. The expenses incurred over repairs and maintenance should be allowed to be carried over for one or two years so as to spread over the benefit of the expenditure over the periods for which it is availed of. As regard ***valuation the method adopted is original cost less the aggregate depreciation.*** In special circumstances, such as accident, etc., a special depreciation will have to be charged.

(xi) ***Live stock*** – A register of live stock, showing date of acquisition, identification marks or name, price paid depreciation charged etc., should be maintained. Every animal should be identified by registration number or by its name, where there are only a few animals. ***The basis of valuation should be re-valuation at the end of each year. In the***

case of animal, such as working bullocks, milch cattle, etc., their working or useful life and their usefulness to the society should be taken into consideration. ***It has also to be noted that calves, heifers and other young animals appreciate in value, as they grow old.*** It should be seen that necessary adjustments are made on the death or disposal of any of the animals.

VII-2 VERIFICATION AND VALUATION OF CURRENT ASSETS-

1. Investment – An investment ledger should be maintained recording all transactions relation to individual investments. At the top of each ledger account, necessary particulars regarding date on which interest or dividend become payable, scripts, right and right issues attaching the investments, etc., should be duly recorded. There should be separate columns to show the gross interest or dividend received tax deducted at source and net amount received. Where no income is received during the year in respect of any investment, inquiries should be made. *Arrangements made for the physical control of the securities should be examined. Physical control over the securities and other investments should be with a responsible officer other than the officer who is authorized to sanction purchases and sales of the securities, if they are not in demat format.* All securities should be preferable lodged with the bank of safe custody.

(i) **Verification of securities-** where securities lay in the custody of the society the auditor should examine each scrip carefully. The title to the securities should be carefully examined to ensure that the security is held in the name of the society itself. It is not sufficient merely to count the number of share, certificates or Scripts. The certificates, warrants or the securities themselves should be examined carefully to see that, they are complete in all respects and prima facie in order and are duly registered in the name of the society. Where the document inspected is not a certificate or a warrant, i., e., where it is a transfer receipt or a letter of allotment, it should be seen that the document has been correctly described and the description of the decumbent agrees with particulars mentioned in the ledger. Where securities are lodged with the Bank for safe custody, the auditor should directly call for a certificate from the Bank. ***The certificate received from the Bank should specifically state that the securities have been held for safe custody free from any lien. If they are held for any specific purpose, the certificate should specify the purpose for which they are held.*** Where shares and securities purchased have not been delivered by the broker or the Bank through whom the purchases have been made, a certificate should be obtained from the broker or the bank concerned to the effect that the share certificates or securities have been held by them on behalf of the society and that they have no lien over them. As on the date of balance sheet, the auditor should obtain a schedule of investments held by the society. The list (or schedule) of investments should give the full description of the investment, i.e., its serial number, face value, whether fully paid the extent of uncalled liability if not fully called, etc. These particulars should be compared which the particulars entered in the Register or Ledger of Investments. Immediately after inspection the security or certificate, the auditor should put his initials or tick against the particular items in the list so as to prevent its presentation once again. The list should be initiated or the tick made only if the document inspected is a complete of title. Otherwise, it should be ticked with a distinctive tick or mark indicative of the document inspected, so as to remind the auditor that further evidence of title is required to be examined.

Where securities have been kept with the bank for safe custody or as collateral security for financial accommodation granted by the bank, this schedule of investments

should be compared, which the certificate issued, by the bank. ***Each item in the schedule should be initialed or ticked only after inspecting the document itself*** or correspondence on the subject or the specific item in the certificate issued by the bank, which has custody of the securities. Where securities are kept with Bank for safe custody, this schedule should be checked with the safe custody certificate issued by the Bank. Each item in the schedule should be initialed only after inspection of document itself or the relevant correspondence relation to the security or the specific items in the certificate issued by the Bank.

In the case of bearer warrants, it should be seen that interest coupons are in order and re attached to the Scripps itself. The numbers of such coupons should have been noted on the schedule.

in case of securities purchased through Demat accounts from the depository, and lodged in the same account, the auditor should verify the certificates issued by the depository at the end of financial year, and statement of purchase and sales documents should be verified from the account abstracts provided by the depository time to time to the society. If the society has not obtained the account abstracts, the auditor should call it through the society and verify the sale and purchase documents with these statements.

(ii) ***Valuation of securities*** – In the case of securities, which are quoted in the market, quotation on the date of the balance sheet, should be obtained and the mean between the higher and lower prices should be taken for purpose of valuation. For the securities valuation purpose the Reserve Bank of India has issued guidelines for the Cooperative Banks, it should be seen that the valuation is made according to these guidelines which are described elsewhere. In respect of Urban banks and DCCB and SCB the rates are made available from agencies like FIMMDA and quoting them in their website. The list or schedule should show the market value of the quoted and unquoted securities on the date of the balance sheet. Aggregate book value and market value of the quoted and unquoted investments should be shown separately in statement. Investment should be stated in the balance sheet at cost or market value, whichever is lower. Market values may be compared with the cost either by comparing the cost of each investment separately with its market value and providing for all falls in the value below cost. However, any appreciation in the market value of the securities should not be taken credit of. Another and more useful method adopted is to compare the aggregate cost of all the investments with their aggregate market value and provide for the net shortfall in the market value of the securities. Treasury bills should be shown as current assets and shown at cost or at their face value discounted at the market rate if this is less.

(iii) ***Investment by Cooperative Banks:*** The DCCB' and Urban Banks are required to invest their funds in the Government securities and other securities of trusts and public undertakings. The Reserve Bank Of India has issued various guidelines and directives regarding these investments, how they are invested, exposure norms for each type of investments, Brokers that are to be appointed, business limits operated by these brokers, opening of SGL/CSGL and demat accounts, investment policy, audit of these investments, reports of auditors, provisions regarding fluctuation of prices, trading of scripts, classification of investments, all these points are described in the Banking part of this manual. Auditors are required to study them and apply at the time of audit of cooperative banks. Various circulars, which are issued by the Reserve Bank, are detailed below.

MASTER CIRCULARS

Sr. No.	Circular / Directives No.	Subject
1	UBD.BR Cir.19/ 16.26.00/2002-03 dated 29 th October 2002	Dematerialization of PSU Bonds
2	UBD.CO.BSD.I.PCB 44/12.05.05/ 2000-	Guidelines for classification and

	2001 dated 23 rd April 2001 and UBD. CO. BSD.I.PCB. (Cir) 34/ 12.05.05/ 99.2000 Dated 24 th May 2000 and UBD. CO. BPD.PCB. (Cir) 11/ 09.29.00/ 2003.04 Dated 2 nd September 2003 and even No. Circular 12 Dated 4 th September 2003	valuation of Investments by banks
3	BP 23/ 16.26.00/ 2002-03 Dated 2 nd November 2003.	Valuation of securities for purpose of SLR
4	BPD.PCB. CIR 56/ 09.29.00/ 2003-04 Dated 2 nd July 2003	Investment Portfolio of Banks transaction in securities.
5	MASTER CIRCULAR DOBD No.BP.BC .21 /21.04.141/ 2003-04 Dated 2 nd September 2003	Prudential norms for classification, valuation and operation of investment portfolio by banks . This circular is issued for ALL SCHEDULED COMMERCIAL BANKS

Though the Circular referred at 7 is for the Schedules Commercial Banks the guidelines are also useful to the Cooperative Banks, for their Investment portfolio management.

2. Accounting Standard – Accounting for Investments (AS 13)

The Institute of Chartered Accountants of India has issued accounting standard No. AS 13 on the Investments. Which read as follows:

- 1) The society should disclose current Investments, and long-term investments.
- 2) There should be further classification of these investments in (a) Government or Trust Securities, (b) Shares, debentures or bonds; (c) Investment properties (d) Others specifying nature.
- 3) Cost of Investment: The Cost of investment should include acquisition charges such as brokerage, fees and duties.
- 4) An investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost should be the fair value of the securities issued (which in appropriate cases may be indicated by issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued. If an investment is acquired in exchange for another asset, the acquisition cost of the investment should be determined by reference to the fair value of the asset given up. Alternatively, the acquisition cost of the investment may be determined with reference to the fair value of the investment acquired if it more clearly evident.
- 5) Societies holding investment properties should account for them as long-term investments.
- 6) Investment classified as current investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis, or by category of investment, but not on an overall basis.
- 7) Investments classified as long term investments should be carries in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determine and made for each investment individually.
- 8) Any reduction in the carrying amount and any reversals of such reductions should be charged or credited to the profit and loss account.
- 9) On disposal of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to the profit and loss account.

3. Disclosures: 1) The following information should be disclosed in the financial statements.

- a) the accounting policies for determination of carrying amount of investments;
- b) classification of investments as specified in Para 1 and 2 above;
- c) The amounts included in profit and loss account for, I) interest, dividends, (showing separately dividend from subsidiary companies/societies), and rental on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Tax paid. II) Profit and losses on disposal of current investments and changes in the carrying amount of such investments; III) Profits and losses on disposal of long term investments and changes in the carrying amount of such investments;
- d) Significant restriction on the right of ownership, realisability of investment or the remittance of income and proceeds of disposal;
- e) The aggregate amount of quoted and unquoted investment, giving the aggregate market value of quoted investments;
- f) Other disclosures as specifically required by the relevant statute governing the society.

4. Disclosures as per Cooperative Act: 1) The “N” form Balance sheet requires the investments should be stated as (a) Government securities (b) Other Trust Securities, (c) Non-Trust securities, (d) Shares of other Cooperative societies (e) Shares, debentures or bonds of companies registered under the companies Act., and (f) Fixed deposits.

2) The Note in margin of this form requires to state the nature of investment, the mode of valuation (Cost or market value) should be mentioned, and if the value of any security is less than the market value, a remark to that effect should be made against each item in the balance sheet. Quoted and un-quoted securities should be shown separately as per the marginal note.

3) For the depreciation of the investments there is provision in Rule 49 A (xiii) and section 65 provides for the investment fluctuation fund for depreciation in the assets.

The note in margin requires to state the nature of investment, which denotes to the classification of the investments, whether the investment is of current or long-term nature.

5. Stocks and works in progress – The need for valuation of stock in trade or closing stock of goods arises because on the date of preparing the balance sheet, there would always be in stock goods purchased or manufactured during the year or in process at the close of the year, which will have to be sold during the following year and to arrive at the correct figure of profits, it would be necessary to eliminate in the accounts, the cost incurred for their purchase or manufacture and to charge the same to the profit of the year during which these goods would be sold. In case of consumer stores, marketing and processing societies and manufacturing societies, *the verification of the physical existence and valuation of trading stocks, stocks, stock on hand of raw materials, stores, partly finished goods or goods under process, works in progress and finished goods are of considerable importance, inasmuch as unless they are correctly shown, the balance sheet will not show the true and fair view of the financial position of the society and the profit and loss account will not give the correct results of the working of the society.* It is also possible that profits might have been **deliberately manipulated** in order to warrant declaration of dividend at higher rates of payment of increased remuneration to the Managing Director.

6. Verification of physical existence of stocks – The process of verifying physical existence of each item of stock at the close of the year or at the end of any specific period is known as annual or periodical stock-taking. Complete physical counting of all the stocks on hand should be made at the end of the year in case of all societies, which have taken up trading or manufacturing activities. A number of progressive concern have adopted a system known as perpetual inventory or continuous stock taking system under which stocks are verified throughout the year, so that all the items in stock are verified at least once during the course of the year. This system provides a better control over the stocks, but can be adopted only where proper quantity accounts are maintained.

As regards physical verification of stock, although textbooks on auditing state that, stock taking is not the duty of the auditor and this position has been accepted in more than one legal decision, auditors of co-operative societies should note that they are required to carry out their audit in accordance with the procedure laid down by the Registrar. From a perusal of the audit memo. forms prescribed for consumers societies, marketing societies, producers societies and similar other societies, it will be seen that the auditor is required to physically verify stocks of the some important items. (Vide Registrar's Circular No. ADM/243(Con)/ADT, dated the 24th November 1959). *Stock taking is an important duty of the auditor. The auditor should not neglect this aspect during audit.* It is true that the auditor is not qualified or is it possible for him ever if he possessed the necessary qualification to take actual measurements, weights or count stocks. However, he should attend at the time of stocktaking and observe the operation, viz., taking actual measurements, weighing or counting the various items in stock. In case of small societies, the entire stock will have to be verified, while in the case of large societies, like sugar factories, spinning mills and other processing and industrial society, departmental stores, wholesale and retail consumers stores, etc., since the number of items to be checked is large, cent percent verification of the stocks may not be possible. In such cases, the auditor should associate himself with the staff as may be necessary having regard to the size and importance of the society should be deputed to observe actual stocktaking in all the societies in charge of the auditor (Registrar's Circular No. ADT/552, dated the 21st December 1970)

7. Method of stocktaking, Annual stock taking - In most concerns, stock is taken on last day of the year and for this purpose, the business is closed on the last day or the last few days immediately preceding or for following the close of the year. The store or godown where the goods are lying is divided into number of sections and each section is placed in charge of one or more batches of stock takers whose work is supervised by responsible officer possessing necessary technical qualifications. Generally, each batch of stock takers consists of two persons, one person calling out the description and quantity of the goods and the other person entering them on the stock sheets. The process is repeated again with the position reversed, the person who called out the description and quantity verifying the correctness of the entries made in the stock sheets, and the other member of the team, who had entered the figures now measuring, weighing or counting the goods and calling out. The auditor should make careful enquiries into the entire system of stock taking, entering and pricing. He should satisfy himself that an adequate number of persons were engaged in stocktaking and each step has been independently checked and further supervised by responsible officers.

8. Observance of stock taking - During his observance of stock taking, the auditor should attend to the following points:-

- (i) He should satisfy himself that the organization for stocktaking has been properly planned and written instructions are issued to all the persons concerned.
- (ii) He should also satisfy himself that the stock takers are doing their work properly and that each step has been independently checked and further supervised by responsible officers. In particular, he should satisfy himself that slow moving and absolute substandard stocks are properly segregated and recorded in separate stock sheets. For this purpose, it would be necessary to ascertain from the records, the periods for which the goods are lying in stock.

9. Checking of store sheets- Final stock sheets presented to the auditor should be compared with the rough stock sheets filled in by the stock takers at the time of stocktaking. Quantities shown in the stock sheets are compared with the balances in the stock accounts and the bin cards and discrepancies noted should be got clarified.

Having carefully examined the whole system of stock taking the auditors should check the stock sheets and carry out his inquiry as under:-

- (i) Check totals of stock sheet bearing in mind that there is no double entry check upon these totals.
- (ii) Check calculations, bearing in mind that items calculated as singles, may, in fact be doubles, dozens or even grosses.
- (iii) Compare stock sheets with those of the previous years, particularly as regards prices and quantities, making careful enquiries about the fluctuations and also ascertaining whether any part of stock has been held for a long time and become absolute.
- (iv) In case of raw materials, stores and trading stock (i.e., goods purchased for resale **compare prices with latest invoices and market prices ruling at and after the date of the balance sheet.** (AS 4) In the case of finished and semi-finished goods, their net realizable value in the form of finished products should be taken into consideration .
- (v) examine the Goods Inward Books for the last few weeks of the period and trace any large item into the stock and into the Purchase Register .
- (vi) Trace any large sales towards the end of the period into the goods Dispatched Register and see that these goods, if not delivered have not been included in the stock .
- (vii) In case finished goods, ascertain the basis upon which overheads have been charged.
- (viii) Where quantities can be checked easily this should be done by deducting the total sales from the total purchases plus opening stocks allowing for small differences on account of wastage .
- (ix) Inquire whether any goods belonging to the society are in the hands of the consignees, selling agents or distributors or lying in depots or warehouses. It is likely that some of these might have been omitted.
- (x) While examining stock sheets, see that no plant machinery ,tools, furniture and similar other capital goods are not included.
- (xi) After the Trading Account is drawn up and the amount of gross profit arrived at comparing percentage of gross profit to sales with that of previous years. If there is any marked difference enquire in to the reasons.

Specifically observe that the sales effected during the period is very small or considerably small, however there is gross profit or there is no sell at all, then also there is gross profit, then the possibility of overvaluing the stock increases. This results in showing profit, which can be distributed from the capital funds.

- (xii) Periodical manufacturing or production reports, statement of expenses incurred under different heads etc. submitted time to time to the Board of Directors,

provide an important means of verifying the accuracy of the value of closing stock. Although these will not form part of the regular financial audit these statement should be checked and their accuracy and reliability ascertained.

10.Valuation of stock in trade – After the stocks taken and the quantities entered in the stock sheets, the price at which each item in stock should be taken should be entered by a responsible officer. Calculations, extensions and totals should be made by one clerks and checked by another. All persons taking part in stocktaking should have initialed the stock sheets and the whole should be certified by the Chief Engineer and the Managing Director. ***Normally, stocks should be valued at lower of cost or market price which for this purpose would mean bet realisable value or replacement cost in case of materials and stores. The overriding consideration if choosing the basis for stock valuation is that the basis chosen should give a true and fair view of the position and the results of that business and this basis should be applied consistently every year-*** Reference should be made where appropriate to purchase invoices and cost records. Cost may be determined by specific identification or on the basis of average or standard cost. *In case of consumers societies including departmental stores’ and also in the case of farming societies for valuation of crops harvested, the adjusted selling price method of determining cost would be more appropriate.* These have been discussed in more detail in subsequent paragraphs. However, ***it should be noted that under no circumstances, stocks should be valued above market price.*** In addition cost . i.e., purchase price, incidental charges like transport charges, clearing and forwarding charges, municipal octroi, insurance etc. may also be included.

Prices of some of the important items should be verified by obtaining quotations from the market or by examining the latest invoices in the files of the society. *All calculations, extensions and additions should be checked* and it should be seen that all stock sheets are duly initialed by all the persons taking part in the stocktaking and valuation of the stocks. It should also be seen that the final summary showing the aggregate value of the stocks is signed by the Managing Director and other senior officers. Stock sheets should be examined to ensure the absolute and a slow –moving stocks are segregated and a lower value shown against them.

11.Accounting Standard: Valuation of Inventory: (AS 2) : The Institute of Chartered Accountants of India have issued accounting standard regarding valuation of inventories. This accounting standard does not apply to the plantations, forestry, agricultural commodities and livestock; extractive industries such as mining, quarrying etc.; work under progress under long term contracts, such as engineering , real estate development, and construction projects, Shares, debentures and other securities held as stock in trade, immovable properties and loose tools.

Definitions: a) Inventories: this includes tangible property held for sale in the ordinary course of business, or in the process of production for such sale, or for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares.

b) historical cost: means the appropriate combination of cost of purchase, cost of conversion and other costs incurred in the normal course of business in bringing the inventories upto their present location and condition.

c) Cost of Purchase: purchase price includes cost of purchase, including duties and taxes, freight inwards and other expenditure directly attributable to acquisition, less trade discounts, rebates, duty drawbacks and subsidies, in the year in which they are accounted, whether immediate or deferred , in respect of such purchase.

d) Cost of conversion: it includes (a) costs which are specifically attributable to units of production i.e. direct labour, direct expenses and sub-contracted work; and (b) production overheads, ascertained in accordance with either the direct costing or absorption costing method.

e) **Historical cost:** inventories are which includes Raw materials and components, work in progress, finished goods, and stores and spares, normally stated at the lower of historical cost and net realisable value. The reason behind this is, the cost of previous years is carried to next year until they are sold or consumed. However, if there is no reasonable expectations that net realisable value would cover the cost incurred (as a result , for example, of deterioration, obsolescence or change in demand. It is necessary that cost, which cannot be recovered, should be charged against the revenue of the current period. The meaning is very simple that, the charge of any deterioration obsolescence or change in demand should effect in which the goods are sold only.

f) **Net Realisable value:** is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

g) **Accounting standard:** The Institute of Chartered Accountant of India has issued the following accounting standard regarding valuation of the inventories.

i) Normally the inventories should be valued at lower of historical cost and net realisable value i.e. market value otherwise stated.

ii) This valuation is made on the basis of single unit or group of units.

iii) The methods of valuation are done by using the methods- FIFO, LIFO or Average Cost methods.

iv) The historical cost of manufactured inventories may be arrive at on the basis of either direct costing or absorption costing. Where absorption costing has been use, the allocation of fixed cost to inventories should be based on the normal level of production.

v) Overheads other than production overheads should be included as part of the inventory cost only to the extent that they clearly relate to putting the inventories in their present location and condition.

vi) Inventories of consumable stores and maintenance supplies should ordinarily be valued at cost. In appropriate circumstances, however, this may be valued at below cost.

vii) Inventories of by-products should be valued at lower of cost and net realisable value. Where cost of the by-product cannot be separately determined. It should be valued at net realisable value.

viii) Inventories of non-reusable waste or inventory of reusable waste for which facilities for reprocessing do not exist should be valued at net realisable value.

h) Disclosures: The accounting policy adopted for valuation of inventories, including the cost formulas use should be disclosed in the financial statement. Where the base stock method is used, the difference between the value at which it is carried and the value by applying the method at which stocks in excess of the base stock is valued should be disclosed. There should be consistency in the method applied for valuation of method.

i) Discloser in Cooperative Act: As per the note in margin of 'N' form balance sheet it is required to disclose “ the mode of valuation and stock shall be stated and the amount in respect of raw material partly finished goods and stores required or consumption should be stated separately. Mode of valuation of works in progress shall be stated,”

12. Auditor's duty as regards valuation –The duties of the auditor regarding stock are (a) to verify the existence of the stock (b) to check the ownership of the stock and (c) to see that the stock is properly valued. Falsification of accounts, is frequently affected by means of stock manipulations. Unless, satisfactory records of quantities, accounts are maintained,

or the system of standard costing is in operation, the books of accounts will not disclose what stocks should be there on the date of the balance sheet.

The types of manipulations, which are to be guarded against are as under :-

- (i) ***Incorrect calculations, extensions and additions,***
- (ii) ***Incorrect pricing***
- (iii) ***Inclusion of goods in stock, the invoices for which have not been included in purchases.***
- (iv) ***Inclusion of goods in stock, which have already been sold and entered as sales prior to the date of the balance sheet.***
- (v) ***Non-inclusion of stocks in the hands of agents, in warehouses, in sale depots, etc.***
- (vi) ***Omission to provide for diminution in value in case of damaged, and out of fashion goods, and over valuation thereof.***
- (vii) ***Value of stocks on an incorrect basis.***
- (viii) ***Inclusion of stocks, which, in fact, do not exist.***
- (ix) ***Inclusion of such goods in stock, which are not part of stock. such as furniture, loose tools etc.***

If proper stock accounts have been maintained, any material difference shown by the stock books and the stock sheets should be carefully investigated. The auditor should ***enquire into the whole system of stocktaking, entering, pricing and checking stock statements and find out the exact basis upon which valuation has been made.*** It should be seen that the basis of valuation adopted at the beginning of the year is ***consistently*** followed-

The basis of stock valuation is required to be stated in the accounts. The basis of valuation may be described in one of the following ways :-

- (1) At cost.
- (2) At lower cost and net realisable value.
- (3) At the lowest of the cost, net realisable value and replacement price.
- (4) At cost less provision to reduce the net realisable value.

The expression “ **market value** ” does not indicate whether the net realisable value or the replacement value is intended. It is, therefore, not appropriate to describe the basis as “ at market rates ” or “ at cost ”, or as “ valued by the officers of the society ”, etc. It may be noted that the word “ cost ” would be inadequate unless it is accompanied by the explanation of the extent to which overhead expenses have been included. In case of manufacturing societies, the appropriate description would be “ ***cost includes materials, factory wages, factory expenses and an appropriate proportion of production and administrative overhead charges, but excludes fixed overheads*** ”.

13. Valuation of By products – In manufacturing processes, which yield byproducts, as for example, molasses in sugar factories, cotton waste in spinning mills, oil cakes in oil mills, broken rice and bran in rice mills, etc., ***It may no be possible to ascertain the cost of the by-products. In such cases, by-products may be valued at their current ruling prices in which case, the cost of the main product must be calculated after crediting the anticipated sale proceeds of the by –products. The selling price basis of valuation may also be adopted in farming societies producing crops with an annual cycle and on the date of the balance sheet, the crops harvested may be valued on the basis of prices likely to be realised after deducting selling cost such as transport to market centers, selling agent’s commission (Dalali) market cess and other expenses connected with marketing.*** It is considered that this would result in a more understandable presentation of the society’s affairs as in this way, the year’s account would reflect the results of the entire

crop cycle. In these circumstances, the basis of valuation should be indicated in the accounts.

14. Points to be noted while valuing stocks- The auditor should satisfy him that the system of stocktaking is appropriate and all stocks have been properly valued. If satisfactory stock records are not maintained, the auditor should mention in his report.

While valuing stocks on hand the following points should receive specific attention :-

- (i) *Value of goods held on consignment should be excluded.*
- (ii) *All goods sold, but not dispatched should be excluded.*
- (iv) *Stocks sent on consignment should be included.*
- (v) *Unsold goods on consignment should be valued at cost and not at selling price.*
- (vi) *Where purchases have been made, but invoices have not been received, necessary adjustments should be made crediting the accounts of the suppliers.*
- (vii) *Absolute and unserviceable goods and also slow –moving goods should be shown separately*
- (viii) *Where goods have been received , but purchase invoices have not been received, necessary adjustments should be made regarding the account of the suppliers.*
- (ix) *As regards stock in the hand of third parties such as agents, consignees, etc., a certificate showing the details of quantities and their values should be obtained from the agents or consignees.*
- (x) *As regards stocks in transit, it should be seen that these are duly received subsequently and have been entered into the “Goods Received Book ”.*

The auditor should compare the total value of the stocks on hand with that of the previous year. In case values differ materially, reasons for the same should be ascertained. Where stocks held are larger than those held in the previous year, it might be due to large holding of slow- moving stocks, absolute or stocking for future in anticipation of rise in prices. As already suggested, ***the auditor should also compare the percentage of gross profits to turnover with that of the previous year and obtain reasons for fluctuations, if material.***

15. Verification of works in progress - In industrial concerns, at any time in addition to raw materials and finished goods, there would also be unfinished goods or goods in the process of manufacture. At the time of periodical stocktaking, it is necessary that the quantity of un-finished goods and works in progress should also be verified and their value included in the total of stocks on hand. The verification of the physical existence and value of un-finished goods and works in progress, present a number of difficulties and special methods are required to be adopted for their verification and correct valuation. The method adopted for verification and correct valuation. The method adopted for verification would depend upon the type of the goods produced and the manufacturing process and no uniform method can be recommended for their verification. The stage upto, which the goods are manufactured or works are in progress, should give an indication of their valuation. In case of manufactured goods, the additional cost required for completion of the manufacturing process can be ascertained and the value of the un-finished goods or goods under process can be calculated by deducting these accounts from the cost of production. Where the principle of standard cost or may other method is adopted for calculating the cost of production, it should be seen that the totals of the stock sheets agree with the balances in the standard cost accounts. Where the item of works in progress appear in the balance sheet, it should be ensured that the amounts shown represent only cost of material and labour. Only a reasonable proportion of the factory on cost may be allowed to be debited. The administrative on cost should not be allowed to be added.

16. Stock valuation certificate to be obtained from management- A certificate in the form given below should invariably be obtained from the management of the society, with such modification considering the nature of business of society.

.....society, Ltd.

Date.....

To,
The Auditor ,

Dear Sir,

We hereby certify that, the inventory as at the close of March 31, 20 , summarized as follows :-

	Value Rs.	Mode of valuation
(a) Stock in Trade , i.e., goods purchases for resale.		
(b) Raw materials ..		
(c) Work –in - progress including semi- finished goods, goods in process, etc		
(d) Finished goods		
(e) Stores and spare parts		
(f) Loose tools		
(g) Others		
Total		

The stock taking, was taken under the supervision of responsible persons and certify that :-

- (i.) The inventory is the property of the society and that there is no mortgage, assignment or other lien upon any of the goods listed. (If there is any charge, the same may be stated).
- (i) No goods received on consignment have been included.
- (ii) The quantities listed were on hand and were determined by actual count, weight or measurement.
- (iii) Excesses /shortages between the physical inventories and book balances amount to Rs. have been adjusted in the books of accounts.
- (iv) the liability for all goods included in the inventory has been taken up in the book, and
- (v) absolute or unusable goods have been reduced to their net realisable value.
- (vi) We further certify that, the stock is at its fair and true value as per our accepted accounting policies, and there is no change in accosting policy, during this financial year. (If there is change shall be indicated with the effect on profit and loss account)

Yours faithfully,
(Sd)

The above certificate should be signed by the Chief Engineer, Works Manager, Factory Manager or other Technical Officer–in-charge of the Manufacturing operations and also by the Managing Director, Secretary or other Principal Executive Officer of the society.

17. Sundry debtors – A very important item appearing on the assets side of the balance sheet of almost all types of societies is “loans outstanding” or “Sundry Debtors”. In case of co-operative banks and credit societies, the item of “loans and advances” or “loans due members” is perhaps the most important item on the assets side. In case of consumers societies, marketing societies and other societies conducting trading activities there would be sundry debtors for credit sales. Advance payments might have been made or deposits kept with suppliers against purchases or orders for supply of materials or services to be rendered. There would also be advances made to directors and employees to meet expenses for buying materials or against. The amounts shown under “Sundry Debtors” should include all amounts due in respect of goods sold on credit, services rendered or in respect of other contractual obligations, but should not include any amounts which are in the nature of loans or advances which should be shown under the separate heading of “loans and advances” or “loans due from members”. The auditor should obtain confirmations for the balances with the debtors. Sundry debtors includes following items, auditor should take care while auditing these items as described in following paragraphs.

RBI DIRECTIVES BDD: *The reserve bank of India and Nabard have issued various guidelines in regards bad and doubtful amounts to be calculated, for the purpose of providing them, are explained elsewhere.*

18. Outstanding advances – This item is ordinarily included in “Sundry Debtors” but many times, it is shown under a separate heading and is mostly composed of advance made to directors and employees, which are yet to be accounted for. Advances should have been made only **for specific purpose** and the director or employee to whom the advance is given should be asked to **render accounts as soon as the purpose for which the advance has been given, has been served**. Thus, if advances are made for making purchases or for meeting traveling expenses and other expenses, the advances should be cleared immediately the purchases are made or the officer or employee returns to headquarter. Advances have been made or deposits kept with suppliers against order, the advance paid should have been adjusted in the invoice or deducted from the total amount of the bill. If these procedures are followed, then, as at the end of the year, only temporary advances granted recently for specific purposes, should be outstanding and the amounts adjusted early during the following period. **However, in many of the societies, some of the directors, employees and officers, taking advantage of their position, obtain large amounts as advances under some pretext or other, keep the amounts with themselves for long periods and subsequently refund the advances in cash either in one lump sum or in installments as it suits them. The auditor should make a note of all such cases and obtain explanation of the management and also of the director or officer concerned and if the explanation given or the clarification furnished is not considered satisfactory, should not hesitate to include such payments in his schedule of irregular payments. If the amounts involved are large and no satisfactory explanation is forthcoming, a case of temporary misappropriation should also be made out. In all cases, the purposes for which the advances have been made, should be ascertained and if it appears that the sole purpose of granting the advances was merely to accommodate the director or officer, proceedings under section 88 of the Maharashtra Co-operative Societies Act should be instituted.**

(a) **Checking of outstanding advances**- all items outstanding at the close of the year should be carefully examined and it should be seen that the advances have not been outstanding for long periods and have been granted for specific purposes. As regards advances made to contractors against construction work and supplies of materials, these

have been dealt with already. These advances are generally shown under the heading “ Building account ” or “ Construction account ”.

A statement showing particulars of the various items appearing under the heading “ Sundry Debtors ”, “ Advances outstanding ”, etc., should be obtained and agreed with the figure appearing in the balance sheet. Trade debtors i.e. Sundry Debtors for credit sales should be distinguished from other debtors such as debtors for advances, deposits against orders or advance against purchases advances to directors and officers. Schedules of different types of advances of outstanding at the close of the year should be obtained and checked with the personal ledgers and other records and the total agreed with the amount shown against the items in the balance sheet. In case of trade debtors, it should be seen that the control accounts are maintained up-to-date and reconciled with the totals of the personal ledger balance at regular intervals. Where there are a large number of ledgers, there should be suitable sectional control accounts in the general ledger. Statements of accounts should be sent regularly to all debtors and other customers who have regular dealing with the society. Differences reported by them and the manner in which they have been dealt with should be ascertained. Items under dispute should receive particular attention.

While checking ledger balance on the schedule, notes should be made showing the period during which the debt or other debit balance has been outstanding, Whether it has been subsequently recovered and if not, why it has been allowed to remain outstanding and whether any action has been taken for its recovery. Any other information, which will enable the auditor to judge whether the debt appears to be good and recoverable, should also be collected. A list of all accounts, which are overdue, should be prepared and checked by the auditor.

(C) Deposits with suppliers – As regards deposits with suppliers or for services, it should be seen that, these are of a normal character, such as deposit for telephone connection, security deposit with Municipality, Electricity Board or other local authorities or corporate bodies and recognized wholesalers and distributors. Receipts issued by them should be seen and periodical confirmations should also be obtained as evidence of the deposit till continuing with them. It should be seen that such deposits when they are made are carried as assets in the balance sheet and not written of as “ telephone charges ”, “ Municipal taxes ” or “ Electricity charges ”, etc. Where deposits of a special character or of a substantial amount are made, such as advance payment of taxes, advance payment of deposit for water connection, electric installation, income tax and other taxes, etc. these should be verified according to the circumstances of particular case and their adjustment watched.

(D) For obtaining confirmations from the sundry debtors the auditor should call the details of outstanding balance from the society and communicate it to the concern debtors, asking him to confirm the balance shown in the letter and if he disagree with the balance shown ,in letter sent account abstract for reconciling the balance at the society level. The format of letter is as-

(Letter calling confirmations from sundry debtors./ creditor, suppliers, advances etc.)

From : Name of the auditor and address, date

To, the concern debtor, address

sir,

We are auditing the accounts of the ----- society, ltd. -----
 ---- Taluka- ----- District, for the period from dated----- to dated----- as a statutory auditor. The society has shown following balances with you, in its account books, you are request to please confirm the balances shown below, are agreed with your books of account on the date 31/3/ . If your books does not agree with these balances,

please sent us account abstract as per your books, so that the balance can be reconciled with the books of society.

Sr. No.	name of the account	narration of amount	balance Dr. or Cr.	Amount shown by the society	Remarks if any

You are also requested, to sent this confirmation or account abstract as the case may within a period of 10 days, from the receipt of this letter, so that we can take necessary notes, in our audit report, if we have not received with this period we will presume that, the balances are agree with the books maintained by you in your account books.

sincerely your

signature and name of the auditor signing

19.Loans outstanding – Loans outstanding in co-operative societies except those doing banking business, are generally fixed loans repayable in one lump sum or in installments specified in the loan bond or agreement . Loans advanced to members would be different according to the nature of the business operations conducted by the society and the nature of security, which the borrower can offer. the method of checking loans outstanding is described in the following paragraphs :-

Lists of loans and advances outstanding on the date of the balance sheet should be obtained and checked with the loan ledgers and the total of the list of balance should be agreed with the balance appearing in the control account in the General Ledger . While checking loan balances , the following points should be seen.

(i) **Amount outstanding** - The outstanding balance in any account should not exceed the maximum limits for individual loans, if any, prescribed for different types of loans in the by-laws. Where special loans or loans in excess of the prescribed limits have been sanctioned to any individual or institution, authority for the same should be seen. For the cooperative banks the Reserve Bank of India and NABARD (national Bank) has prescribed certain limits to be advanced to the individual, group of individuals, and industries, it should be seen that these exposure norms are followed by them.

The period for which the balance has been outstanding – If the loan has become overdue, whether extensions have been granted properly. If the period of payment has not been extended, how long the loan has been overdue and what steps have been taken for its recovery. Whether notices have been promptly issued and legal proceedings instituted.

The make up of the balance – It will have to be seen whether the balance consists of only advances made or also includes interest capitalized and amounts debited to the party on account of charges and expenses incurred such as godown rent, insurance charges etc. Legal expenses incurred for recovery, such as notice fees, court-fees, lawyer's fees, arbitration fees and expenses etc., will have also to be debited and included in the balances except the cooperative banks as they have to show these expenses separately under the heading "sundries" as per guidelines of the Reserve Bank.

Security for the loan – The nature of the security and whether it is adequate and easily realisable. If the loan has been sanctioned against personal security; whether the sureties are alive and good for the amount; if secured by other security, whether the value of the security adequately covers the outstanding balance and also interest accrued and accruing; whether it can be easily realised should occasion arise; it should also be seen that a condition is incorporated in the agreement where-under the borrower undertakes to make up the margin in case the security becomes inadequate owing to price fluctuations.

Whether there are any other circumstances, which indicate the debts becoming irrecoverable, such as death or resignation or removal from service of the borrower or his sureties, insolvency of the borrower, attachment of his property or salary under an order or decree of a civil court.

Where the loan is repayable in installments, whether all the previous installments have been promptly paid as and when they become due.

Loans to committee members – Sub-section (2) of section 75, lays down that at every annual general meeting of the society, the committee shall lay before the society a statement showing the details of the loans (if any) given any of the members of the committee or any member of the family of any committee member, including a society or firm or company of which such member or members of his family is a member, partner, or director (as defined in the explanation 1 to clause 2 of section 75 of the Act, family in this explanation includes wife, husband, father, mother, brother, sister, son, daughter, son-in-law, daughter-in-law) during the last preceding year. Thus, along with the balance sheet and the profit and loss account, a list of loans given to members of the committee and their family members with their involvement as directing or member concern, has to be laid before the annual general meeting. This would ensure that the members of the committee taking advantage of their position do not appropriate large funds of the society by sanctioning to themselves disproportionate loans.

20.(a) Confirmation of Debit balance (SA 505 – External confirmation) – The outstanding balance in Sundry Debtors Account should be checked with whatever evidence is available, viz. statement of accounts, record of payments, confirmation letters issued, balance confirmation letters received, etc. Confirmation of balance by direct communication with debtors will have to be carried out where the number of debtors is small and the outstanding amounts are large, however, it may not be possible where the number of debtors is very large. In such cases, direct communication with selected debtors with balances exceeding a specified amount will have to be made. Such confirmation of ledger balances may be positive under which method, the debtors is communicated the exact balance in his account and asked to confirm the same or point out discrepancies, if any. The confirmation may also take the negative form when the debtors in further informed that if no reply is received from him within the period specified in the letter, the balance would be taken as being correct. Where the number of accounts is very large and the balance involved is small, the negative method of securing confirmation of ledger balances may be adopted. However, where the outstanding balances or where the auditor suspects the correctness of the accounts, it would be advisable for the auditor to send the debtor a statement of his account with the society and request him to communicate the discrepancies, if any. Where passbooks are issued to members, and other constituents, who have dealings with the society, these should be called for and returned to the constituents duly filled in with a request to check their accounts and confirm the outstanding balances.

(b) **Issue of statement of accounts** – In central co-operative banks and urban banks, urban credit societies, rural credit societies, and salary earners societies the borrowers, are issued passbooks or periodical statements of accounts are issued to them, monthly, fortnightly, weekly and in some cases, even daily. At the end of each accounting period, the closing balances in their accounts are communicated to them and they are requested to verify their accounts and confirm the correctness of the balances. The negative form of getting balance confirmation is generally adopted and the borrowers are informed that if they do not reply or make further enquiries before a specified date or within a specified period from the receipt of the communication, it would be presumed that they have accepted the correctness of the balance as communicated to them. In all cases, however, irrespective of whether confirmations have been obtained or not, the system of follow-up of receivables, collection of debts and action taken against defaulters should be carefully examined.

(c) **Verification of Members Pass Books** – In agricultural credit societies and other rural societies and also the smaller urban credit societies, outstanding balance should be verified with the members' pass-books. This is necessary since members of these societies are illiterate or and trusting people and have full faith in the honesty and integrity of the secretary and other office bearers. They do not always try to check whether their transactions with the society have been correctly recorded or not. During the course of audit of these societies, the auditor should try to contact as many members as possible and check their passbooks. Also, by putting intelligent questions, he should try to satisfy himself that their transactions with the society have been correctly recorded. A list of members whose accounts have been verified, should be prepared and their signatures should be obtained against their names for having accepted the correctness of the balances shown against them. A Members' Verification Register should be maintained in the form prescribed by the Registrar. This Register should be seen by the auditor during the course of his audit and a note made of members whose accounts have not been verified during the course of the last three years. Instruction contained in Registrar's Circular No.ADT/243, dated 9-5-1972 should be noted. for this purpose the auditor should obtain the confirmation from the members as well as depositor in the following form

Sr. No.	name of the lonee/ depositor	Amount outstanding as on 31/3/				signature of member/ depositor
		type of deposits		type of loans		

Before me

auditors signature and date

(d) **Issue of account slips in salary earners societies** – In salary earners societies, in addition to pass books, slips containing particulars of amounts to be recovered from the members on account of dues of the society under various heads, are also issued so as to enable members to know beforehand what amounts would be deducted from their salaries on account of the dues of their society. These account slips or extracts from deduction sheets are generally distributed through the departments or sections in which the members are working. A certificate from the head of the department or section to the effect that the account slips have been duly distributed should be obtained and filed along with copies of the monthly recovery sheets.

(e) **Confirmation of accounts in Banks** – In central banks and urban banks, confirmation letters should be sent to all borrowers who have been sanctioned fixed loans, cash credits or overdrafts. The auditor, during the course of his audit, checks exhaustively confirmation slips received back from the borrowers. The system followed for issue of confirmation letters and securing confirmation of balance by the bank should be ascertained and it should be seen that confirmation letters have been sent to all borrower in respect of borrowers who have failed to return the confirmation slips issued to them, enquiries should be made to ascertain whether their non-compliance is due to any dispute with the society about the correctness of the balance or about any of the items debited to their accounts.

(f) The auditor may call the confirmation from the banks for there balances shown in societies account books by sending letter, however the banks some time not responds to the letter of auditor, in such cases, the auditor shall request to the society, to call such confirmations and account abstracts. The format of letter shall be as-

(Letter calling confirmations from the banks.)

From : Name of the auditor and address, date

To, the concern bank, address

sir,

We are auditing the accounts of the ----- society, ltd. -----
 ---- Taluka- ----- District, for the period from dated----- to dated----- as a statutory auditor. The society has shown following balances with you, in its account books, you are requested to please confirm the balances shown below, are agreed with your books of account on the date 31/3/. If your books does not agree with these balances, please sent us account abstract as per your books, so that the balance can be reconciled with the books of society.

Sr. No.	name of the account	narration of amount	balance Dr. or Cr.	Amount shown by the society	Remarks if any

You are also requested, to sent this confirmation or account abstract as the case may within a period of 10 days, from the receipt of this letter, so that we can take necessary notes, in our audit report, if we have not received with this period we will presume that, the balances are agree with the books maintained by you in your account books.

sincerely your

signature and name of the auditor signing

21.Examination loans outstanding – (a) Assessment and treatment of doubtful and bad debts – It is necessary that the balance sheet and the profit and loss account of the society checked and certified by the auditor should disclose fairly and accurately, the financial position of the society during the period covered by the audit. It is, therefore, an important duty of the auditor to examine the balance sheet very carefully and see that all the assets, which are shown in the books , appear at their proper value that they exist in fact and that

no asset has been disposed of or charged in any way without the transaction being recorded in the books of the societies. Sub-clause (iv) of clause (6) of Rule 69 of the Maharashtra Co-operative Societies Rules, provided that the audit memo shall contain a schedule with full particulars of any money or property belonging to the society which appears to the auditor to be bad or doubtful debt.

In agricultural credit societies, central banks, urban banks, salary earners societies and other institutions whose main activity is dispensing credit loans outstanding forms a major portion of the assets. As already stated, examination of debts is one of the most important duties of the auditor. Outstanding loans and advances in banks and credit societies consist of current dues and overdues. ***An overdue account is an account in which the principal outstanding or any portion thereof or any installment, which has become due has been defaulted.*** Overdues are further required to be classified by the auditor in good, doubtful and bad. Examination of overdue debts is a special responsibility of the auditor under sub-section (2) (i) of section 81, which defines the duties of the auditor.

A bad debt is a debt which is considered to be irrecoverable. Such a debt will have to be written off against the Bad Debts Fund or any other reserve or even share capital since it has been ascertained and ***reckoned as bad debt after all possible methods of recovery have been tried and proved futile.*** A doubtful debt is one, the recovery of which in whole or in part, is uncertain. All such debts should be carefully examined and financial prudence requires that adequate provisions should be made against such debts.

(b) classification of debts into bad and doubtful.- to classify a debt as bad or doubtful, ***the two main considerations are security for the debt and the period for which the debt has been defaulted.*** If the security for the loan is reduced to nil and the loan has been outstanding for a fairly long period, there is every chance of the debt turning out bad. However, if the security has been impaired, debt outstanding has been overdue for a period, which is not considered too long, the debt may be termed “doubtful” and classified as such. It, therefore, becomes necessary to examine the security behind the loan and the period for which the loan has been overdue in order to determine whether a particular debt should be classed as doubtful or as bad.

(b) security for loans.- The security for loans in **agricultural credit societies** falls under one or more of the following categories:-

(i) Personal security of the borrower and sureties. Generally two sureties are taken.

(ii) Charge against crops, vide section 47 of the Maharashtra Co-operative Societies Act. However, this charge is difficult to enforce since once the crops are harvested and come out of the field, it is difficult to establish that they were raised out of the loan made by the society.

(iii) Charges against lands by way of declarations made under section 48 of the Maharashtra Co-operative Societies Act. This is the most common form of security for crop loans and if the value of the lands declared is sufficient, no other security is insisted upon. Sureties are taken only when the value of the lands declared is considered insufficient or the lands held are not owned by the borrowing member but are held by him as tenant.

In **urban banks and societies**, the security takes the form of tangible, immovable or moveable property held by the borrowing member although in a very large number of cases of small loans, the security obtained is personal security of the borrower and one or more sureties, generally two. Immoveable property is got ***mortgaged*** to the society while loans against goods may be either against pledge of the goods or mere hypothecation in which case possession of the goods remains with the borrower. In **salary earners**

societies, the security behind the loan is the undertaking given by the employer to deduct and pay over to the society dues of the salary of the member against authority given by him. *It is however, cleared that the section 49 (2) specifically states that the undertaking from the employer is not necessary when, the agreement is executed by the member and society, providing to deduct his loan borrowed from the society from his salary.* The employee is bound to deduct when he receive a copy of agreement and demand from the society for requesting deduction from the society of his member, who is employee.

The nature and extent of the security available will have to be carefully examined before classifying a debt as doubtful or bad.

The period for which the loan has been defaulted, is another important factor for determining whether the debt should be classified as doubtful or bad. For this purpose, *the correct age of an overdue loan will have to be ascertained by ignoring book adjustments and unauthorized extensions.*

CHARGE FOR COMPANIES- If in case society finance loans to the companies registered under Companies Act, the provision under section 125 of that Act, specifies that, the financing society shall register the charge of the loans advanced to the company and the assets mortgaged for the same, within stipulated time limit. Generally companies are financed by the cooperative banks, the auditor shall see that, in such cases the society has registered the charge with the Company Registrar with time. The auditor should study the provisions of Companies Act in this regards.

22..Procedure for classification of debts- Examination of overdue debts is a special responsibility of the auditor under sub-section (2) (i) of section 81, which defines the duties of the auditor. *A list of overdues with full particulars regarding age, security, action taken for recovery etc., should be obtained by the auditor before he proceeds to examine and classify them into good, doubtful and bad.* This list should be carefully examined by the auditor with special reference to security available and of the overdue . Any delay in referring to arbitration under Section 91 of the Act, cases of defaulters and in sending awards obtained, for execution should be enquired into. After a careful scrutiny of all overdue accounts in the above manner, the auditor should proceed to classify the overdues into good, doubtful and bad, in accordance with the instruction contained in the Registrar's circular referred to above. The information should be obtained in the following proforma for the purpose of certification of bad debts, for agriculture credit societies .

Column No.	Particulars of the column	Details
1	Loan account number	
2	Name of the member	
3	Amount of loan advanced	
4	Amount outstanding	
5	Of which overdue	
6	Period for which it is overdue	
7	Nature of security	
8	Amount considered Doubtful	
9	Amount considered as bad	
10	Reason for doing so.	

To facilitate the assessment of doubtful and bad debts by the auditors, it is necessary that all the account books and registers should be written up-to-date. In agricultural credit societies, it is necessary that the assets or “ Haisiyat Register (or Jindagi Register) ” should be maintained up-to-date and verified by the Bank Inspector or other responsible officer of the Bank or the Department at regular intervals. In urban banks

and societies, it is necessary that the Members' credit worthiness and surety liability. Register should be maintained up-to-date. All societies are required to maintain "Arbitration Register".

Nabard (National bank) has issued master circular and various circulars in respect of primary agricultural societies for assessing, classification and Provisioning of the bad and doubtful debts (IRC or prudential norms), which are explained elsewhere. The auditor should obtain soft copies of these circulars from website of NABARD. (www.nabard.org) In central banks, periodical financial statements and stock statements obtained from the borrowing societies should have been filed properly and the Advances Register and Ledgers should be posted up-to-date. Agricultural credit societies are required to furnish fortnightly recovery statements during the recovery season and it the duty of the officers of the bank to scrutinize them and take prompt action to pull up the societies, which show slackness in effective recoveries.

Worksheet for estimating the bad and doubtful debts at **Central Banks for the purpose of writing off.**

Column No.	Particulars of the column	Details
1	Sr. No.	
2	Name of the society	
3	Date of financial particulars	
4	Total loans outstanding against the members	
5	Total loans of which overdue for more than 1 years (against column 4)	
6	Book value of assets	
7	Erosion the value of assets (bad debts / assets 100%)	
8	Erosion the value of assets (doubtful debts / assets 10%)	
9	Total (column 7+8)	
10	Realisable value of the Assets (column 6 - 9)	
11	Outstanding liabilities a) Borrowing outstanding from the bank	
12	b) of which overdue for more than one year	
13	c) Interest payable to the bank	
14	d) of which overdue	
15	e) Borrowing from the Government	
16	f) Other borrowing if any	
17	g) Other outside liabilities	
18	Total (column 11+13+15+16+17)	
19	Amount considered as Bad	

{Notes: (1) Particulars in this statement may filled in the from the audit reports of the societies.

(2) The financial particulars may relate to the last day of the cooperative year for which the latest audit report is available.

(3) the banks dues from the society may be considered irrecoverable if the same are not covered by good loans outstanding from members of the society or the realisable value of assets of the society is not sufficient to meet its outside liabilities. The extent of erosion of the dues to the central bank will be determined after taking into account the dues to the government, and specific charge created on any of the stock or other assets by way of hypothecation, mortgage or otherwise and appropriating the balance of the realisable assets on prorata basis among all the creditors having a like claim. }

Nabard (National bank) has issued master circular and various circular in respect of District Central Cooperative Banks for assessing , classification and Provisioning of the bad and doubtful debts (IRC or prudential norms) , which are explained elsewhere.

23.(a) Procedure for writing off of bad debts – Under provisions of Rule 49 of the Maharashtra Co-operative Societies Rules, no loss or other outstanding dues found to be irrecoverable can be written off unless it has been certified as irrecoverable by the auditor. The Rule lays down that all loans including interest thereon and recovery charges in respect thereof, which are found to be irrecoverable and certified as bad debts by the auditor appointed under Section 81 of the Act, shall *first be written off against the Bad Debt Fund and the balance, if any may be written off against the Reserve Fund and the share capital of the society* . The rule further lays down that all other dues and accumulated losses or any other loss sustained by the society, which cannot be recovered and have been certified as irrecoverable by the auditor, may be written off against the reserve fund or share capital of the society.

(b) Auditor's responsibility for certifying bad debts- It will thus be seen that before any loss incurred by the society can be written off, it has to be certified as bad or irrevocable by the auditor. The auditor thus assumes a **great responsibility** as all amounts certified by him as bad will be written off and no indication of the existence of the debt or other outstanding would be available once the debt is written off. **The auditor has, therefore, to be very careful before he certifies a debt or loss as bad and irrecoverable .**

The Cooperative Tribunal has held that for instituting proceedings under Section 88 of the Maharashtra Cooperative Societies Act, it is, not necessary that the debt outstanding should be written off. It is sufficient to show that due steps were taken to recover the dues, but they could not be recovered. It is, therefore, desirable to classify a debt as doubtful and continue to show it in the accounts rather than writing it off, unless the auditor has satisfied himself that all remedies for recovery of the debt or loss have been taken including proceedings under section 88 for reimbursement of losses were taken. in case of irrecoverable loans, it has to be seen that cases of the defaulters were referred to arbitration or negligence on the part of the committee, proceedings should have been instituted against persons found to be negligent. Byelaws of co-operative societies specifically lay down that it is the duty of the committee to consider the overdues and take prompt steps to recover dues and overdues.

As regards losses which are to be written off it should be seen that these are genuine trade losses incurred during the normal course of the business of the society and that they are not the result of any activity taken up by the committee which is not permitted under the byelaws.

(c) Additional conditions to be fulfilled for writing off bad debts.-Under provision below Rule 49, the following additional conditions are required to be fulfilled, before any bad debts or losses can be written off:-

- (1) Prior approval of the general body should have been obtained.
- (2) Prior approval in writing of the Registrar and the Central Bank to which the society is indebted should have been obtained. If the society is not affiliated to the central bank or is affiliated but is not indebted to the central bank, prior approval of the Registrar should be obtained.
- (3) In case of central banks, prior approval of the state co-operative bank and the registrar has to be obtained.

While giving approval, the registrar may impose such conditions as to writing off and the recoupment of the Bad Debt Fund ” and restoration for partly or whole of the amount written off against the Reserve Fund from out of future profits as he may deem fit.

Societies classified as “ A ” or “ B ” at the time of their last audit, however, enjoys a special privilege. The Rule permits them to write off bad debts and losses from out of the Bad Debt Fund specially created for the purpose without seeking permission of the Registrar or the central bank. However, the other requirements, viz., sanction of the general body and certification of the auditor must be complied with. Thus in all cases, the auditor is the authority to decide whether the debt or loss is irrecoverable.

(c) **Provision to be made for doubtful and bad debts-** Under section 65(1) and rule 49 (A) of the Act, before arriving at the figure of net profit, adequate provision is require to be made for all amounts required to be written of as bad debts and losses which cannot be adjusted against any fund created out of profits. Thus, a fair estimate of the likely bad debts has to be made every year and necessary provision made for writing them off. **However, no bad debt can be written off against current profits and before writing off any debt as bad, the procedure laid down in Rule 49 has to be followed.** Where bad debts or losses cannot be ascertained exactly, necessary contribution based on estimates should be made in the Bad Debt Fund, which should be charged to the profits. If there are excess profits after payment of dividend at a fair rate and making other appropriations, the remaining profits may be carried to the Bad Debts Fund.

(d) **Certificate for writing of bad debts:** The auditor is required to give certificate for writing of the bad debts. The certificate should be the following format.

“ This to certify that, I have examined the enclosed list of overdues and losses provided by the society for the purpose of writing of them. And I certify that,

- 1) I have examined the enclosed list provided by the society and satisfied that the necessary steps for recovery has been taken by the society, and that are to the satisfaction of me to prove that the loans / losses are irrecoverable.
- 2) The losses are for business are business losses of the society, and are not due to negligent of the management of the society.
- 3) That the society has obtained necessary prior approval from the General body of the society, vide resolution No. dated
- 4) That the society has made necessary provision of Bad and Doubtful fund to write off these losses.
- 5) The society is in “ A /B/ C/ D “ audit class in the last audit.
- 6) The amount certified as Bad is Rs.....(Inwards Rs.....) against the Bad debts fund Rs.....

Date

Sd/-

Place:

Auditor

24.Prepaid expenses- These should be verified from the bills received and payments made subsequently. Where the expenses, such at rent, rates, taxes etc. are payable on time basis proportion of the payment which relate to the period subsequent to the date of the accounts, should be calculated and shown under the heading “ prepaid expenses ”. The usual payments of such type are for insurance prima paid in advance, municipal taxes, motor vehicle taxes, membership fees, subscriptions etc.

25.Deferred Revenue Expenditure – As we have seen, there are certain items of expenditure, which are primarily of a revenue nature, but the benefit of the same in not exhausted during the period covered by the profit and loss account and not required to be capitalised. Such expenditure termed “deferred revenue expenditure ”may be carried forward and written off within the period during which the benefit arising from it is likely to be felt, so as to avoid an unduly heavy charge being made against the profits in year. Examples of such expenditure are alteration to plant, heavy repairs to buildings, plant and

machinery, painting of buildings, abnormally heavy expenditure over advertisement etc. Preliminary expenses incurred by the society prior to commencement of its activities have been dealt in the following paragraph. Even after the society has commenced its activities, there will be expenses of the nature explained above which will have to be treated as deferred expenses and written off, during the course of the following years. Thus, where a new wing is added to the factory building, the cost of the expansion of the building should be capitalized, but where only repairs and alteration have been carried out, the expenditure should be treated as deferred revenue expenditure. Other expenses, which are generally allowed to be treated revenue have been given above. Where deferred revenue expenditure appears to have been shown in the balance sheet, it should be seen that amount carried forward is reasonable. Reasons for not charging the entire amount to the profit and loss account of the year should be ascertained and only such proportion of the expenditure incurred, which reasonably pertains to a subsequent period, or where the benefits accrued from the expenditure would be felt during the coming years, should be allowed to be shown as deferred revenue expenditure.

26. Investment amortization: The urban banks and District Central banks are permitted to trade in Government securities transactions, the securities purchased by these banks are many times to be purchased at the market rate, which is much above of the face value of the security. The excess value paid for the securities, if not sold the excess amount of face value is treated as deferred revenue as it is not realisable. The banks should be required to debit this amount to the investment amortization account, and should be written off in the remaining life of the security till maturity.

27. Fictitious assets – Besides the above assets, there are also certain assets, which sometimes appear in the balance sheet. These may be fictitious assets, which in fact, are capital expenditure which may not have resulted in identifiable profit earning assets and which still remains to be written off. The usual examples of fictitious assets are preliminary expenditure or formation expenditure development expenses, expenditure incurred other than experiment and research etc. Where debentures are issued, commission and discount on issue of debentures will also be fictitious assets. The auditor should check the balance carried forward from year to year and ascertain the reasons for their continuance.

28. Accounting Standard AS 8 : Research and development: a) Generally the research and development activity is not undertaken by the Cooperatives except such as Iffco, Kribhaco, etc., however, some sugar factories or spinning mill spends very less amount on research and development. Separate accounts are not maintained for the same. The cost of research and development includes, a) salaries, wages, other related costs of personnel engaged in research and development, costs of material and services consumed for it, depreciation of building, equipment and facilities which are used for this purpose, amortization of the cost of building, equipment and facilities used for this purpose, overhead costs related to R and D payments to outside bodies for R and D, and other related costs.

b) Criteria of R and D to deferred the expenses: The above cost of Research and development should be deferred if, the product or process is clearly defined and it is attributable to the product or process, the technical feasibility has been demonstrated, it is accepted to use the product by the management, the selling and administrative, and research and development cost will be covered from the future revenues. It should be deferred on scientific basis.

29. Preliminary expenses- The amount debited to preliminary expenditure account should be carefully scrutinized. Generally, every society has to incur some expenditure prior to its registration. The following expenses can be shown under the heading “ preliminary expenditure ”.

- (1) Printing of byelaws, (2) Printing of accounts forms and registers, (3) Stationary, (4) Postage, (5) Reasonable expenditure of promoters over convinces and miscellanies expenditure.

Along with the application for registration of a society, the promoters are required to submit a statement of preliminary expenses incurred by them. At the time of first audit, the auditor should check the statement and see that the expenditure incurred is reasonable. In the first general meeting of the society held after its registration, the promoters are required to present a statement of expenditure incurred by them up to a date not more than 14 days prior to the date of holding the first general meeting. In this statement, all money received from the promoters and other applicants for membership of the society are to be shown. The entire amount collected from the promoters by way of share capital and entrance fees (also contributions towards formation expenses recovered from prospective members, if any) are required to be credited into the Bank. The bank account is generally opened in the name of these promoters, one of who is styled as the “chief promoter”. No withdrawals are permitted from this account except with permission of the registering authority. In some of the societies, promoters collect contributions towards formation expense from prospective members. Promoters are required to furnish a statement of expenditure incurred by them along with the application for registration of the society. Promoters are also required to prepare statement of receipts and payments, which is required to be adopted by the members at their first general meeting. From the receipts and payments statement, the auditor is required to prepare a statement showing the amounts collected from members and also liabilities incurred by the promoters in the name of the society. This statement will be the basis for preparation of final accounts. As explained above, all expenditure incurred up to date of commencement of production activities, may be permitted to be capitalised in the case of societies which have undertaken manufacturing activities.

As regards other types of societies, certain expenditure incurred for organisation activities may have to be allowed to capitalise. Thus, for example, in case of consumers societies, all expenditure incurred for interior decoration and also over publicity and advertisement may be allowed to be capitalized.

Where considerable amounts have been borrowed and the interest is required to be paid, the interest paid on borrowed funds up to the date of commencement of the activities may also have to be allowed to capitalise.

Although in the above types of activities, preliminary expenses and other miscellaneous expenses incurred prior to commencement of activities, or even prior to registration of the society may be allowed to be capitalized, by correspondingly increasing the value of assets, it is not prudent to capitalise any expenditure which does not add to the value of the asset. Thus, expenditure incurred over outside painting and interior decoration, advertisement, publicity, etc., should be treated as deferred revenue expenditure and written off during the course of the next three to four years.

30. Debit balance of Profit and loss Account – If the results of the working of the society reveal the losses, the losses incurred, i.e. the debit balance in the profit and loss account, will have to be carried forward, unless it can be written off against accumulated profits or reserve fund or share capital, with the prior approval of the general body. Registrar and central financing agency, if indebted and affiliated, as per rule 49 of the Maharashtra Co-

operative Societies Rules, 1961. All future profits will have to be utilised first for utilising previous accumulated losses.

The debit balances of profit and loss account carried over from year to year will have to be shown on the assets side of the balance sheet until they are written off.

31. Verification of cash on hand and in Bank – (a) Counting of cash on hand: *Cash on hand should be counted on the date of the balance sheet in case of all important societies.* Since the audit is to be carried out up-to-date or till the end of the previous year, *cash on hand should be counted during the course of audit.* However, the cashbook from the date upto, which the accounts are audited, till the date of counting of the cash, should be examined carefully to ensure that the cash on hand is correctly arrived at. While physically verifying cash on hand, the entire cash balance including petty cash, cash in sales depots, cash in branches and other offices should be brought in one place and verified simultaneously. Regarding urban banks and DCC banks having more than one branches in one city, cash should be counted simultaneously. The institute of Chartered Accountants of India has suggested that cash should be verified by surprise check and particularly opening cash should be checked. This is necessary to prevent substitution cash balances.

The officer counting the cash on hand should obtain a summary of the cash counted by him (viz., denomination and number of currency notes and coins) and also offer remarks in cashbook about counting of cash such as

“ I have counted / verified the cash balance as per cashbook on / / amounting to Rs..... (Inwards Rs.....), produced by shri.....Cashier/Secretary/ Treasurer (or the designation of the officer handling cash as he has been authorized by the board), the same is ~~verified by me and~~ found correct as per cashbook, the same is in the custody of shri....., after verification, the denomination of the cash is detailed below.”

Denomination in Rs.	No.s	Amount Rs.
1000		
500		
100		
50		
20		
10		
5		
2		
1		
coins		

cash is in my custody after verification

verified by me

Cashier/Secretary/ Treasurer

Statutory auditor

Place: Date: / /

Time of counting:

The verifying officer should write denomination of the cash, date of verification, where the cash is of opening of the day or closing of business, place of counting and sign the cashbook.

The statement of cash counting obtained by the verifying officer should be signed by him and also the Manager or Managing Directors of the society and also by the auditor counting the cash. The cashbook should also be signed by the auditor mentioning the amount counted and the name of the officer of the society who presented the same and the

date on which the cash was counted. (Registrar's Circular No. ADM.243. Dated 16 September 1957 and 8th August 1959).

(b) Cash in Bank – Every society has a bank account. All co-operative societies are required to open their banking accounts with District Central Bank of the district. Societies in Greater Mumbai are required to have their accounts with the Maharashtra State Co-operative Bank or Mumbai District Central Bank. All cash in excess of the limit prescribed Rule 107-C or in the byelaws, has to be remitted into the Bank. Societies in the mofussil may also open an account with the Maharashtra State Co-operative Bank in addition to the District Central Co-operative Bank. However the society is required to keep its cash balance with DCCB or MSC having at least "A" class for last three consecutive years. Cash in Bank should be verified from the passbook, Bank statements and Bank balance certificates. If the balance does not agree it will be necessary to prepare a reconciliation statement. The bank reconciliation statements should be prepared at regular intervals by the cashier or other officers receiving the bank statements. These reconciliation statements should be checked and it should be seen that the bank balance agrees as per the Bank statement. *It is also necessary to obtain balance certificates from the bank in order to ensure correctness of the bank balance.* The auditor should himself write to the bank to furnish to him the balance certificate of all the accounts of the society with the Bank *the format of letter calling balance certificate is given in elsewhere.*

Items in the reconciliation statements on the date of the balance sheet should be traced during the following period. If there are any outstanding items, enquiries should be made.

(c) Opening of account and deposit of fund with other banks - Under clause (a) of Section 70, a co-operative society is required to deposit its funds with the District Central Co-operative Bank or the State Co-operative Bank having at least "A" class for last three consecutive years.. Under clause (d) (Newly inserted) of the Section, for deposit of funds in any co-operative bank or banking company, permitted by rules, or by general or special order in that behalf by the State Government, for this purpose. Rule 54 provides in this regard that, In case eligible bank not available as provided in clause (a) of section 70 for investment of funds in area of operation of the society, the society may invest its funds in a mode permitted by the rules, or by general or special order in that behalf by the state Government or in mode permitted by the authority authorised by the State Government in this behalf. Hence, prior permission of the authority has to be obtained for opening an account with an urban bank or a commercial bank if they are not in approved list. While granting permission to open an account with either of the co-operative bank or a commercial banks, the authority may also impose such conditions as he may deem proper, such as maximum amount, period for which deposit can be made etc. Auditors should see that prior permission of the authority to open an account and deposit funds with any bank other than the District Central Co-operative Bank and the State Co-operative Bank has been obtained and that the conditions laid down by the authority while granting the permission are duly observed. Under clause (e) of the section 70 the societies are permitted to invest their funds in any other mode permitted by the rules, or by general or special order of the State Government. The RBI/ registrar has restricted urban banks and urban credit societies; non-agricultural credit societies to deposit their funds in another urban bank. The Reserve Bank has also prohibited urban cooperative banks for investing their funds in the another cooperative urban banks vide its Circular No. UBD.BR. 43/ 16.20.00/ 2000-01 date 19th April,2001. They are allowed to invest only with strong scheduled Urban Cooperative Banks who complied with the following norms;

- a) The bank is complying with the prescribed level of CRAR
- b) Net NPA's of the bank is less than 7%

- c) The bank has not defaulted in the maintenance of CRR/SLR requirements for the last two years.
- d) The bank has declared net profits for the last three consecutive years.
- e) The bank has 'A' rating from Cooperative Auditors for the last three consecutive years
- f) The bank is complying with the prudential norms.
- g) The strong scheduled banks are also prescribed certain limit to accept the deposits from non-scheduled banks that are I) the deposits accepted should be within the limit of 10% of its total deposits ii) the rate of interest should be market related. iii) total deposit on any one non-scheduled bank should be to the limit of 20% of its capital funds.

Scheduled Urban cooperative banks should not place their deposits with other scheduled cooperative bank or non-scheduled cooperative bank.

Where the society have more than one account, the above procedure for checking the bank account should be followed and balance certificates should be obtained in respect of all bank account.

(d) Importance of verification of cash on hand- *In order to prevent misappropriations of cash balance, it is not only necessary to insist the cashbook is always written up-to-date, but also it is also necessary that satisfactory arrangements exist for independent verification of the cash balance.* At the close of business, a responsible officer should verify actual cash on hand and compare it with the balance shown in the cashbook. The Chairman in the case of primary agricultural societies and the Manager or the Managing Director in the case of the bigger societies should verify the cash on hand at the close of the day and sign the cashbook. The closing cash balance should be mentioned on figures as well as in words along with the name and designation of the person having custody thereof. In case of the larger societies, the cashbook should be signed by the cashier or Treasurer who has custody of the cash balance as well as the Managing Director, Manager, Secretary or other officer who has been specially **authorized** for the purpose.

It may also be mentioned that unless adequate and satisfactory arrangements have been made for the surprise checking of the cash on hand at frequent but irregular intervals, the cashier is apt to be tempted to misappropriate a portion of the cash balance, which he knows will not be normally required for the day-to-day business of the society. *The knowledge that somebody in authority might at any time demand production of the entire cash balance, generally keeps away the potential offender from committing misappropriation.*

(e) Precautions to be taken while counting cash- a number of precautions are required to be taken by verifying officers and auditors while verifying cash balance. If different cash balance are maintained, such as imprest cash with local branches and depots, cash of different sections of departments, etc., all the cash balance need to be called for simultaneously and verified, as there is always the danger of substitution.

In case of primary agricultural societies, which have group secretaries, there is also the likelihood of the cash balance of one society being utilised for making good the deficit of another society in-charge of the same Secretary. Similarly, when the same person happens to be the Chairman or Treasurer of a number of institutions and has with him the cash belonging to more than one institution, unless the cash balance of all the societies are simultaneously demanded for verification, there is always the likelihood of the deficit of the cash balance of one society being made good by drawing from the cash balance of another society.

In a number of societies, particularly, those which have been conducting fair price shops it is usual to find a large portion of the cash balance held in the form of coins which is difficult to count. When a large amount is held in the form of loose coins of different

denominations, a portion of it can always be misappropriated, since inspecting/ verifying officers and even office bearers of societies do not always have sufficient time and patience to carry out complete verification. However, if coins of different denominations are sorted out and kept in separate bags duly sealed and the bags are not to be opened except in the presence of responsible officers, this form of misappropriation can be prevented.

(c) ***Measures to be taken for preventing temporary misappropriation of cash*** – Temporary misappropriation can also be committed by deliberately delaying payment into bank, on the plea that remittance could not be sent before the close of the banking hours. One or two days taking can easily be misappropriated. Cash balance may also be misappropriated temporarily by taking wrong totals and / or by wrong extraction and carrying forward of cash balance. Where audit is not carried out up-to-date, the transactions for the intervening period (i.e. from date up to which audit has been carried out and the date on which cash has been actually counted) will have to be checked quite often in order to reduce the cash balance advances, shown to have been made to directors or staff. The reasons for payment of advances should be noted. It should be seen that advances made are genuine and for proper reasons.

It has also to be remembered that even though adequate and satisfactory arrangements are made for frequent verification of the cash on hand, the cashier and secretaries of some of the co-operative banks and societies are shrewd and influential persons. They can always find obliging friends who are willing to give I. O. Us. or even undated cheques which come handy whenever cash balance is to be produced for verification *To be effective, therefore cash verification should be a surprise to the cashier and the verification should catch him unaware.*

As already stated the easiest method for concealing shortage of cash and the one which is being commonly adopted is for the cashier to find excuses for not writing the cashbook up-to-date. Unless the cashbook is written up-to-date and the exact cash balance ascertained, counting of cash will have no meaning. It is therefore, necessary for verifying officers to see that the cashbook is always written up-to-date.

(d) ***Auditor's responsibility for verifying cash and hand*** – It may be mentioned that most of the frauds relating to the cash on hand have come to light only when the auditor visits the society and calls for the production of cash balance for his verification. ***Section 81 of the Maharashtra Co-operative Society Act specifically lays down that audit under the section includes the verification of the cash and securities of the society.*** In addition to the auditor, other inspection officers including co-operative officers and Assistant Registrars besides the Bank Inspectors can demand production of the cash on hand for verification. However, the general impression appears to be that it is only the duty of the auditor to count the cash during the course of his audit. The Registrar has issued very clear instructions in this respect in his circular. No. RSR-61 dated 30-10-1954. If all the inspecting officers make it a point to demand production of cash balance, at the time of their visits to the societies, there would be considerable fewer cases of misappropriation. The auditor should also obtain certificate in the following form regarding cash on hand on the date of the balance sheet.

“Certified that the cash balance mentioned on the balance sheet at 31st March 20. Represents cash on hand in the Head Office and all the branches, pay offices, depots and other offices of the society/bank situated at different centers in the area of operation of the society /bank and custody certificates in respect of all these cash balances have been obtained from the Manager /Accountant /Cashier /Agent, etc., of the branch, depot or other offices concerned”.

This certificate should be signed by the Chairman and the Managing Director or other principal executive officers of the society. The auditor should pass remarks regarding cash verification by him or by other authorities, in his audit report.

32. Arrangement and grouping of Assets in form “ N ” and disclosures – As regards display of the various items of assets in the balance sheet instruction contained in the marginal note in form “ N ” have been summaries below for the items wherever related. Corresponding figures at the end of the previous year are also required to be given. *Discloser required to be given as per this form are italicized in forgoing paragraphs.*

1. Cash and Bank balance

Fixed deposits and call deposits with central bank and other approved banks should be shown under the heading “ Investment ” and not under the heading “Cash and bank balances”.

2. Investment- Investment should be shown under the separate heads: -

The nature of each investment and the mode of valuation (cost or market value) should be mentioned. If the book value of any security is less than market value, a remark to that effect should be made, against each item.

Quoted and un-quoted securities should be shown separately.

III. - (1) Investment of staff provident Fund, (2) Advances against staff provident Fund.

3.- Loans and advance. -In case of Central Banks and other Federal societies, loans due by societies and individual members should be shown separately.

Loans and advances should be shown under heads mentioned in “N” form: -

Out of loans and advances outstanding following disclosure is required to be made

Of which overdues, Rs.....

(Amount overdue is required to be shown in the column for particulars by way of specific note).

The following amounts are also specifically shown in the column for particulars: -

Loans due by managing committee members Rs.....

Loans due by Secretary and other employees Rs.....

Note. - Sub-section (2) of section 75 provides as under: -

At every annual general meeting of a society, the committee shall lay before the society a statement showing the details of the loans (if any) given to any of the members of the committee or any member of family (as defined in the Explanation 1 to sub-section (2) of section 75) of any committee member (including a society or firm or company of which such member or members of his family is a member, partner or director, as the case may be) and the details of repayment of loan made , during the last preceding year and the amount outstanding at the end of the year. The family as per this clause includes, wife, husband, father, mother, brother, sister, son, daughter, son-in-law and daughter in law.

It should be seen that this requirement is complied with.

4. Current assets are to be shown under different heads: -

Mode of valuation of stock should be stated.

Amount in respect of raw materials, partly finished goods and stores required for consumption are required to be stated separately. Mode of valuation of work in progress has to be stated.

5.- Fixed Assets – Fixed assets should be shown under different heads: -

Under each head, the original cost and the additions thereto and deductions there from made during the year and the total depreciation written off or provided upto the end of the year should be stated.

VII –3 VERIFICATION AND VALUATION OF LIABILITIES

1. **Classification of liabilities – Owned capital and borrowed capital** – The liabilities of co-operative societies will be different according to the types of societies and the nature of activities undertaken by them. However, they are generally shown under the following heads in their balance sheets.

(1) Share capital (2) Statutory reserve (3) Other funds (4) Deposits from members and non-members (5) Borrowings secured and unsecured (6) Trade creditors, (7) Outstanding creditors and provisions.

All liabilities except capital and the statutory reserve fund and other funds built out of profit which constitute the owned funds of the society, are to be grouped under two heads –long term and current liabilities. **Long-term liabilities are those, which are not payable within a year. Current liabilities are those payable within a year.** Deduction of total current liabilities from the total of current assets would show the adequacy or otherwise of the resources available to the meeting its day-to-day needs. The excess of current assets over current liabilities is an extremely important figure, which would reveal the financial stability of the society and its disability to meet its day-to-day commitments arising during the course of its business.

(a) Share capital – State participation in the share capital of co-operative society – The authorised share capital of the society should be ascertained from the byelaws. It should be seen that, this is not exceeded. The authorised share capital can be increased by an amendment to byelaws. The auditor should advise the society to increase the authorised share capital whenever he finds that as a result of issue of new shares to new members and applicants for membership. The state has been participating in the share capital of a number of important cooperative institutions. Accordingly issue of a special class of shares redeemable preference share has been provided for in the byelaws of most of societies. Government contributes towards these preferential shares, which are issued to Government only. However, these share carry no special right to any fixed dividend and dividend at the rate declared by the society and payable to ordinary shareholder only is paid to Government on the shares held by it. Conditions regarding payment of dividend, redemption of the shares, creation of the Share Capital Redemption Fund, etc., are contained in the Government orders sanctioning the share capital contribution and it will be the duty of the society to see that these conditions, which have been accepted by the society.

Where there is no provision of preferential shares in the byelaws of the society, byelaws does not provide for authorised or paid up capital for state Government or any local body, the auditor should suggest to the society to modify its byelaws suitably and also bring this facts to the notice of the registering authority. Redeemable preference shares issued to Government are always fully paid of, although ordinary shares of the society might have been partly paid up.

Under section 55 of the act, in the event of the society of which shares are purchased by Government, is wound up, the liability of Government in respect of the share contributed by it is limited to the amount paid in respect of such shares. Shares issued to Government are “fully paid ”and hence the question of any further liability does not arise.

(b) Principal State Partnership Fund and subsidiary State Partnership Fund –These funds are required to be created and maintained by the Apex society (State Level Institutions) and the central society (Central Cooperative Banks and other central societies), respectively. Contributions to the Principal State Partnership Fund, received by the Apex society are to be utilised only for purchasing directly share other society or for contribution to the Subsidiary State Partnership Funds established by the Central societies

from out of which the central society has to purchase shares of primary societies affiliated to it. Section 50 provides maximum limit of 25% for holding the share capital in cooperative credit structure societies (includes primary agricultural societies, district central banks and state cooperative bank) to be held by the State Government. Under sub section (1) of Section 58, all moneys received by an apex society in respect of share purchased from out of the Principal State Partnership Fund on redemption of the shares or by way of dividend are otherwise required to be credited to that fund. Under sub section (2) of the section, all moneys received by the Central State Partnership Fund on redemption of such shares are by way of dividend or otherwise are in the first instance, to be credited to that fund and then transferred to the Apex Society for being credited by them to their Principal State Partnership Fund. Sub section (3) further provides that all moneys and dividends credited to the Principal State Partnership Funds specified above should be paid to the State Government irrespective of whether the shares stand in the name of the Apex Society or Central society. The State Government is not entitled to get any return on the above, as per clause (4) of section 58.

(c) Societies which receive Government share capital contribution – At present Government share capital contribution is provided to the following types of societies, under the various schemes approved by the Central and State Governments: -

- (1) Credit societies and service co-operatives (seva societies, formerly large sized and small sized multi-purpose societies).
- (2) District Central Co-operative Banks.
- (3) Maharashtra State Co-operative Bank, Maharashtra State Agricultural and Rural Development Bank, Maharashtra State Co-operative Housing Finance Society.
- (4) Maharashtra State Co-operative Marketing Federation, District Marketing societies and primary marketing societies.
- (5) Processing societies including sugar factories and spinning mills.
- (6) Fishery societies, poultry societies, piggery societies. Dairy Societies.
- (7) Co-operative Wholesale and retail stores and certain other primary consumers societies.
- (8) Industrial societies including labour contract societies and forest labourers societies.
- (9) Weavers societies.
- (10) Housing societies for backward classes.
- (11) Farming societies.

Share capital contribution in case of primary agricultural credit societies and District Central Banks is indirect whereas share capital contribution in case of all other societies is direct. As such, only the State Co-operative Bank and the District Central Co-operative Banks are required to maintain the principal and subsidiary State Partnership Funds, respectively.

A) Own Capital: Every Societies byelaw provides share capital contributed by the members of the society. The auditor should verify the schedule provided by the society, with the personal ledger balance and General ledger. The auditor should confirm that the balances are agreed with the balance shown in the General Ledger. The maximum limits for holding shares by any individual is prescribed in Section 28 of the Act, auditors should observe that is adhered to.

2.Valuation of Shares: The valuation of shares is required while refunding the share capital to the member after ceasing of his membership as per rule 23 of the Maharashtra Cooperative Societies Rules 1961 only if the society having limited liability for shares.

For the unlimited liability of shares the societies are required to refund the actual amount received by them.

In case of limited liability, the society shall refund the amount as it is arrived at by a valuation based on the financial position of the society as shown in the last audited balance sheet preceding the cessation of membership. The rule also provides further that, the amount so refund should not exceed the face value of share, though the valuation is more than the face value as per byelaws. In case of value less than the face value, then the amount refunded should be the less value, as it comes from the valuation.

The value required to be refunded, should be as per last audited balance sheet, thus, it means that the auditor should give the valuation in his audit report every year. The rule 23 provides the manner of valuation as dividing net worth of the society by number of shares the valuation of share should be arrived. Thus the auditor has to first calculate the net worth. net worth is also defined in the explanation under the rule as- ***“Net worth means paid-up share capital plus free reserves(Reserve fund, unutilized building fund, dividend equalization fund, carried forward balance net profit, any other fund which is not marked specifically for any liability) minus accumulated loss.”***

The accounting ~~concepts~~ standard provide for valuation of shares, as the ***net realisable value of the assets divided by the number of shares of paid up capital***. For arriving the net realisable value should be determined as under, by the auditor for the cooperative societies.

Sr. No.	Particulars	Amount
A	Own Funds	
1	Paid up share capital	
2	Statutory Reserve	
3	Building Fund	
4	Other Free Capital Reserves (created from appropriation of Net Profits)	
5	Profit of the current year	
6	Total (column 1 to 5)	
7	Minus Accumulated losses (if any)	
8	Net realizable value of Assets	
9	No of paid up shares	
10	Value per share (column 8 divided by column 9)	
11	Face value of per share	
12	Excess / decrease of value per share	

Notes: a) The revenue reserves created by charging profit and loss account should not be considered for valuation of share as they represents erosion in the value of the assets, such as depreciation fund, Bad and doubtful fund, investment fluctuation fund etc. however, excess provision may be considered by the auditor, for valuation. But the same should be disclosed in the audit report.

b) Funds like employees provident fund, gratuity fund should not be considered for the purpose of valuation.

c) Funds created for the specific purpose as per Byelaws out of appropriation of profit may be considered for valuation if they are not utilised for the same purpose.

d) The another method for valuation of shares would be on the basis of realisable value of the assets is described below. This also gives the ***net worth*** of the society.

Sr. No.	Particulars	Amount
1	Total assets	

a)	Liquid Assets	
b)	Current Assets	
c)	Fixed Assets (minus depreciation on them or if depreciation fund is created it should be subtracted from the assets)	
2	Total of Assets	
3	All receivables	
4	All payables	
5	Net of receivable and payables + or – (3-4)	
6	Net realisable assets (2-5) or net worth	
7	No. of shares (excluding Government share capital)	
8	Book value of the shares (6 divided by 7)	

Explanatory Notes: 1) The liquid assets should include the cash and bank balance, investment, which are realisable immediately, call deposits, and money at short call notice etc.

4) Current Assets: includes stocks, stock of printing stationary, vehicles, safe and furniture, dead stock, furniture and fittings, fixtures, etc.

5) Fixed Assets: includes land and building, machinery and plants, lease hold lands, etc.

6) Other receivable: includes all other items excluding mentioned in 1,2,3, above, including the loans and advances, sundry debtors, but does not include fictitious assets like preliminary expenses, or losses carried forward, accumulated losses etc. as they are to be deducted from the own funds.

7) Other payables includes: Government share capital, share anamat, deposits, borrowings, other payable, sundry creditors, and other items of liability side excluding the profit, or accumulated profits.

8) It should be noted that the share capital, statutory reserves, capital reserves, as stated in above paragraphs, should not considered for this purpose, however the net of own funds should be tallied with the amount of net realisable assets, as per the first method of valuation.

4. Reserves and Provisions- Statutory reserve fund- Under section 66 of the Maharashtra Co-operative societies Act, all co-operative societies are required to carry one fourth of their net profits to the statutory reserve fund. The Registrar has however, been empowered under the section to permit societies to contribute a lesser amount to the Reserve Fund, but not less than one tenth of the net profits. Thus, creation and maintenance of the reserve fund out of the annual profits is compulsory under the provisions of the Act and no distribution of profits can be made until necessary amount as required under Section 66 of the Act is carried to the statutory Reserve Fund. The Reserve Fund is indivisible and it can be used only for purposes permitted under the Act, viz., for writing off losses and bad debts or for some public purpose likely to promote the object of the Act or for some purposes of the State or local interest. In addition to amounts credited out of profits, byelaws of societies generally lays down that entrance fees, donation not earmarked for specific purposes and other unusual or extra-ordinary receipts should also be credited to reserve fund. Capital profits on sales of immovable properties and other fixed assets and similar other non-recurring receipts, which are not to be distributed by way of dividend, are also required to be credited to reserve fund or some other fund. Under Section 66 of the Act, the reserve fund of the society may be used in its business or invested outside the business of the society subject to the Provisions of Section 70 of the Act. However, under Rule 54 of the Maharashtra Co-operative Societies Rules, reserve fund is required to be invested separately The Registrar has directed that the reserve fund of primary societies

should be deposited with district central co-operative banks. The district central co-operative banks and urban banks are required to deposit their reserve fund with the Maharashtra State Co-operative Bank. Limited Mumbai.

5.A) Investment of reserve and other funds: The district central cooperative banks or state cooperative bank can invest their 50 % of the reserve fund in their business, subject to the prior approval of the Registrar. If the reserve fund is equal to or more than its paid-up share capital such society may invest that portion of the reserve fund which is in excess of its paid-up share capital, or a portion thereof, in its business decided by general body meeting with prior approval of the Registrar. In addition to the modes specified in clause (a) to (d) of section 70 the societies can invest their funds in debentures issued by the Cooperative Agricultural and Rural Multipurpose Development bank or State or central Government loans. The housing societies are permitted to invest their fund for expenditure on the maintenance, repair and renewal of building of the society if they are formed on co-partnership basis. The processing societies and industrial societies, such as, sugar factories, spinning mills etc. are permitted to invest in acquiring, purchase or construction of lands, buildings, and machinery, decided by general body meeting with prior approval of the Registrar. Government has also permitted by notifications mention below, to contribute upto 10 % of their reserve fund for the purposes of National Defence fund, or other fund approved by Central Government, National defence certificates, or defence deposit certificate or koyana relief fund.

GN C and R DD NO. CSL / 1562/ 54874-J DATE 20.11.62
GN C and R DD NO. CSL / 1562/ 25415-J DATE 18.4.64
GN C and R DD NO. CSL / 1567/ C-3 DATE 20.12.67

5.(b) Funds created out of profits – The term “fund” should strictly speaking denote investment of a reserve outside the business of the society. Thus, the term should be applied only when the particular reserve is represented by specific investments outside the business of the society. The Institute of Chartered Accountants of India has recommended that all reserves, which are not represented by specific securities should be called reserves or reserve account and the term “ Reserve Fund ” should be used only when the amount of the fund is invested outside the business of the company. However, so far as co-operative societies are concerned, there is no such distinction made either in the Act or the Rules and the term “ fund ” is indiscriminately used to denote all reserves created out of profits irrespective of whether the amounts thereof are represented by specific investments outside the business of the society. The Statutory Reserve Fund, however, has to be distinguished from other funds inasmuch as in the act itself, it is styled as “fund”, although in certain cases, it may not be represented by actual investments.

(a) **Meaning of “ Reserve ”** – The term “ *reserve* ” has not been defined either in the Co-operative Societies Act or the Companies Act. The term, however, has been negatively defined in the Companies act as “ *not including any amount written off or retained by way of providing for any known liability* ”. The term “*provision*” means any amount “*written of or retained by way of providing for depreciation, renewals or diminution in value of assets as retained by way of providing for any know liability of which the amount cannot be determined with substantial accuracy*”. The Companies Act further lays down that *where a provision in the opinion of the directors of the company in excess of that which is reasonably necessary for the purpose, the excess must be treated as a reserve and not as provision*. This provision has been made with a view to prevent in creation of secret reserves during years when large profits have been made. However, no such provision has been made in co-operative law and societies are

free to create any number of reserves either by charging the amounts to profits or by way of appropriation of profits and since practically no distinction has been made between reserves and provisions and there are also no statutory restrictions on the amounts to be provided for undermined liabilities and anticipated losses, the creation of secret reserves is facilitated. It is therefore, the duty of the auditor to see that all amounts held back or retained from profits are correctly shown in the balance sheet under their proper heads. ***He has to ascertain that the provisions made for undermined liabilities and anticipated losses are reasonable and where they are in excess of what he considers reasonably necessary***, they should be shown under the heading “Reserves” and not as “provisions”. A certificate expressing the opinion of the Board of directors that, the amounts provided for or considered by them as reasonably necessary should also be obtained.

5(c) Provision for losses and unascertained liabilities – It has, however, to be noted that the existence of reserves including the statutory reserve fund entirely depends upon the valuation placed on the different assets and if these are excessive either owing to inadequate provision for depreciation or inclusion of fictitious assets or any other reason, the reserve may be merely nominal or may be considerably smaller than what it has been made out to be in the balance sheet.

5.(d) Provision – A provision is required to be made when a loss is anticipated, but the amount thereof cannot be ascertained exactly. As the loss will have been incurred before the date of the balance sheet, the profit and loss account for the year will have to be debited with the estimated amount of the loss, so as to show the correct position and a provision account created and shown on the liability side. *Such provisions will have to be made for losses likely to be sustained on the realisation of certain assets and also for accruing liabilities the amounts of which cannot be precisely ascertained, which will not result in the acquisition of corresponding assets.* Examples of losses in the realisation of assets are bad debts, rebates, discounts or other allowances etc. It is the duty of the auditor to see that either such losses are written off, or adequate provision is made to meet them.

5.(e) Provision for unascertained liabilities – As regards unascertained liabilities, it is likely that bills discounted may be dishonored, guarantees may have to be fulfilled, or damages under pending action, claims for which have not been admitted may have to be paid. Losses might also result from fire or other risk not fully covered. Such provisions are to be shown either under their proper headings or under the general heading of “***suspense accounts***”. The auditor has to see that adequate provision has been made for all such accruing liabilities. However, no provision is required to be made for liabilities accruing which would result in the acquisition of assets of corresponding value, as, for example, orders for purchase of capital goods, forward sales or purchases, unfinished contracts, etc., *except where special commitments have been made and losses are anticipated.*

6. Assessment and treatment of Doubtful and Bad Debts – Auditor’s responsibility as regards adequacy of provisions- *In preparing and examining the balance sheet of the society, it is the duty of the auditor to satisfy himself that all the assets shown in the balance sheet appear at their proper value, that they exist in fact and that no asset has been disposed of or charged in any way without the transaction being recorded in the books of the society.* Sub-clause (iv) of clause (6) of rule 69 of the Maharashtra Co-operative Societies Rules provides that the audit memo shall contain schedules with full particulars of any money or other property of the society, which appears to the auditor to be bad or doubtful debt. Examination of overdue debts has been made a special

responsibility of auditor in view of their far-reaching consequences on the financial position of the society. All overdues in agricultural credit societies and non agricultural credit and non credit societies are required to be classified into good, doubtful or bad in accordance with the instructions of the Registrar contained in various Circulars, are to be calculated and provided for. The auditor should carefully study these circulars and the **principles** enunciated therein should be applied for the classification of the outstanding debts of other types of societies. For the district central banks and urban banks Reserve bank and Nabard has issued prudential norms for classification, recognitions and provisioning under their Master circulars No. UBD/BSD/IP.30/ 12.05.05/2001-02 dated 26.12.2002 and NO. NB. DOS. No. POL/ P-57.2002-03 Circular No. 193/ DOS.21/2002 dated 17.8.2002 respectively, Which are subsequently modified on every year in July, should be required to be studied and applied for the classification of bad debts.

Having ascertained in the manner laid down in the Registrar's circulars. The extent of doubtful and bad debts in the society and the amount of the provision he considers necessary, the auditor should proceed to check the provision for Bad Debts Account or the Bad Debts Fund Account in the general ledger and see that the required entries have been made therein. It should be seen that necessary entries have been made therein. It should be seen that necessary entries have been passed either through the cashbook or the journal.

7. Writing off of bad debts – Section 65(1) and Rule 49 A of the Act requires that all bad debts should be written off before arriving at the amount of net profits. However, instead of writing off bad debts against current profits, it is more appropriate to write off the bad debts against the provision for Bad Debts or the Bad Debts Fund already existing or brought forward from previous year and fresh provision made after reviewing the bad debts position then existing. The difference on the account will then represent the extent of the new provision that is required to be made by debiting to the profit and loss account for the year. It has to be noted that writing off bad debts by directly debit in the amount of the bad debts to the current profits, amounts to **bypassing the provisions laid down in Rule 49 of the Maharashtra Co-operative Societies Rules and should be objected to by the auditors.**

Where the provision for bad debts is considered inadequate by the auditor, he should discuss the matter with the management and suggest the committee to increase the provision, and he should **qualify his report and also deal with it in his audit memo.** He has to certify the adequacy of provision for urban cooperative banks and District Central Banks, State cooperative bank and have to report the same to the Reserve Bank and Nabard respectively.

8. Depreciation in the value of Investments- Investment Fluctuation Fund. - Where a large number of investments are held and the market value of the investments on the date of the balance sheet is less than their book value, it is necessary to provide for the loss that has occurred. This generally is done by creating an Investment Fluctuation Reserve or Provision for Depreciation of Investments by debiting the required amount to the annual profit and loss account each year and crediting the Investment Fluctuation Fund or Provision for Depreciation of Investments. Contribution to the Investment Fluctuation Fund is compulsory under provisions of Rules 51 and sub rule (xiii) of the rule 49 A of the Maharashtra Co-operative Societies Rules. For the urban cooperative banks Reserve Bank of India has issued circular No. BPD.PCB.Cir. 12/09.29.00/2003.04 dated 4th September 2003 for creation of investment fluctuation Reserve and investment depreciation Reserve respectively, These circulars are modified and converted into master circular by the

RBI/Nabard, for the investments held for trading and sales and for investments held till maturity. Auditors are required to study them for provision purposes in the urban banks.

9.Sinking Fund- A sinking fund is created either to redeem an existing liability at the end of a certain period or to provide for the diminution the value of existing assets, which will have to be replaced at the end of the stated period. ***Societies, which are permitted to raise funds by issue of debentures, are required to create a sinking fund for the redemption of the debentures at the end of the period for which they are issued.*** Housing societies, Industrial Estates, State Agricultural and Rural Development bank and similar other societies, which acquire immovable property like buildings, factory sheds, etc., are required to create sinking fund which is required to be invested outside the business of the society. As already stated the creation of the sinking fund entails a charge on the profit and loss account every year of an amount which, if invested at compound interest, will produce the required amount necessary to redeem the liability as acquire the new asset at the end of the given period. Thus, societies, which have issued debentures, will be enabled to pay off the debenture replacing their buildings. Will have sufficient money to construct a new building. In case of debentures, the investments of the sinking fund are held in the names of the trustees in accordance with the terms of the trust deed. In case of housing societies, however, since there are no creditors, and the investments belong to the society itself, sinking fund certificates are required to be issued to the members who have contributed towards the sinking fund at regular intervals according to the provisions of there Byelaws. The sinking fund is created by debiting to profit and loss account according to the provisions of sub rule 2(1) of Rule 49 A of the Maharashtra cooperative societies Rules 1961.

10.Bonus Equalization Fund - Rule 52 of the Maharashtra Co-operative societies Rules provides for the creation of the Bonus Equalization Fund. Sub-rule (1) permit societies to create out of their profits a Bonus Equalization Fund for payment of bonus to members and non-members, other than paid employees. *As regards payment of bonus to paid employees, necessary provision has to be made before calculating the net profit and is therefore, a charge on profits, whereas provision for payment of bonus as contemplated in Rule 52 forms an appropriation of the profits and has to be approved by the annual general meeting.* Under clause (4) of section 2 of the Act, ***“bonus”*** means payment made in cash or kind out of the profits of the society, to a member or to a person who is not a member, on the basis of his contribution (including any contribution in the form of labour or service) to the business of the society, and in the case of a farming society, on the basis of both such contribution and also the value or income or, as the case may be, the area of the lands of the members brought together for joint cultivation as may be decided by the society , but **does not include any sum paid or payable as bonus to any employee of the society, under the Payment of Bonus Act, 1965.** Sub-rule (2) lays down that the Bonus Equalization Fund shall be utilized only for payment of bonus.

11.Dividend Equalization Fund – Sub-rule (2) provides for the creation of the Dividend Equalization Fund out of the net profits made by the society. The sub-rule lays down that contribution in any one year shall not exceed two percent of the net profits and contribution to this fund shall cease when the amount of the funds amounts to ***nine percent of the paid-up share capital*** of the society. The society may draw upon this fund in any year only when it is unable to maintain a uniform rate of dividend it has been paying during the preceding five years or more. It is thus clear that the fund can be drawn upon only in lean years when the society is unable to maintain a uniform rate of dividend

on its shares and will not be available to increase the rate of dividend in any year to a level above that at which it has been paying during last five years or more, subject to the recommendation of the rate by the Board of Directors, which cannot be changed by the General meeting as per provisions of the sub rule (4) of the rule 52 of the Maharashtra Cooperative Societies Rules 1961.

12. Other funds and provisions – Funds to be charged to profits and to be created out of profits- The term “ fund ” as already stated, it very loosely used in the Act and the Rules. It is used to describe not only funds created out of profits, but also other amounts charged to profits or set apart, not only out of profits, but also out of realizations for meeting unforeseen losses and undetermined liabilities, which should be appropriately shown under the heading “ *provisions*”. However, since the Act does not make any distinction between reserves and provisions, the nomenclature specified in the byelaws of the society to describe these funds or provisions, may be used for purpose of balance sheet. Section 65 and Rule 49 A of the Maharashtra Co-operative Societies Act permits societies to create a number of funds and reserves out of there annul profits. Creation of some of the funds in compulsory under the provisions of the Act Rules and byelaws of the society, while financial prudence necessitated creation of some other funds and provisions. The nomenclatures of these funds and provision generally indicate the purposes for which they have been created and are being maintained. Thus, Bad Debts Fund and Provision for Bad Debts as already explained is maintained and has to be utilized for writing off bad debts. Charity Fund is created and maintained for payment of charities. Building Fund is created to enable the society to conserve funds to have a building of its own. Although, may of the so called “ funds ” are in the nature of reserves and provisions, neither Form “ N ” nor the instruction contained in the marginal notes against the various items require them to be shown under their correct headings.

13. Legal provisions regarding creation and maintenance of certain funds- Funds created by charging to profit and loss account: It has also to be noted that section 65 (2) of the Act does not make any distinction between funds contribution to which are to be charged to profits and other funds which are to be created by way of appropriations of the net profits except statutory reserve fund and bonus equalization fund, charity fund under section 69. Auditors, however, should object to creation of funds and reserves, which have not been specifically permitted under the provisions of the Act, Rules and the byelaws of the society. Contribution to the following funds are required to be charged to the profits for the year before arriving at the amount of net profits: -

- (a) Co-operative education and training fund [Rule 49 A (ix)]
- (b) provision for election fund for payment of election expenses; [Rule 49 A (x)]
- (c) Bad Debts Fund and provision required writing off bad debts. [Rule 49 A (xi)]
- (d) Investment Fluctuation Fund. [Rule 49 a (xiii)] [Rule 49 A (2)] and rule 51
- (e) Share capital Redemption Fund. [Rule 49 A (xii)] and [rule 51(ii)]
- (f) Purchase rebate payable to members and non-member customers of consumers societies (Patronage bonus) [Section 65(2)].
- (g) Sinking Fund or guarantee Fund. [Rule 49 A (2)] and [Rule 51 (i)]

Under provisions of Rule 49 A, contributions to the following funds are required to be made before arriving at the net profits as state above.

- (1) Contribution, if any, to be made to any sinking fund or guarantee fund constituted under the provisions of the Act, Rules or byelaws of the society for ensuring due fulfillment of guarantee given by Government in respect of any loan raised by the society.

(2) Provision considered necessary for depreciation in the value of any security, bonds or shares held by the society as part of its investments.

(3) Any provision required to be made for the redemption of share capital contributed by Government or by a federal society.

These funds are compulsorily required to be maintained.

As regards amounts to be credited to these funds, it has to be noted that the amount to be credited to the Share Capital Redemption Fund will depend on the period during which the share capital has to be redeemed as per terms and condition laid down by Government. Similarly, the contribution to the sinking fund or guarantee fund will also be laid down by Government and will depend on the amount of the guarantee given. The amount of the Investment Depreciation Fund will have to be determined on consideration of the values of the specific securities held by the society.

14. Funds created by appropriation of net profits: The Rule 50 (1) of the Maharashtra Cooperative societies Rules 1961, provides that society may appropriate its profit for education of members, any co-operative or charitable purpose including relief to poor, education, medical relief and advancement of any other general public utility upto 20% of the net profits. Rule 50 (2) provides for appropriation of net profit for creation of following funds.

- (a) Development fund
- (b) Dividend Equalization Fund; and
- (c) Any other fund created under bye-laws

Apart from the above provision the various sections provides the appropriation of funds after arriving at net profit are 1) charity funds under section 69, and 2) reserve fund under section 66 of the Act.

15. Charity Fund – Section 69 of the Maharashtra Co-operative Act permits a society to create and maintain a charity fund out of its profits by crediting to this fund an amount **not exceeding 20 per cent of its net profits** for the year. Out of this fund, donation and charities can be made only with the approval of state federal society, as notified by the State Government. The State Government has notified as the federal society for the purpose is Maharashtra State Co-operative Union [Notification No.WPC.2872/10211/C-5 Dated 13.4.1972.]. Donations approved under the Income tax Act can, however, be debited as trade expenses, but other payments by way of donations, contributions to funds or by way of charities will have to be made only out of the Charity Fund created under provisions of this section and approval of the State federal society notified by the State Government, will have to be obtained. It should also be seen that the limit of 20 per cent laid down in the Act is not exceeded. This limit as we have already seen includes donation in the form of advertisements in souvenirs, etc. It has, however, to be noted that approval of the State federal society is necessary for payments to be made out of the Charity Fund and not for setting aside or crediting amount to the Charity Fund out of the annual profits. “Charitable purpose” under section 2 of the Charitable Endowments Act, 1860, includes relief of the poor, education, medical relief advancement of any other object of general public utility, but does not include a purpose, which relates exclusively to religious teaching or worship.

16. Provision for Overdue Interest – As we have seen, Rule 49 A of the Maharashtra Co-operative Societies Act clearly lays down that all interest accrued and accruing in accounts, which are overdue, should be excluded from the amount of the net profits. Overdue loan accounts are those accounts in which the principal or any installment, which

has fallen due, has been defaulted. If interest not actually realised, i.e. interest receivable, has been included in profits, it is necessary that portion of interest receivable, which is overdue, should be deducted. This is done either by debiting the interest account and crediting the “ Provision for Overdue Interest ” account, or by deduction overdue interest from the total amount of interest. Either way, it should be seen that no overdue interest is taken to profits. This has been dealt with separately. For urban banks, and District Central and state cooperative banks various guidelines are issued by the Reserve bank of India/ Nabard should be adhered to.

17. Contingent liabilities – It is possible that there may arise in future liabilities relating to transaction effected in the past. Thus, for example, bills might have been discounted before due dates, cheques might have been credited to accounts by the Bank before their realisation and similar other cases like the discounting of hundies, etc. The society may also be holding certain partly paid shares on which full amounts have not been paid. Guarantees issued by the society may still be outstanding. There may also be pending arbitration cases and suits filed in the civil courts against the society, results of which have not been known. There might also be claims made which might not have been accepted by the society such as income tax or other taxes. The auditor should enquire into all such matters with a view to ensure that adequate provision is made in the accounts for these liabilities. Ordinarily, unless the liabilities are definite, provision is not made in the accounts. However, the position is required to be made clear by means of a footnote below the balance sheet.

18. Arrangement and grouping of liabilities and disclosures – From “ N ” Liabilities – The following are the instruction contained in the marginal notes regarding the manner in which the various items of liabilities are to be shown in the balance sheet. These are kind of **disclosures to the balance sheet**. Corresponding figures at the end of the previous year are required to be shown.

I. **Share capital** – *Share capital contributed by Government and by co-operative societies and different classes of individual members are to be shown separately. Terms of redemption or conversion of any redeemable preference shares need to be mentioned.*

Summary of authorised and subscribed share capital distinguishing between the various classes of capital, number of total shares to be issued and face value of each share needs to be shown separately. Calls in arrears are to be shown as a deduction from subscribed capital and calls received in advance as an addition.

Subscriptions received towards shares and amounts credited to Share Suspense Account pending transfer to share capital account are to be shown as a separate item.

II. **Reserve Fund and other funds-** (a) *Statutory Reserve Fund (i.e. Reserve Fund created and maintained under Section 66) and other reserves and funds are to be shown separately.*

(b) *Additions and deduction since last balance sheet are to be shown under each of the specified heads.*

(a) *Funds in the nature of reserves and funds created out of profits for specific purposes are to be shown separately.*

Funds are required to be shown under various heads: -

III. **Staff provident Fund** – *Staff Provident Fund and any other fund such as insurance or bonus fund, gratuity fund etc., maintained for the benefit of the employees need to be shown separately.*

IV. Secured Loans- *The nature of the security should be specified in each case. Where loans have been guaranteed by Government or State Co-operative Bank or Central Co-operative Bank, a mention thereof should also be made together with the maximum amount of such guarantee. Loans from (1) Government, (2) State Co-operative Bank or Central Co-operative Bank State Bank of India and other banks should be shown separately.*

Secured loans should further be classified as per “N” form

V. Deposits – *Deposits from societies and individuals should be shown separately.*

Deposits should be classified as per “N” form

VI. Profit and loss account

Profit for the last year

Less – appropriations

Add- current profits.

VI. Contingent Liabilities, which have not been provided for, *should also be mentioned in the Balance Sheet by way of a footnote.*

CHAPTER VIII

ACCOUNTING STANDARD (POLICIES)

1) **Introductory:** The auditor has to certify the true and fair position of the financial statements, as per M.S.C. Act, however, what constitutes “ true and fair” view has not been defined in Companies act as well as cooperative Societies act. Considering this, the Institute of Chartered Accounts of India has constituted Accounting standards Board and the Auditing practices Committee, has issued accounting standards, and standard auditing practices. The intention behind this is, to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view.

2) In the preface to the statements of accounting standards, the committee has stated that, while discharging the Statutory Auditors their attest function, it will be the duty of the Statutory Auditors to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audit reports. In the event of any deviation from the standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statement may be aware of such deviations. The Statutory Auditors have to insure whether societies have followed the Accounting Standards in preparation of accounts and presentation of financial statements, if not, they have to qualify their report accordingly. The Statutory auditors who do not follow the instructions containing Government notification will be deemed to be negligent in carrying out their duties and necessary disciplinary action will be taken against such auditor including removal from panel.

3) **Applicability to Cooperative Societies:** There is provision in the Cooperative Societies Rules, Rule no. 69(3), that auditor shall state “whether in his opinion accounting policies adopted by societies are as per accounting standards laid down by State Government or by ICAI, New Delhi. The Reserve Bank of India has issued some instruction regarding applying accounting standards and disclosures to the financial statements in regards of Cooperative Banks.

4) **Accounting standards:** uptill now the Institute of Chartered Accountants of India issued 28 Accounting Standards as detailed below. The standards which can be and how would be applied to the various types of societies is mentioned in notification issued by Government of Maharashtra. For applicability purpose, societies are classified in 3

categories and standards which apply to every category is given against that category which is as follows.

1	Level one Societies	a) b) c)	Banks Societies whose turnover (excluding other income) exceeds Rs. 50 crores in immediately preceding accounting year Societies having borrowing including deposits exceeds Rs. 10 crores at any time during immediately preceding accounting year.
2	Level Two Societies	a) b)	Societies having turnover (excluding other income) exceeds Rs. 1 crore but does not exceed Rs. 50 crores in immediately preceding accounting year. All societies having borrowing (including deposits) exceeds Rs. 1 crores but does not exceed Rs. 10 crores at any time during immediately preceding accounting year.
3	Level Three Societies	a)	Societies not covered in (1) and (2) above

5)

6) Applicability of Accounting Standards (AS) to different Level of Societies :

Sr. No.	Level of Societies	Applicable AS
1	Level one Societies	AS 1,2,3,4,5,6,7,9,10,11,12,13,14,15,16,17,18,19,20, 22,24,26,28,29
2	Level Two Societies	AS 1,2,4,5,6,7,9,10,11,12,13,14,15,16,18,19,20,22,24,26,28,29
3	Level Three Societies	AS 1,2,4,5,6,7 AS 9,10,11,12,13,14,15,16,19,20,22,26,28,29

8) Note : Applicability of AS 19,20,28,29

9)

10) There are some exemptions in application of certain matters to Level 2 & Level 3 Societies as follows :

AS	Levels II Societies	Level III Societies
19	Certain disclosures relating to reconciliation and break up of minimum sublease payments, minimum sublease payments and general descriptions are not applicable (i.e. paragraphs 22(c), (e) and (f); 25(a), (b) and (e); 37 (a) and (f); and 46 (b) and (d)).	Same as level II entities. Further disclosure of accounting policy of initial direct costs is not applicable (i.e. paragraphs 37 (g) and 46(e).
20	Diluted earnings per share (both including and excluding extraordinary items) is not required to be disclosed.	Same as level II entities. Further, information required by paragraph 48(ii) is not required to be disclosed.
28	Have an option to measure 'value in use' on the basis of reasonable estimate thereof instead of using present value technique. Consequently, if they exercise that option, the relevant provisions of AS 28 such as discount rate etc. and the disclosure requirements of paragraph 121 (g) will not be applicable.	Same as level II entities.

29	Paragraphs 66 and 67 relating to certain disclosure not -applicable	Same as Level II entities.
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11)

12) These accounting standards are available on website of Institute which is **www.icaai.org**

13)

These Accounting Standards are as follows.

Sr. No.	Accounting Standard No.	Name of Accounting Standard
1	1	Disclosure of Accounting Policies
2	2	Valuation of Inventories
3	3	Cash Flow Statements
4	4	Contingencies and Events Occurring after the Balance Sheet Date
5	5	Net Profit or Loss for the period, Prior period items and Changes
6	6	Depreciation Accounting
7	7	Construction Contracts
8	9	Revenue Recognition
9	10	Accounting for Fixed Assets
10	11	The effects of Changes in Foreign Exchange Rates
11	12	Accounting for Government Grants
12	13	Accounting for Investments
13	14	Accounting for Amalgamations
14	15	Employee Benefits
15	16	Borrowing Costs
16	17	Segment Reporting
17	18	Related Party Disclosures
18	19	Leases
19	20	Earnings per share
20	21	Consolidated Financial Statements
21	22	Accounting for Taxes on Income
22	23	Accounting for Invt. in Associates in Consolidated financial statements
23	24	Discontinuing Operations
24	25	Interim Financial Reporting
25	26	Intangible Assets
26	27	Financial Reporting of Interests in Joint Ventures
27	28	Impairment of Assets
28	29	Provisions, Contingent Liabilities and Contingent Assets

CHAPTER IX

AUDIT REPORT AND FOLLOW-UP OF AUDIT

IX-1 Standards on Auditing (SA)

Consequent upon 97th amendment in Constitution of India, certain amendments are made in Maharashtra Co-Operative Societies Act 1960 w.e.f 13th day of August - 2013 Section 81 (2) is amended as under.

"The audit under sub-section (2) of Section 81 of the Act shall be carried out as per Auditing Standards notified by the State Government from time to time"

Therefore, it is necessary to notify Auditing Standards. The institute of Chartered Accountants of India, New Delhi has issued 37 Auditing Standards so far. Government Of Maharashtra here by notifies that the Auditing, Review and Other Standards as notified by ICAI, New Delhi are applicable to audit of Co-Operative Societies to the extent applicable to respective Audit. These Auditing, Review and Other Standards are issued and updated by the Institute of Chartered Accountants of India and are available on website of Institute which is "www.icaai.org" All auditors (Government auditors, Chartered Accountants, Certified Auditors) should comply with auditing standards. Non-Compliance with auditing standards by auditors will amount to negligence in duties and necessary action will be taken against auditors.

Particulars of Auditing Standards is as follows.

Sr. No.	Auditing Standard No.	Name of Auditing Standard
1	200	Overall Objectives of the Independent Auditor
2	210	Agreeing the terms of Audit Engagements
3	220	Quality control – an audit of financial statements
4	230	Audit documentation
5	240	The Auditors responsibilities relating to Fraud
6	250	Consideration of Laws and Regulations in an Audit
7	260	Communication with those charged with Governance
8	265	Communicating Deficiencies in Internal Control
9	299	Responsibility of Joint Auditors
10	300	Planning an Audit of Financial statements
11	315	Identifying and Assessing the risks of Material Misstatement
12	320	Materiality in Planning and Performing an Audit
13	330	The Auditors responses to Assessed Risks
14	402	Audit considerations relating to an entity using a service organization
15	450	Evaluation of Misstatements identified during the Audit
16	500	Audit Evidence
17	501	Audit Evidence – Specific considerations for selected
18	505	External confirmations
19	510	Initial Audit engagements – Opening balances
20	520	Analytical procedures
21	530	Audit Sampling
22	540	Auditing accounting estimates
23	550	Related Parties
24	560	Subsequent Events
25	570	Going concern
26	580	Written Representations
27	600	Using the work of another Auditor
28	610	Using the work of Internal Auditors
29	620	Using the work of an Auditors Expert
30	700	Forming an opinion and Reporting financial statements
31	705	Modifications to opinion in the Independent Auditors
32	706	Emphasis of matter para and Other matter paragraph
33	710	Comparative information – Corresponding Figures
34	720	The Auditors responsibility in relation to other information
35	800	Audits of Financial Statements prepared in accordance

36	805	Special considerations – Audits of single financial statements
37	810	Engagements to report on Summary Financial Statements

IX-2 Audit Files

A. Maintenance of audit files. -For the efficient conduct of any audit and satisfactory reporting, it is necessary to collect all information of importance into a properly kept file, which should contain all the documents, working papers, schedules and the audit notes and queries taken down during the course of audit. In order to avoid overloading of the file, the Registrar has directed that all documents of permanent interest should be segregated from routine working papers and schedules and kept in a permanent file called the “A” file, which should be maintained by the auditor for each society in his charge. This “A” file should contain a copy of the registered byelaws of the society and subsequent amendments received from the Registrar along with business rules and other rules and regulations framed by the society such as staff Provident Fund Rules and Service Rules, Rules for payment of allowance and reimbursement of expenses incurred by the directors and the staff, etc. Papers of current importance, such as schedules, bank reconciliation’s, balance certificate obtained from Banks etc., should be filed in a “Current file”, along with audit notes and queries taken down during the course of audit.

The “A” file should also have a separate section for recording matters of permanent interest such as list of account books, names of officers and extent of their authority. A brief resume of arrangements for internal control, deficiencies and weakness of internal check, accounting and sanctioning procedure, presentation of accounts, creation and maintenance of various files, etc., should be kept in the same file. Details of important contracts or agreements relevant to the audit and also all matters, which may obviate the lengthier and not so easy process of referring to various original documents, may also be included. It also includes the important resolutions of the board of directors, General meeting or any other committee, financial statements of audit period, ratio analysis records, and communication with the management. Audit program, audit allotments and worksheet of the staff, copies of letter issued for confirmation and confirmations received, explanations obtained from the ex employees and working employees or member or directors of the society, copies of various information received from the society should be maintained as a current file for the year under audit.

In carrying out audit following points should be considered by auditor and necessary remarks should be included in his audit report and also maintain the record thereof in his audit file.

I. Internal Check.

- (I) In what respect the system of internal check is defective.
- (II) Possibility of collusion between members of staff.
- (III) Reliability of otherwise of the officers handling cashbook and personal ledgers and any change necessary.
- (IV) Any other remarks.

II. -Staff.

Integrity of staff in general.

III. -Audit.

- (a) What portion of transactions is not audited?
- (b) Percentage checking done in regard to what items.
- (c) What transactions require particular attention?
- (d) Other loopholes noticed, Benami transactions suspected, etc.
- (e) Accounts of different nature merged in one another, business not allowed by the byelaws, but carried on in the name of Managing Director or other officer of the society.

- (f) Any doubt or suspicion felt at the time of checking cash, securities or godowns or any other transaction of the society or Bank.
- (g) Any other remarks concerning audit.

IV. -Directors and their interest.

- (i) Directors and their relationship, if any, with any member of the staff.
- (ii) Indirect transaction carried on by Directors with the society, if any. Abuse of powers and their position by any of the directors or any indirect undue advantage taken by any of them.
- (iii) The degree of control exercised by the Manager or the Managing Director over the senior members of the staff and the degree of control exercised by the senior officers over the rest of the staff, capacity of staff for their work.
- (iv) Behavior of the staff towards the members of the public and the relationship of the society with other institutions.
- (v) Any other remarks.

While laying down the above procedure, it is not the intention that the auditors should necessarily try to collect the above information, but, if in the course of their audit, they happen to come across any such information, they should note it in the audit files and necessary remarks should be given in the audit report. It is also not intended that they should confine themselves only to the points mentioned above. They may, if they think necessary, mention any other points not mentioned above.

IX-2. AUDIT NOTES AND QUERIES.

3. Rectification on the spot. - During the courses of his audit, the auditor will have to mark his own notes about the working of the society, the irregularities noticed by him also points which require further clarification or explanation. All the minor defects and irregularities should be got corrected and rectified as and when they are noticed so that the management would be careful to avoid recurrence of such irregularities. As they are raised rather than taking exhaustive notes and attending to them later on to get cleared. Even matters, such as want of sanction, unattested corrections, unsigned documents, incomplete statements, etc., should also, wherever possible be got rectified on the spot and need not be reduced to writing unless they are considered important enough to be mentioned in the audit memo. Where additional particulars or further clarifications or explanations are required, these should be obtained during the course of audit as and when the points arise and should not be left over to be explained later on after the audit is completed. However, notes will have to be made of all objectionable items and serious irregularities and even of the minor irregularities, if they occur so frequently that they are required to be pointed out in the audit memo in a general way. Some of the queries and objections may also be of such importance that they may have to be discussed with responsible officers of the society. This should be done as promptly as possible before the audit report is drafted.

4. Writing out audit objections: - Query Sheets- All audit objections or queries as they are called should be written legibly on the left side of the objection memo or query sheet as it is called and sufficient space should be left on the right hand side for the replies by the management. Full particulars of the transaction such as date, amount, name of the party, receipt or voucher number, cashbook or ledger folio, etc., should be mentioned and the nature of the objection raised or the clarification or explanation considered necessary should be clearly indicated. Against each query, the information sought or clarification required or the reply of the management is to be furnished. If the reply or the clarification or explanation is considered satisfactory, the objection raised may either be scored out or a

distinctive tick indicating complete satisfaction should be made under initials of the auditor. However, since in the smaller societies, the secretary himself writes the accounts and there are no full-time employee, instead of reducing to writing every query or objection, the auditor may be intelligent to question and obtain necessary clarification on the spot so that it may not be necessary to make note of either the objection or the reply unless it is considered to be important enough to merit its inclusion in the audit memo. It has also to be noted that it may not always be possible to obtain written explanation or reply from the secretary every time. In such cases, the oral reply or explanation of the secretary or other office-bearer should be noted against the query along with the name and designation of the officer furnishing the reply or explanation. For the ready reference a query sheet is given below.

Query sheet: No. _____ Confidential / non confidential Date: _____

To,

The Chief executive Officer/ Managing Director

...Cooperative Society

Subject: Audit information regarding...

Sir,

Please refer to the subject cited above,

An addition information / explanation is required in the points raised below. You are requested to submit the information against the query in the provided margin. And submit to this office within 24 hours, with duly signed.

Sr. No.	Query for which explanation/ information is required.	Reply or Explanation from the management

If the provided margin is not sufficient to reply, please enclose separate sheet of reply with this query sheet, and return the query sheet in **origin**.

Sd/-

Statutory Auditor

Sd/-

CEO/MD or authorized officer

5. Usual audit objections. -The usual audit objections would ordinarily be of the following types: -

- 1) Unattested corrections, unsigned documents, incomplete documents and statements, i.e., documents in which spaces have been left blank or otherwise incomplete.
- 2) Mistake in calculations, extensions and totals, wrong calculation of interest, dividend rebate, etc., incorrect receipts or payments resulting from application of wrong, rates, incorrect calculations, extensions or totals.
- 3) Cancelled receipts or cheques, the original or the outer form of which have not been attached to the office copy (carbon copy) or the counterfoil.
- 4) Remittances received for which official receipts from the printed receipt from the printed receipt books or other official acknowledgements have not been made.
- 5) Payments for which vouchers are not available. List of missing vouchers should be separately prepared giving full particulars of the payments for which supporting vouchers have not been obtained.
- 6) Defective vouchers such as (a) vouchers in which full particulars are not mentioned, (b) Payment made to a person other than the payee without written authority of the payee, (c) Payments for which supporting documents or sub-vouchers have not been attached to the voucher, (d) Vouchers which are not stamped, (e) Vouchers which are not in proper form

or are not in the name of the society, but are addressed to the Chairman, Managing Director, Directors, Manager or the Secretary (by personal name with or without mentioning designation) individually.

7) Receipts or vouchers which do not agree with the entries in the cashbook in some material respects, such as date, amount, name of payee, head of account to which credited or debited, etc., receipts or vouchers in which the amount in words and figures does not agree.

8) Defective loan bonds, agreements, promissory notes, etc. Also incomplete documents and statements, i.e., documents in which spaces have been left blank, unsigned or unattested documents and statements.

6. Objectionable expenses. They include-

(a) Expenses which are not incidental to the business of the society or do not seem to have been incurred for the purposes of the society.

(b) Expenses considered heavy or abnormal considering the size of the institution, the nature of its business and importance of the occasion.

(c) Unfructuous expenses, i.e., expenditure, which bring no return or other wasteful expenditure.

(d) Other irregular expenses such as personal expenditure of the directors or officers paid by the society.

(e) Expenses, which are not properly sanctioned.

(f) Irregular loans and advances such as: -

(1) Loans made to non-members or on the suretyship of non-members.

(2) In agricultural credit societies, loans made without obtaining declarations creating charge on the land of the borrowers.

(3) Unauthorized loans to members of the committee, secretary or other officers.

(4) Loans, the amount of which exceed the individual limits mentioned in the byelaws, or the credit limits sanctioned in the normal credit statements as finally approved by the bank. Also, special loans for which approval of the bank and or the Registrar, have not been obtained.

(5) Loans, which are against the provision of the Act, Rules, and byelaws directions, issued by the Registrar or the Central Bank. Loans and advances made in contravention of the orders of the Registrar issued under provision of Rule 42 of the Maharashtra Co-operative Societies Rules.

(6) Benami loans, i.e., loans, the amounts of which are persons other than the borrowers.

(7) Imprudent advances such as loans, which are not properly, secured, loans of minors, loans sanctioned for purpose not permitted by the byelaws, etc.

(g) Sales made on credit where no provision for credit sales exists in the byelaws. Also, credit sales in excess of credit limit sanctioned.

(h) Investment or employment of funds in a manner not permitted under the Act, the rules or byelaws of the society or against the directions of the Registrar or the Central Bank.

(i) Other transactions, which involve breach of the provisions of the Act, Rules or the byelaws of the society.

7. Special Notes regarding serious objections. - Besides routine audit objections enumerated above, the auditor will have to make his own notes of the more serious irregularities, which cannot be got rectified on the spot and which call for special action on the part of the committee. There might also be other matters, which require to be brought to the special notice of the general body or of the Registrar. The following are matters in respect of which the auditor will have to make special notes: -

- (1) Unusual matters, which call for specific explanation.
- (2) Expenditure of a revenue nature, which has been capitalized.
- (3) Unsatisfactory arrangements for custody of cash, securities, stores and other property, control over receipts and disbursement of funds, defective system of accounting, failure to maintain necessary account books and registers, incomplete accounts, deficiencies in the arrangements for internal check, defective store control, etc.
- (4) Cases in which the normally accepted canons of business and financial propriety are not observed.
- (5) Transactions not adhering to the standard accounting policies effecting profit and loss account and Balance sheet.
- (6) Entries in the books, which appear to be misleading or passed intentionally with a view to concealing irregularities.
- (7) Cases in which the provisions of the Act, Rules and of the byelaws have been infringed, such as failure to hold general meeting, irregularities in the election or appointment of officers, failure to hold committee meetings regularly, transaction of business without quorum, etc., misuse of delegated authority or exercise of owners in excess of delegated authority.
- (8) Activities undertaken, such are not covered by the object clause of the byelaws. Employment or utilization of funds for business that is not permitted under the Act, Rules or byelaws of the society.
- (9) Borrowing exceeding the limit laid down by byelaws without prior permission of the Registrar.
- (10) Particulars of amounts, which ought to have been but have not been brought into account. Irregularities in the realization of amounts due to the society.
- (11) Advances taken by office bearers and members of the staff, which have not been accounted for and remain to be recovered.
- (12) Loans and advances which have become irrecoverable or are not likely to be recovered in full. Other bad debts and losses, which could have been avoided.
- (13) Property held by the society, which is not likely to fetch its full value. Property, which have no clear title, and requires to regularised in the name of the society. Investment, which cannot be realized, or the market value of which is less than their book value.
- (14) Particulars of losses other than normal trade, losses for which the committee or other office-bearers could be hold liable. Cases in which members of the committee or officers have taken advantage of fluctuation in market and have benefited themselves.
- (15) Moneys and other property of society, which has been unauthorisely, retained by any of the office-bearers.
- (16) Inefficient working of manufacturing and processing units, abnormal wastage's and manufacturing losses.
- (17) Missing loan bonds and other documents, such as promissory notes, applications, agreements, etc.
- (18) Other matters considered important by the auditor.

8. Recording information of confidential nature. - In addition to the audit objections and informative notes taken down by the auditor, certain additional information of a confidential nature about the working of the society and its financial position to the conduct of the office-bearers, and the manner in which the affairs of the society are being managed will have also to be collected by the auditor and referred to whenever necessary so that he would always be on his guard and will not be deceived. It is likely that the auditor during the course of his audit might come across transactions, which might not

have been in the interest of the institution, or which have been entered into primarily with a view to benefit certain individuals. *There might also be entries in the books of accounts, which might arouse his suspicions. It would be the duty of the auditor to make notes of all matters which appear to be rather out of the way and probe them to the bottom so as to be satisfied that no serious irregularities lie hidden.* It has to be remembered that in the minds of the public at large, detection of frauds is such an important function of the auditor as to overshadow his other functions. Members and creditors of societies believe that the appointment of the auditor by the General Body or by Registrar would adequately safeguard their interests although honesty and integrity are not given sufficient consideration while electing office bears. The auditor has, therefore, to approach very cautiously. He need not, however, approach his work with the feeling that there is always something wrong with the society or that he has to deal with people who are not quite honest. He is entitled to believe that everybody is honest. At the same time, if he fails to take note of transactions which are irregular or overlooks entries which appear to be out of the way, in the belief that everything is alright with the society or that the integrity and honesty of the office-bearers should not be doubted, he is likely to be deceived and frauds and serious irregularities might remain undetected for which he might subsequently be held liable. If brief notes are taken of all unusual matters, the auditor would be put on his guards and it would be easy for him to determine which are the matters, which call for greater attention and detailed scrutiny.

IX-3 DRAFTING OF THE AUDIT REPORT

9. Legal position regarding submission of audit report. - Filling in printed audit memo form.- The auditor is required to submit the following documents being part of audit report.

Sr.No.	Particulars	Specified / Provided by	Remarks	Draft / Specimen Annexure number
1	Audit memorandum (audit certificate)	Under Sub-Rule 3 of Rule 69	Form N 1 for co-operative banks and N 2 for other type of societies. The certificate also shall quantify shortfall in various provisions over profit or loss and state clearly that after considering the effects of all provisions whether there is profit or loss to the society / over statement or under statement of profit.	
2	Audit report	Section 81 (5 b) and Sub-Rule 3 of Rule 69 / Specified by the Registrar. The Registrar has stated in his circular No. ADT/H-1/A.M.dated 10 th December	Audit report should be made in three parts as under Part A :- it should include (a) fraud (b) misutilisation of funds (c) misapplication of funds (d) manipulation of accounts (e) falsification of accounts (f) auditor shall quantify shortfall in various provisions over profit or loss and state clearly that after considering the effects of all	

		<p>1986 to write on the points mentioned in the sub section (2) of the section 81 of the Act. For purpose of clarity, the Registrar has directed in the ADT/243/dated 12th March 1974 and circular No. ADT/ H-1/ lepahawal/ rachna/ dated 19th May 1997. that the report should be divided into three parts as part A, Part B, and part C:</p>	<p>provisions whether there is profit or loss to the society. (g) serious infringement of provisions of Act, Rules, Byelaws and notification. (h) misutilisation of capital / loan / grant received from Government. (i) personal expenses which are debited to Profit and loss account. (j) contravention of cash limits as per Rule 107 (c). (h) payment in cash in excess of the limits laid down in the Income Tax Act as per Rule 107 (d). Part B :- (a) remarks on scrutiny of Balance sheet and Profit and loss account. (b) deficiencies in working of societies. (c) activities undertaken beyond the object of society (d) observation on meetings of AGM, BOD and committee meetings. (e) remarks on growth or decline in deposit / capital / loan / profits etc. and important ratio analysis. (f) contravention of provisions of other allied Act like Stamp Act, Labour laws, Contract Act, etc. Part C :- (a) deficiencies in vouching, receipts, expenditure voucher. (b) unauthorized / not sanctioned expenditure. (c) expenditure which appears to be excessive to the auditor considering the size and volume of society. (d) general deficiencies observed in loan documents. (e) travelling expenditure of Board of Directors and Staff members beyond their powers and which appears to be excessive.</p>	
3	Audit memo	Specified by Registrar .	<p>Form no.1 – mandatory for all types of societies. Form no. 2 and onwards :- depending on type of society.</p>	

4	Specific Report	Section 81 (5 B)	In respect of fraud, this report is to be submitted to the Registrar within 15 days from the date of audit report and file FIR with the permission of Registrar	
5	Special Report	Section 81 (5 B)	In respect of financial irregularities resulting into loss to the society, auditor has to file special report along with audit report.	
6	Financial Statements	Rule 69 (3)	The auditor is required to duly certify the following statements approved by the management. (a) Balance sheet as on close of co-operative year. (b) Profit and Loss account (income and expenditure account) for the co-operative year / particular period. (c) notes on accounts and accounting policies. (d) cash flow / receipt and payment. (e) schedules forming part of Balance sheet and profit and loss account (income and expenditure account).	
7	Long Form Audit Report	As specified by Reserve Bank of India	In case of Urban co-operative bank, State Co-operative Bank, District Central Co-operative Bank, auditor shall prepare and submit Long Form Audit Report along with Audit Report.	
8	General Remarks	As may be required while drafting LFAR and audit memo.	Repeated mistakes like vouchers are not having signature of approving authority, not signed by payee, vouchers are not numbered, cash book, bank book are not numbered, required supplementary documents / evidences are not attached with vouchers, suggestions for improvements, etc.	
9	Audit Classification Mark sheet	As specified by the Registrar in case of societies and in case of bank as specified by Reserve Bank of India and	Auditor shall prepare the audit classification mark sheet and award audit classification which should form part of Audit Report.	

		Nabard.		
10	Schedules	Section 81, Rule 69 (6)	<p>Schedule 1 - All transactions which appear to be contrary to the provisions of Act, Rules and Byelaws.</p> <p>Schedule 2 – All sums which ought to have been accounted but not brought into accounts.</p> <p>Schedule 3 – All material impropriety and irregularity in expenditure or in realization of money due to the society.</p> <p>Schedule 4 – All moneys and properties of the society which appears to the auditor bad or doubtful of recovery.</p> <p>Schedule 5 – If government assistance is received, but not applied for the purpose for which it was granted.</p> <p>Schedule 6 – Personal expenditure debited to revenue.</p>	
11	Audit Report summary (Executive summary)	As provided by Rule 69 (7)	Auditor should prepare summary of important points contained in his report for being read out in the annual general meeting. This summary should contain all the important points omitting the descriptive portions. It is not necessary to repeat the entire list of irregularities, but the more serious and important once may be mentioned inviting reference to the respective paragraphs in the general remarks. The summary of the audit memo along with the explanation of the management should be placed before the annual general meeting for its consideration.	

Whatever is contained in Special Report and Specific Report should also form part of Part A of the Audit Report.

All the queries and sub-queries in the printed audit memo should be gone through carefully and appropriate reply given against each query. The replies should be brief and to the point. All sub-queries should be reply separately. There should be no vagueness about the information furnished or the marks made against any query. If the reply to any query cannot be accommodated in the space provided for it, the point may be clarified in the “**General Remarks**” and the reply to the query may only invite attention to the relevant paragraph in the “general remarks” along with page number of audit report or the separate report accompanying the audit memo. All information furnished should be correct

and should always agree with the information contained in the final accounts, lists of overdues, schedules and other statements accompanying the audit memo. The questionnaires which shall be used to which types of societies is listed below.

Sr. No.	Query sheet form No.	Type of society to which it is applicable.	Draft / Specimen Annexure number
1	1	All types of Societies.	
2	2	Test audit report for all type of societies audited by the auditor	
3	3	Agriculture Produce Market Committee.	
4	4	District Central Cooperative Banks	
5	5	Land Development Banks (Now Agriculture and Rural Development Bank)	
6	6	Agricultural and credit societies, multi purpose societies, seva sahakari sanstha.	
7	7	Urban Cooperative Banks	
8	8	Salary Earners Societies	
9	9	Agricultural Sale Purchase Society	
10	10	Farming Societies	
11	11	Lift Irrigation Societies	
12	12	Crop Protection Societies	
13	13	Ginning and Pressing Societies	
14	14	Oil Mills	
15	15	Rice mills	
16	16	Agricultural and Industrial Processing Societies	
17	17	Sugar Factories	
18	18	Industrial Sangh and Weavers Societies	
19	19	Spinning Mill	
20	20	Forest Labour's Societies	
21	21	Labour Contract Societies	
22	22	Dairy Societies	
23	23	Dairy Union	
24	24	Fisheries Societies	
25	25	Poultry Societies	
26	26	Piggary Societies	
27	27	Consumers Stores and Societies	
28	28	Housing Societies	
29	29	Cooperative Producers Societies	
30	30	Printing Press	
31	31	Transport Societies	
32	32	Industrial Estate	
33	33	Education Societies	
34	34	Supervising Unions regarding PACS at Taluka and District level.	
35	35	District Cooperative Boards	

10. Certification of the Balance sheet and the profit and loss account. - Sub-rules (3) and (4) of Rule 69 of the Maharashtra Co-operative Societies Rules, 1961, further require the

auditor to furnish a certificate regarding the correctness of the balance sheet and the profit and loss account of the society examined by him. The provision is as under.

Rule 69 (3) :- The auditor shall loss to the society.

Rule 69 (4) :- (i) to (iv)

IX – Contents of Audit Report

(a) Part A :- This part should consist of the serious irregularities, on which the registrar has to take action immediately. Also contains the serious irregularities in administration of the society, serious breaches of Act, rules and byelaws. Or the points which are required for making the special Report, for taking actions against the Society, by the Registrar.

Part A of audit report shall generally include following items.

1. Fraud
2. Misutilisation of funds and properties
3. Misapplication of funds
4. Manipulation of accounts
5. Falsification of accounts
6. Auditor shall quantify shortfall in various provisions over profit or loss and state clearly that after considering the effects of all provisions whether there is profit or loss to the society.
7. Serious infringement of provisions of Act, Rules, Byelaws and notification.
8. Misutilisation of capital / loan / grant received from Government.
9. Personal expenses which are debited to Profit and loss account.
10. Contravention of cash limits as per Rule 107 (c).
11. Payment in cash in excess of the limits laid down in the Income Tax Act as per Rule 107 (d).
12. In case of banks, property sold under Securitization Act 2002 below Reserve Price.
13. Contravention of unit exposure norms and sectoral exposure norms in case of UCB, MSCB and DCCB.
14. Sanctioning of unsecured loans in excess of limits as specified by RBI in case of banks and in excess of limits as specified in Byelaws in case of other societies.
15. Exceeding the borrowing power as specified by Section 43 and Rule 35 of MCS Act.
16. Repaying the share capital by the contravening the Rule 23 of MCS Rules 1961.
17. No action against overdue in excess of one year.
18. Transactions with relatives of Board of Directors, companies, firms in which directors are interested are not at the reasonable rates.

Format of Part A :-

The following are the major discrepancies found during the audit.

Sr.no.	Particulars	Instances / Examples which requires reporting	Auditor's remarks
1	Fraud	1) Debiting excess amount than the voucher amount / bill amount. 2) Withdrawing the amount from bank but not crediting in cash book 3) Debiting the bank account without depositing the amount in bank	During the period under audit fraud of Rs.----- is detected. The said fraud has been committed by using ----- modus operandi (without security / fabricated documents / false security, etc.). The following persons are

		<p>4) disbursing loans without sanction / without security / without loan documents / using forge documents</p> <p>5) any other transaction with the intention to defraud the society by any person.</p>	<p>responsible for fraud.</p> <p>1....</p> <p>2...</p> <p>3...</p> <p>If there is no fraud, the auditor should mention the following remarks. "During the audit period, we have not found any fraud". This remark is mandatory.</p>
2	Misutilisation of funds and properties	<p>When the funds are not used by following due procedures E.g.</p> <p>1) purchasing / constructing building without inviting the tenders</p> <p>2) purchasing the computers without inviting the tenders.</p> <p>3) selling the movable / immovable properties without inviting bids</p> <p>4) selling the movable / immovable properties below Reserve Price (Upset price)</p>	<p>During the audit period, funds and properties of societies are misutilised as under :-</p> <p>1...</p> <p>2...</p> <p>3...</p> <p>In case, there is no misutilisation of funds and properties, he should give following remarks. "During our audit period, we have not found any misutilisation of funds and properties"</p> <p>This remark is mandatory.</p>
3	Misapplication of funds	<p>If the society raises the fund for the particular purpose but uses them for another purpose, then there is misapplication of funds. E.g.</p> <p>1) State Government has granted loan for construction of go-down, but use for payment of salary or other regular payments.</p> <p>2) Use of sinking fund for day to day maintenance without passing required resolution in General Body.</p> <p>3) Use of revenue reserve / general reserve for creating Reserve for Bad and Doubtful Debts.</p> <p>4) Not using Government share capital redemption fund for repaying Government debt / capital on due date.</p>	<p>During our audit period, we have found following misapplication of funds.</p> <p>1...</p> <p>2...</p> <p>3...</p> <p>If there is no misapplication of funds, auditor should make remark as under. "During our audit period, we have not found any misapplication of funds."</p> <p>This remark is mandatory.</p>
4	Manipulation of	1) Crediting interest received	We have found following

	accounts	<p>account without being amount actually realized In contravention of Income Recognition Asset Classifaction (IRAC) norms.</p> <p>2) Loans showing to be recovered without actually being recovered by debiting new loan account.</p> <p>3) Window dressing of accounts. E.g. loan account debit deposit account credit without deposit actually being received.</p>	<p>manipulation / window dressing of accounts during our audit period.</p> <p>1...</p> <p>2...</p> <p>3...</p> <p>If there is no manipulation of accounts, then auditor should give his remarks as under.</p> <p>“we have not found any manipulation of accounts during our audit period”</p> <p>This remark is mandatory.</p>
5	Falsification of accounts	<p>1) Amount recovered from one party and credited to other party there by showing incorrect position of state of affairs. E.g. A’s account has become NPA. B’s account is in PA category. Amount received from B is credited to A’s account to conceal NPA.</p> <p>2) Showing stock items and value of stock when there is no stock is in existence.</p>	<p>We have found the following falsification of accounts during our audit period.</p> <p>1...</p> <p>2...</p> <p>3...</p> <p>If there is no falsification of accounts, the auditor is required to give following remarks</p> <p>“During our audit period, we have not found any falsification of accounts”</p> <p>This remark is mandatory.</p>
6	Quantify shortfall in various provisions	<p>Society has shown net profit of Rs.1 crore and there is shortfall in following provisions.</p> <p>1) NPA provision Rs.60 lakh</p> <p>2) Overdue Interest provision Rs.40 lakh</p> <p>3) Bonus provision Rs.10 lakh</p> <p>4) Gratuity provision Rs.5 lakh</p>	<p>Considering total shortfall of Rs.115 lakh, society has incurred loss of Rs.15 lakh instead of Net profit of Rs.1 crore shown in the Profit and Loss account.</p> <p>If there are no shortfalls in provisions, auditor should state “There are no shortfall in any provisions”</p> <p>This remark is mandatory.</p>
7	Serious infringement of provisions of Act, Rules, Byelaws and notification.	<p>1) Not holding Annual General Meeting before 30th September as provided in MCS Act 1960.</p> <p>2) Payment of dividend out of capital by not calculating net profit as per Rule 49 A.</p> <p>3) Not holding election even after completion of tenure of</p>	<p>We have observed following infringement of provisions of Act, Rules and Byelaws</p> <p>1...</p> <p>2...</p> <p>3...</p> <p>If there are no infringement of Act,</p>

		<p>Board of Directors as per Section 73 (CB) (14)</p> <p>4) Receiving deposits from non-members / public by co-operative society as per Section 43(1).</p> <p>5) Providing loans to non-members and to the persons residing out of area of operation as per Section 44.</p> <p>6) Investment of funds in contravention of Section 70.</p> <p>7) Funds not to be used for proceedings filed or taken against officers in personal capacity as per Section 71 A</p> <p>8) Not investing Employee Provident Fund as per Section 71.</p> <p>9) Payment of dividend in excess of 15% as provided in Section 67.</p> <p>10) Appropriation of net profit in contravention of section 65 (2)</p> <p>11) Non-creation of Reserve fund as provided in Section 66.</p> <p>12) Distribution of funds to the members in contravention of Section 64. E.g. Distributing certain amount as medical benefit to the members in addition to dividend.</p> <p>13) Exceeding the borrowing power as specified by Section 43 and Rule 35 of MCS Act.</p> <p>14) Repaying the share capital by the contravening the Rule 23 of MCS Rules 1961.</p>	<p>Rules, Byelaws and notifications, auditor shall state “we have not found any infringement of provisions of Act, Rules, Byelaws and notifications.</p>
8	Misutilisation of capital / loan / grant received from Government.	<p>Non utilization of government loan received for construction of go-down and using it for some other purpose.</p>	<p>During the audit period, the society has received the government grant of Rs..... for purpose and same has been utilized for the same purpose. We have not found any misutilisation</p>

			of government loan. This remark is mandatory wherever there is government loan / capital.
9	Personal expenses which are debited to Profit and loss account.	1) Telephone expenditure of personal nature of directors and staff paid by society. 2) Use of vehicle for personal purpose by directors and staff	During the audit, it is observed that, telephone / vehicle expense of Rs..... incurred by the directors / staff has been debited to Profit and loss account. It is required to be recovered.
10	Contravention of cash limits as per Rule 107 (c).	Cash holding limit as per Rule 107 (c) for credit society is Rs.25,000/- and if actually cash maintained is more than Rs.25,000/- for more than 3 working days continuously.	During the audit, it is observed that, on the following days, cash on hand has exceeded in prescribed limit as per Rule 107 (c) If there is no contravention of cash limits, auditor shall state, "During the audit, we have not observed any contravention of Rule 107 (c)" This remark is mandatory.
11	Payment in cash in excess of the limits laid down in the Income Tax Act as per Rule 107 (d).	As per Income Tax Act, any payment exceeding Rs.20,000/- should be paid only by account payee cheque. If any payments are made contravening the above provision, the same should be reported.	It is observed that, following payments are made in cash contravening the provisions of Income Tax Act as per Rule 107 (d). If there is no contravention of cash payment, auditor shall state, "During the audit, we have not observed any contravention of Rule 107 (d)" This remark is mandatory.
13	In case of banks, property sold under Securitization Act 2002 below Reserve Price.	The flat acquired by the bank under Securitization Act 2002 has been sold for Rs.20 lakh when the Reserve Price was Rs.25 lakh	During the audit, it is observed that, following assets have been sold below the Reserve Price. 1... 2... 3... If there is no sale below the Reserve Price, auditor shall state, "During the

			audit, we have not observed any sale of property below Reserve Price” This remark is mandatory.
14	Contravention of unit exposure norms and sectoral exposure norms in case of UCB, MSCB and DCCB.	UCB has sanctioned loan of Rs.40 lakh when exposure limit was Rs.30 lakh. Outstanding of this loan was Rs.45 lakh	During audit period, we have observed that, bank has sanctioned loan in excess of exposure limit and limit was exceeded by Rs.10 lakh. If there is no contravention of unit and sectoral exposure, auditor shall state, “During the audit period, we have not observed any contravention of unit and sectoral exposure” This remark is mandatory.
15	Sanctioning of unsecured loans in excess of limits as specified by RBI in case of banks and in excess of limits as specified in Byelaws in case of other societies.	Bank has sanctioned unsecured loans totaling Rs.130 crores. The limit as specified by RBI i.e. 10% of total asset as per last audited Balance Sheet is Rs.110 crores.	During the audit, we have observed that, the bank has sanctioned the following limit in contravention of RBI directions. 1... 2... 3... If there is no contravention of any of the RBI guideline regarding sanctioning exposure norms, auditor shall state, “During the audit, we have not observed any contravention of RBI guidelines regarding unsecured loans, exposure and any other guidelines” This remark is mandatory.
17	Transactions with relatives of Board of Directors, companies, firms in which directors are interested are not at the reasonable rates.	Computers are available in market for Rs.50,000 of a particular configuration, but purchased from director’s company for Rs.70,000.	It is observed that, the society has entered into transaction with the following companies in which directors or their relatives are interested and the transactions are made beyond reasonable

			price. 1... 2... 3... If there are no such unreasonable transactions, auditor shall report, "During the audit, we have not observed any unreasonable transactions with directors and their relatives, companies and firms." This remark is mandatory.
18	No action against overdue in excess of one year.	For a prudent running of business of credit, the societies required to recover the money regularly and for any default exceeding one year require to take legal action. In case the society has fails to take such action, it affects the continuity of business and therefore the auditor need to report such accounts where actions are not initiated which is detrimental to the interest of society.	During the audit, we have observed that, society has not taken legal action for recovery in respect of following accounts even though they are in arrears for more than one year. 1) Sr.No. (2) A/c name (3) Amount overdue (4) period of overdue.

(b) Part B :- This part is dealing with such matter as financial stability, loan policy, progress of recoveries and position regarding overdues, mode of conducting business, deficiencies in the arrangements for internal check, infringement of the provisions of the Act, Rules, byelaws and circular instructions of the Registrar the general progress of the society, its achievements and the degree of interest taken by the office-bearers and ordinary members of the society in its affairs. In this part, one of the paragraphs would be devoted for recapitulation and stressing of important points to which attention had been drawn in the previous audit memo, but which have remained unattended to by the society. In that case, a remark that the matter has been touched in the report may be made against the relevant query in the audit memo. The Audit Rectification Report submitted by the society should have been carefully gone through by the auditor, prior to the commencements of his audit and the points reported to have been attended to or rectified should be carefully scrutinized during the course of audit. Mention should be made only of such points, which have not been attended to, or irregularities not rectified.

Part B of audit report shall generally include following items.

- (a) remarks on scrutiny of Balance sheet and Profit and loss account.
- (b) deficiencies in working of societies.
- (c) activities undertaken beyond the object of society
- (d) observation on meetings of AGM, BOD and committee meetings.

(e) remarks on growth or decline in deposit / capital / loan / profits etc. and important ratio analysis.

(f) contravention of provisions of other allied Act like Stamp Act, Labour laws, Contract Act, etc.

Format of Part B :-

The following are the major observations regarding the activity and working of the society found during the audit.

Sr.no.	Particulars	Instances / Examples which requires reporting	Auditor's remarks
1	remarks on scrutiny of Balance sheet and Profit and loss account.	1) Paid up share capital - Balances of paid up share capital of all members should be tallied with balance as shown by balance sheet. The additional share capital issued and number of members admitted including number of members resigned and share capital refunded should be mentioned in this section. 2) Reserves and funds 3) Borrowing 4) Current liabilities 5) Cash in hand and at bank 6) Investment 7) Fixed assets 8) Current assets, loans and advances	1) Share capital – during the audit, share capital amount has increased from Rs..... to Rs..... and number of additional members admitted during the year is much. 2) auditor shall state, whether share linking to borrowing is observed by society or not. 3) whether reserve fund is invested separately and that investment is properly marked as investment for Reserve Fund? 4) whether borrowing amount tallies with the balance as shown by the lending institute's certificate / extract? 5) whether cash in hand is verified by senior officers of society and / or board of directors by surprise check? whether cash in hand and at transit is fully insured ? whether cash is maintained continuously higher than that required making loss of interest to the society ? 6) whether investment amount tally with the balances as shown by respective bankers / F.D.receipts / CSGI certificate ? 7) whether society has made investment in mode which are not permitted by Act and

			<p>Rules ?</p> <p>8) whether society is holding huge investment in stock ? whether there is any unsalable or slow moving stock ?</p> <p>9) whether there are any debtors which are in arrears for more than one year ? whether society has taken any legal action ?</p>
2	deficiencies in working of societies.	Society is not undertaking all activities as specified in the Byelaws and not complying with the principles and values of co-operatives.	The auditor is required to comment whether the society is undertaking the activities as per the objectives for which it is set up and all the principles of co-operatives are observed.
3	activities undertaken beyond the object of society	If the society have undertaken any activities which are beyond the objectives the same should be reported.	The auditor should make a remark if the society has undertaken any activities beyond its objectives.
4	observation on meetings of AGM, BOD and committee meetings.	The auditor should go through the minutes of the AGM, SGM, BOD and committees. Important decisions taken in such meetings whether implemented or not should be commented on. Whether the meeting has been conducted as per the provisions of the Act, Rules and Byelaws ?	The auditor should prepare a list of meetings held and give suggestions for its improvement.
5	remarks on growth or decline in deposit / capital / loan / profits etc. and important ratio analysis.	The societies should prepare annual budget and get it approve in the General meetings.	The auditor should verify whether the societies functioning as per the budget and if there is any deviation, the same should be reported and necessary corrective action should be suggested.
6	contravention of provisions of other allied Act like Stamp Act, Labour laws, Contract Act, etc.	It is possible that societies / banks do not execute their documents as per Maharashtra Stamp Act, 1958 and such documents will not have evidence value. Similarly the gratuity liability is not provided in the books. The various allied Act provisions are not complied.	The auditor is required to make a list of activities undertaken by the societies and applicable Act to them. Any contravention of such Act should be reported and corrective action should be suggested.

(c) Part C :- This part deals with the account irregularities and suggestions of the auditors, and the classification awarded by the auditor to the society.

Part C of audit report shall include following items.

- (a) deficiencies in vouching, receipts, expenditure voucher.
- (b) unauthorized / not sanctioned expenditure.
- (c) expenditure which appears to be excessive to the auditor considering the size and volume of society.
- (d) general deficiencies observed in loan documents.
- (e) travelling expenditure of Board of Directors and Staff members beyond their powers and which appears to be excessive.
- (f) receipt entries (credit entries) not supported by receipts.
- (g) cash book, bank book, day book should be completed every day and signed by responsible officers. If not, necessary remarks should be given in Part C.
- (h) List of missing vouchers and loan bonds,
- (i) List of vouchers on which payee's acknowledgement is wanting.
- (j) List of defective vouchers and loan bonds.
- (k) List of payments which are not supported by documents such as bills or invoices, etc., or for which sub-vouchers are wanting.
- (l) List payments, which are not properly authorized.
- (m) List of items where delegated authority has been exceeded.
- (n) List of remittances for which official receipts are not issued.
- (o) Mistakes in interest calculations.
- (p) Other irregularities to be specified.

X-4 QUALIFYING AUDIT REPORT:

12. Qualification in audit report: The Institute of Chartered Accountants of India has issued a statement on the "**Qualifications in the Audit Report**" which states that,

- 1) Before making a qualified report, the auditor should carefully consider the various aspect in their proper perspectives that when should qualify the report, where to make qualification, how to qualify the report and effects of the qualifications.
- 2) Before qualifying the report, auditor should consider carefully the materiality of the matter. It means that, if the materiality of the matter is negligible and meaningless regarding the true and fair position of the financial statement, he should just express disclaimer to it, instead of qualifying the report.
- 3) If the auditor finds that the items in the financial statement are misstated to such extent that the statement does not give a true and fair view, he should express adverse opinion.
- 4) All qualification should be contained in the auditor's report itself and should appear at one place in order to give the reader a clear view thereof.
- 5) The qualification are made in the auditor's report should be such "**as not leave any room for doubt in the minds of the public**". It means that the qualification should be specific and not vague in nature. As the audit report of the Cooperative Societies is public document, that is open to the General public also, which is not concern with the society, it is very necessary to write the qualification in the specific manner. The qualification should be clear and precise, and should give full information and not merely creates grounds for suspicion.
- 6) The qualification should be preceded with the word "**subject to.....**" or "**except that....**".

7) The auditor should state clearly whether in his opinion a particular matter stated in his report is in the nature of a qualification or is merely an explanation.

8) The auditor should quantify wherever possible, the effect of the qualifications on the financial statements in a clear and unambiguous manner.

9) The qualification may be stated in the long form report of the auditor specifying the paragraphs in the Auditor's report, (Auditors Certificate) where in the qualifications are stated.

13.Examples of the qualifications: The qualifications as per the Cooperative Societies Act are mainly related with the 1) True and fair view of the Financial Statements 2) Maintenance of Books of Accounts and 3) The required information and explanations are received or not.

1.True and fair view of the financial Statements: *The true and fair view of the financial statements means that they shows the correct view and there is no material changes which effects there correctness.* The materiality of the statements is defined by the Institute of Chartered Accountant of India, which states that, “ *items, the knowledge of which might influence the decisions of the user of the financial statement*”. Considering the above, the examples are given herewith.

a) The Sugar factory, dealing his cane transport through the Cane transport society, shown payable as transport charges to the worth Rs. 125 lakhs, after comparing the statements it is found that they their no such amount payable to the transport society, as per records, this is a material effect on the profit and loss account and balance sheet of the Sugar Factory, hence the auditor has to qualify his report, stating that the profit and loss account is incorrect to the tune of Rs.125 lakhs, and the balance sheet which show payable, there is no such need to pay it. This has also effected the cane price of that year.

b)The Urban Bank has computerized branches more than 10, and they are fully computerized. The computers value last year stood Rs. 100 lakhs, the bank was charging depreciation on it, at the rate of 10and and now this year it has charged at the rate of 33%, this will materially effect on the profit and balance sheet of the bank.

c)A Marketing society, having depreciation fund worth Rs. 100 lakhs and assets for which it is created are of Rs. 200 lakhs, the society has diverted the depreciation fund by making entry, crediting the reserve fund and debiting the depreciation fund for Rs. 50 lakhs, this is a material effect on the profit and loss account, as the society has reduced the depreciation fund, which was revenue reserve and added in reserve fund, which is a capital reserve. This has not effected only this, but the society has diverting it increased its borrowing capacity, and appreciated the value of assets also.

d)A marketing society, has no sales during the accounting year, however, the trading account shows, profit in a reasonable manner. After investigation it is observed that the society, has overvalued the stock, by increasing its values in schedules, the stock is unsaleable, and no entry has been effected showing the increase in the cost, which has resulted in gross profit to the society without any sales.

e)An urban has not provided the unsecured portion of the doubtful debts, resulting in increase of profit, and distribution of dividend, which is not liable.

f)The spinning mill has purchased cotton from the traders, at the close of the year on credit, has not passed the entry for payable, and also not included in the stock.

g)Expenditures, which are payable by the society are not provided for.

h)Sales effected on credit is not recorded, and included in the stock of a marketing society.

i)The urban credit society, urban bank, and seva societies have not provided the overdue interest and have taken it to the income, resulting into increase of the profit.

- j) Charity fund is created by the society, by debiting to the profit and loss account, though the society's byelaws and act provides to appropriate it from the net profits. And the society has paid from it donation to the charity purposes.
- k) The sugar factory has sold the assets, while accounting the factory has not considered accumulated depreciation charged till the date of sale, which was credited to the depreciation fund.
- l) The spinning mill has replaced its machinery however it has not made any accounting entry for the sale of the same, considering scrap value.
- m) The sugar factory has replaced its boiler tubes, expending much amount, and has capitalized the same instead of charging it to the deferred revenue account, as the tubes does not increased the capacity or efficiency of the boiler.
- n) The Urban bank has not provided the depreciation in the value of its investments.
- o) The industrial society has repaid its share capital at the face value, however the book value shows erosion in the value of share, which is required to be paid as per the Act.
- p) The seva sahakari society has valued its closing stock at selling price, instead of cost or markets whichever is less, as per consisting policy.
- q) The urban credit society has given loan to the sugar factory, but has shown as deposit, without obtaining any security.
- r) The District central bank has not provided for cadre fund as required by the act.
- s) The marketing society has shown goods on consignment, as its own, without passing the entry for sundry creditors.

15. Example of the transactions involving infringement of the provisions of the Act, the Rules and the byelaws: Few examples of the transactions involving infringement of provisions of the Act, the Rules and the byelaws are illustrated below, the auditor are required to study, the byelaws of the society and accordingly mention the details of infringements in his audit report.

- 1) A society has disbursed a loan outside the area of operation as per byelaws of the society.
- 2) A society has refunded shares to the members, who have resigned, at the face value, however as per the last audit report the valuation of shares is less than the face value. Society has not adhered to the provisions of rule 23 of the M.S.C. Rules 1961.
- 3) An urban bank, urban credit society, and district central bank has disbursed loan, in excess of limits fixed in the byelaws and guidelines given by the Reserve Bank and Nabard and Rule 43(2).
- 4) A society has issued preferential shares to Government without amending its byelaws.
- 5) The society has given membership to the members without crediting, at least, value of a one share as per byelaws.
- 6) Society has not taken share transfer fees for the transfer of shares as per byelaws.
- 7) The society has exceeded the borrowing capacity as per byelaws and sections 43 and rule 35.
- 8) The society has charged interest more than the amount of principle, breaching the provisions of section 44 A.
- 9) The society is not required to accept deposits from the non-member as per byelaws and section 45 of the Act, however the society has accepted the same.
- 10) The society has disbursed the dividend in excess of the limit prescribed in section 67 of the Act.

- 11) The society has created funds by charging the profit and loss account instead of creating them by appropriation as per section 65 and rule 49 A.
- 12) The society has not appropriated 25 % of the net profit towards reserve fund as per section 66 of the Act, or has not obtained permission from the registrar to transfer less than 25% of net profits to reserve fund.
- 13) The society has not provided for the education fund as per the provision of the section 24 A and rule 20 B.
- 14) The urban bank and District Central bank has not invested its funds as per directives of the Reserve Bank of India and Nabard for SLR/CRR purposes violating the Banking regulation Act, section 18 and 24.
- 15) The society has not invested funds as per modes given in Section 70 of the Act.
- 16) The society has not invested its provident fund separately as per provisions of the section 71 and rule 56 of the Act.
- 17) The society has used its funds for personal use as per section 71 A of the Act.
- 18) The member of the board of director of the society has defaulted the dues, however he is continuing as a member of board violating the provisions of the section 73 CA
- 19) The annual General meeting has changed the rate of dividend recommended by the board of directors as per Section 75 and Rule.
- 20) The liquidator has not disposed the surplus assets as per provisions of the section 110 of the Act, in respect of the liquidation society.
- 21) The promoters of the newly registered society have not credited the amount in district central bank, so far collected by them for registration of the society as per Act.
- 22) Society has given traveling allowances, sitting fees, and daily allowances in violation of the section 160 B and Rule 107 A of the Act.
- 23) The urban credit society has not maintained liquid resources as provided in the rule 41 of the Rules.
- 24) The society has not adhered to the conditions laid in rule 42 for granting the loan.
- 25) The member of the society have not hold the shares in proportionate to the loan sanction by the society, as per rule 43 (1) of the Rules.
- 26) Society has borrowed from the non-member in violation of the Rule 46 A.
- 27) Society has made credit sales violating the provisions of the Rule 46 B.
- 28) The society has written off the bad debts without following the procedure laid down in the Rule 49 of the Rules.
- 29) The society has not charged the profit and loss account, expenses required to be charged to it, as per Rule 49 A.
- 30) The society has maintained cash in excess of limits prescribed by the rule 107 C.
- 31) The monetary violations of the bylaw provisions are required to be studied by the auditor and mention them in his audit report.
- 32) The society has paid dividend out of capital funds, as there is no net profit to distribute.

IX-5 Drafting of General Remarks :-

It is necessary that the general remarks should be divided into several paragraphs consecutively numbered, with a clear-cut heading for each paragraph. In order to avoid a vague narrative, each paragraph should begin with a suggestive headline e.g. laxity in collection of overdues, inadequacy of the arrangements for internal control etc.

Some of the auditors merely point out accountancy irregularities. It is necessary that very serious irregularities that exists in the working of the society should be brought out in the audit memo. The points to be referred to in the audit memoranda of different types of societies will be different according to the nature of their operations and the business methods adopted by them. In case of most of the societies, the following should form the subject matter of separate paragraphs.

- (1) Points in the last audit memo. Not attended to by the society.
- (2) Review of progress briefly indicating its achievement and present position.
- (3) Deficiencies and defects to the arrangements for internal control and suggestions for their improvement.
- (4) Management Loan policy (in case of central and Urban and other credit societies) mode of conducting business, employment of funds, overtrading, if noticed, etc.
- (5) Financial position, distribution of assets, adequacy of working capital, proportion of owned funds to borrowed funds, maintenance of adequate fluid resources.
- (6) Breaches of the provisions of the Act, Rules and byelaws of the society, non-observance of the business rules and instructions issued by the Registrar and the federal society.
- (7) Correctness or otherwise of the balance sheet and the profit and loss account. Brief comments or explanatory notes on only such of the items of assets and liabilities, which call for specific mention, should be given. It is not necessary to comment on each and every item of the balance sheet. Only where the auditor feels that remarks are called for or clarification on explanation is necessary in respect of any item, comment should be made.
- (8) Disagreement of bank balances, differences in the agreement of personal ledger balances, stock accounts, etc., where these are noticed, the audit certificate should be properly qualified.
- (9) Regularity of the meetings held and procedure followed. Resolutions passed or decisions taken, which may not be in the interest of the society or of the members in general.
- (10) Loyalty of members and efficiency of management, operational efficiency of the various activities undertaken by the society in particular, working of sales depots, processing units, products etc. according to norms or standard laid down.
- (11) Cases involving misapplication or misappropriation of the funds of the society, frauds etc.
- (12) Proper maintenance and use of vehicles, telephones and other moveable and immovable property of the society.
- (13) Proper safeguarding and insurance of all property held by the society.
- (14) Adequate provisions for depreciation of all wasting assets.
- (15) The auditor showing the operational efficiency of the various activities undertaken by the society may work out various ratios.
- (16) Classification awarded during the year under audit.
- (17) observations of the auditor regarding the affairs of the society. The auditor has to see that the society is *working on sound business lines and according to co-operative principles and the office-bearers are aware of their responsibilities and attend to their duties properly.*
- (18) the accounts of which he has audited.
- (19) the irregularities noticed by him.
- (20) his suggestions for improvement. The suggestions made should be such as can be implemented without much difficulty and without involving the society into undue financial commitments or administrative inconvenience.
- (21) The general remarks should be drafted with due regard to **brevity and preciseness.**

- (22) The general remarks of the auditor should be *concise and to the point*.
- (23) the drafting of the *general remarks should be so planned as to embrace all-important aspects of the working of the society* and defects noticed during the course of audit.

22. Draft Audit Report to be discussed with the management before final report is submitted :- The auditor should prepare the draft audit report and discuss with the management. The Registrar under his circular No. ADT/552, dated 19-5-1966 has issued instructions that auditors should invariably discuss their draft audit reports in the meeting of the Board of Directors or Managing Committee of the society, before finalizing it. Some of the auditors merely discuss the draft audit report with the chairman, Secretary or other office-bearers of the society. Sometimes the draft audit memo is merely handed over to the Secretary or the Accountant for perusal and comments. This is not sufficient. The important points of the draft audit memo should be discussed at a meeting of the Board of Directors of the committee specially called for the purpose, if necessary. The auditor should attend this meeting and explain the points raised by him. The fact that the auditor attended the meeting of the Board or the Committee and discussed the draft of his audit memo with the members present should be recorded in the proceedings of the meeting.

IX-6 AUDIT CLASSIFICATION OF CO-OPERATIVE SOCIETIES

23. Introductory. - At the conclusion of his audit, the auditor is required to award an audit classification to the society. The auditors put all societies in one or other of the following classes.

Audit classification	Remarks
A	Excellent
B	Satisfactory
C	Poor
D	Very bad

The audit class is based on certain recognized principles, which the auditor is required to follow. The various points to be considered while awarding audit classification to agricultural credit societies, central and urban banks, land development banks, consumers societies, marketing societies, forest labourers societies, sugar factories, spinning mills, etc. have been explained in a number of circulars issued by the Registrar. A system of awarding marks according to the extent of fulfillment of various criteria has also been laid down in respect of certain types of societies and classification has to be awarded on the basis of total marks secured by the society.

It would thus, be seen that audit classification is awarded according to well recognized principles and auditors enjoy little discretion in the matter of awarding audit classification. Audit is the only method by which Government and the public can judge the position and achievements of the society and the *audit class indicates the degree of success in achieving the objects* for which the society has been organized and also its present position. Societies, which are awarded a high audit classification year after year, enjoy considerable public confidence and are in a position to raise funds required by them in comparatively *easier manner*. **Audit must be conducted according to established audit practices and the instructions issued by the Registrar and the audit classification awarded after a careful examination of the extent of fulfillment of the various criteria prescribed for the purpose**, since a wrong classification will not only

affect the working of the society and its credit, but will also mislead members and creditors of the society and also the general public as well as the wrong audit classification at higher side also mislead the creditors, depositors, members and Government.

The Registrar has issued a number of circulars laying down definite criteria, which have to be considered by auditors while awarding audit classification. Different criteria are grouped under suitable heads and a system of awarding marks according to the extent of their fulfillment has been prescribed by the Registrar. Audit classification to the society has to be based on the total marks secured by it. A statement showing the different criteria prescribed by the Registrar for the type to which the society belongs and the marks allotted under each head and sub-head, has to be prepared by the auditor to enable him to determine in what audit class the society should be placed. The statement showing the marks allotted under each head referred to above may be shown to the office-bearers of the society if they desire to see it. ***The Registrar in his circular No. ADM/243, dated 6-12-1955, has directed that in order to enable the society to know why the particular audit class has been awarded to the society, the auditor should devote a separate paragraph in his general remarks to be appended to the audit memo, the considerations in view of which the particular audit classification has been awarded to the society.*** Where a system of awarding marks has been prescribed, the auditor should use his discretion as to the extent of fulfillment of the various criteria and be rather liberal in awarding marks, as restrictions have been laid down for awarding maximum marks under particular heads.

So far, the Registrar has laid down specific criteria and maximum marks under each criteria, for the purpose of determining the classification to be awarded in case of the following types of the societies: -

- (i) Agricultural credit, multi-purpose and service societies. (Registrar's circular No.).
- (ii) Marketing societies. (Registrar's circular No. ADT/298/AC dated 23-7-1970).
- (iii) Consumers societies. (Registrar's Circular No. ADT/298/AC, dated 23-7-1970)
- (iv) Forest labourers societies. (Registrar's Circular No. ADT/298/AC, dated 15-2-1969)
- (v) Co-operative Sugar Factories. (Registrar's Circular No. ADT/29/AC, (CSF), dated 10-8-1966
- (vi) Co-operative spinning mills. (Registrar's circular No. ADT/298/AC dated 30-4-1970).
- (vii) Apex and primary land development banks. (Registrar's circulars No. ADT/298/AC, (LDB), dated 15-6-1964 and No. ADT (AC) (LDB) dated 31-8-1967).
- (viii) District Central Cooperative Bank (Registrar circulars No.)
- (ix) Urban Cooperative Banks (Registrar Circular No.)
- (x) Urban Credit Societies. (Registrar Circular No.)
- (xi) Salary Earners cooperative Societies (Registrar Circular No.)

Sr. No.	Type of society to which it is applicable.	Circular issued by the Registrar / Nabard
1	District Central Cooperative Banks	NB.Dos.HO.POL / 1830 /J.1/ 2003.04 (Circular 58/ DoS.3/ 2004 dated 1 st March 2004
2	Land Development Banks (Now Agriculture and Rural Development Bank)	ADT/298/AC, (LDB), dated 15-6-1964 and No. ADT (AC) (LDB) dated 31-8-1967
3	Agricultural and credit societies, multi purpose societies, seva sahakari	

	sanstha.	
4	Urban Cooperative Banks	
5	Salary Earners Societies	
6	Agricultural Sale Purchase Society	
7	Sugar Factories	ADT/29/AC, (CSF), dated 10-8-1966
8	Industrial Sangh and Weavers Societies	
9	Spinning Mill	ADT/298/AC dated 30-4-1970
10	Dairy Societies	
11	Dairy Union	
12	Fisheries Societies	
13	Poultry Societies	
14	Consumers Stores and Societies	ADT/298/AC, dated 23-7-1970
15	Housing Societies	
16	Marketing societies	ADT/298/AC dated 23-7-1970
17	Forest labour societies	ADT/298/AC, dated 15-2-1969

24. Broad principles, - From the above table, it can be understood the audit classification is awarded based on the working of the society. There are other societies, where the Registrar has not issued circular but the auditor has to give the audit classification. The broad principles for awarding audit classification to different types of societies, where specific instructions have not been issued, are as under: -

(i) Co-operative vitality. – Following area to be considered at the time of checking the co-operative vitality and all these added together indicate the co-operative vitality of the society.

(a) The extent of the interest manifested by the members in the working of the society as judged by their **attendance and the extent of intelligent participation** in the general meetings.

(b) The proper selection of the office-bearers.

(c) The outlook of the members of the committee as can be seen by the strict observance of the bye-laws, Act and Rules

(d) the efforts made by them to interest the ordinary members in the economic activities,

(e) Administrative set-up and co-operative ideals of the society and the extent to which these efforts have borne fruits as indicated by the loyalty of the members to the society:

(f) Punctuality in the repayment of their dues and discharge of other liabilities undertaken by them such as pooling and joint sale of produce in case of marketing societies,

(g) participation in the production programs of the society in case of industrial societies purchasing their requirements from the co-operative stores, etc. and

(h) Member willingness to allow their entire economic life to be molded by the society;. Joint efforts for bringing about improvement in living conditions of the weaker section of the community by increasing productivity of their labour, provision of resources required by them, increasing their employment opportunities and saving them from being exploited by the economically stronger section of the community active participation in community development activities are also important consideration.

(ii) Administrative Efficiency. - This is judged by the degree of efficiency attained in the day-to-day working of the society, due observance of co-operative principles and sound canons of business and financial propriety in the conduct of business and the sum total of the results achieved by the society in relation to the maximum which the society is intended or is capable of achieving both from the business and the co-operative stand points. In other words, the extent to which the society has been able to cater to the various

needs of its members and the manner in which its affairs are being conducted, should determine the administrative efficiency of the society. The committee should meet regularly at least once a month and discuss ways and means to develop the business of the society. The general meetings should also be well attended and all important policy decisions should have been taken after careful consideration.

(iii) Operational Efficiency. - This will depend upon adoption of sound purchase policy and maintenance of all stocks at satisfactory levels, preparation of financial budgets and adoption of budgeting system for purchases and sales and costs, avoidance of wastage and effecting economy in costs, full utilization of available resources and manpower and of installed capacity by working multiple shifts, adoption of measures for increasing productivity of labour, prompt and efficient service to members and other customers. Profit earned is only one of the criteria for judging operational efficiency.

(iv) Financial stability. - The following features determine the adequacy of the capital structure and soundness of the financial conditions of the society.

(1) The adequacy of the owned resources of the society in relation to its total needs and its capacity to raise funds to meet the financial requirements of its members;

(2) Proper balance between its own funds and its borrowings and satisfactory increase in own funds;

(1) Proper distribution of its assets as may be appropriate for the type of activity undertaken by the society and standard prescribed by the Registrar and finally.

(2) The precautionary and other measures taken and the policy in working adopted to ensure strict fulfillment of the legal, social, financial and other obligations by the society to its members, creditors and other customers and to the society by its members and other debtors.

(v) Staff. - Unless a society has adequate, competent, properly qualified and trained staff employed under satisfactory conditions and adequately remunerated, it will not be able to discharge its functions satisfactorily.

(vi).Internal control. - A satisfactory system of internal control is the *sine-qua-non* of successful management. The following are the essential features of a sound system of internal control.

(1) Proper delegation of authority and distribution of work and responsibility amongst the officers and the different members of the staff so as to ensure that the work of each employee is checked by another and no individual howsoever highly placed has the sole responsibility for all the phases of a transaction.

(2) Provision of checks and balances at every accounting point to prevent collusion and also to ensure prompt detection of frauds and errors.

(3) Unambiguous fixation of duties and responsibilities of each employee and proper supervision over all these arrangements to ensure smooth and efficient working.

(4) Satisfactory arrangements for safeguarding of the cash, securities, stock in trade and other property of the society.

(5) Maintenance of up-to-date accounts and records and arrangements for internal audit.

(vii) Accounts and Records. - Correct and up-to-date maintenance of account books and records and availability at all times of any financial or statistical information that may be required, correct and up-to-date posting of ledgers, prompt preparation of monthly/quarterly statements of accounts and reports for consideration at Board meetings, maintenance of cost accounts.

(viii)Rectification of audit objections. - Action taken to remedy the defects pointed out by the Auditor and punctual submission of the audit rectification reports, is also an important consideration.

(ix)Overdues. - Punctual repayment of the dues any the members and prompt recovery of other debts due to the society. Prompts and adequate action to recover all dues and overdues and precautions taken to arrest the growth of overdues.

The above are the more important of the general considerations which applicable for all types of societies. However, certain special criteria have to be taken into consideration while awarding audit classification to different types of societies having due regard to the nature of business conducted by them and the special features of their working.

26. Special instructions for certain type of societies. -*The Registrar has* also issued general instructions for awarding audit classification of urban banks and non-agricultural credit societies under Registrar's circular No. ADM-6-20, dated 26-11-1957. Under Circular No. M.F./Audit dated 30-10-1956, the Joint Registrar for Industrial Co-operation and Village industries, Poona, has laid down a criteria for granting audit classification to industrial co-operatives.

The Nabard in its circular No.NB.Dos.HO.POL / 1830 /J.1/ 2003.04 (Circular 58/ DoS.3/ 2004 dated 1st March 2004 has laid down criteria for awarding audit classification to District Central Co-operative Banks, the same is made applicable by the Registrar vide his letter No. ANI/ LEP/ JIMSABANK Vargvari/ 782/ 2004 dated 21st July2004 . These are being followed while awarding audit classification to District Central Co-operative Banks in this State.

27. Appeals against audit classification awarded by auditor. -Although audit classification has to be awarded on consideration of a number of factors and definite criteria, which have been laid down by the Registrar, are required to be taken into consideration, it is possible that some of the societies may feel that they deserve a higher audit classification. Such societies may appeal to the Registrar for raising the audit class awarded to them by the auditor, stating the grounds, which justify award of a higher audit class. The appeal for audit classification is heard by the Registrar as per section 154 of the M.C.S. Act. The Registrar may also raise the audit class if he is satisfied that the society deserved a higher audit class and communicate his decision to the society and the Registrar.

IX-7. SPECIAL REPORTS.

A) For administrative Actions.

29. Circumstances in which Special Reports must be submitted. -A special report should be submitted in respect of the following matters: -

(A) Cases in which important provisions of the Act, Rules or bye-laws of the society have been infringed, such as failure to hold annual general meeting in time, irregularities in the election or appointment of officer-bearers, failure to hold committee meetings regularly, transaction of business without quorum, etc.

(B) Activities undertaken which are not convergent with the byelaws, investment of funds against the provisions of section 70 or in business not permitted by the byelaws.

(C) *Cases in which office-bearers have entered into transactions, which have brought loss to the society and cases in which they have taken advantage of fluctuations in markets and have benefited themselves, or occasioned, unwarranted losses to the society.*

(D) *Imprudent and irregular advances of loans and cash credits, Benami loans, loans against inadequate or non-existing security, disproportionate loans to members of the committee and their relatives or certain influential members, etc.*

(E) *Advances taken by the officers not accounted for or subsequently refunded in cash or debited to account. Temporary misappropriation of cash or other property of the society.*

(F) *Infructuous or objectionable expenditure, expenditure disproportionate to the financial position of the society or the importance of the occasion.*

There would also be many other matters, which the auditor may desire to bring to the special notice of the administrative officers. In all such cases, the auditor should submit a special report.

30. Instructions for preparation of Special Reports. -While submitting a special report, the auditor is required to pay attention of certain vital matters. ***In the first place, he should satisfy himself that circumstances exist which warrant submission of a special report or that there are matters which he considers important.*** His special reports should, therefore, be ***restricted to important matters on which some administrative action is called for.*** Unimportant matters need not be reported. ***Secondly, the auditor should have conducted thorough investigation and collected sufficient evidence to make out cases for civil or criminal liability to be fixed*** on the culprits. *Mere mention of suspicious circumstances without collecting necessary evidence to prove the guilt will not be sufficient. If the auditor is unable to carry out a thorough and complete investigation himself, he should explain the circumstances and suggest ordering of an inquiry.* But before enquiry is suggested, the Auditor should make thorough enquiries and collect relevant evidence himself. *He must exercise powers given to him under the Act and Rules only cases where it is impossible for him to investigate the matter and collect covered by audit, evidence to be collected by visiting distant places, etc., he should recommended enquiry.*

SPECIFIC REPORTS

B-For Criminal Actions.

31. Circumstances in which specific report is required: Indian Penal code (Offences)

The following are the offences which auditors of co-operative societies generally come across during the course of their audit. -

Sr.no.	Nature of offence	IPC section	Instances / explanation	Draft audit remarks
1	Theft	378	Theft of valuables belonging to society by outsiders where FIR is not lodged by the society	During the audit, we observed that the stock / cash / valuable of society for Rs..... has been stolen. But the society has not filed any FIR.
2	Theft by clerk or servant of property in possession of master	381	Theft of valuables belonging to society by employee or any directors of society whether FIR has been lodged or not lodged	During the audit, we observed that the stock / cash / valuable of society for Rs..... has been stolen by the following employees / directors by using the modus

				operandi. But the society has filed FIR on date and investigation is on. / the society has not filed any FIR.
3	misappropriation – <i>misappropriation as dishonest appropriation or conversion for a person's own use of property belonging to another.</i> It also covers subsequent wrongful or fraudulent retention of property .	403	1) Debiting excess amount than the voucher amount / bill amount. 2) Withdrawing the amount from bank but not crediting in cash book 3) Debiting the bank account without depositing the amount in bank 4) disbursing loans without sanction / without security / without loan documents / using forge documents 5) any other transaction with the intention to defraud the society by any person.	During the period under audit misappropriation of Rs.----- is detected. The said misappropriation has been committed by using ----- modus operandi (without security / fabricated documents / false security, etc.). The following persons are responsible for misappropriation. 1.... 2... 3...
4	Criminal breach of Trust - <i>whoever, being in any manner entrusted with property, or with any dominion over property, dishonestly misappropriates or converts to his own use that property, or dishonestly uses or dispossess of that property in violation of any direction of law prescribing the mode in which such trust is to be discharged, or of any legal</i>	405	1) The cashier who is entrusted the custody of cash, misappropriates the cash. 2) The go-down keeper who is entrusted with the stock / inventory of society, misappropriates the same.	During the period under audit, we have detected that, the cashier has misappropriated cash of Rs.

	contract, express or imply, which he has made touching the discharge of such trust, or willfully suffer any other person so to do, commits “criminal breach of trust			
5	Criminal breach of trust by clerk or servant -	408		
6	Criminal breach of trust by public servants, bankers, by merchant or agent etc	409		
7	Cheating	415		
8	Cheating by personation	416		
9	Cheating with knowledge that wrongful loss may ensure to person whose interest offender is bound to protect			
10	Cheating and dishonestly inducing delivery of property	420		
11	Dishonest or fraudulent removal and concealment of property	424		
12	Use of forged document or electronic record as genuine	471		
13	Forged document or electronic record	470		
14	Forgery	463		
15	Making a false document	464		
16	Forgery of	467		

	valuable security-will etc.			
17	Forgery for purpose of cheating	468		
18	Forged document	470		
19	Falsification of accounts	477-A		

32. Criminal misappropriation- the offence most commonly met with in co-operative societies is the misappropriation of its funds. Section 403 defines “***misappropriation as dishonest appropriation or conversion for a person’s own use of property belonging to another.*** It also covers subsequent wrongful or fraudulent retention of property though innocently come by. ***The dishonest intention to appropriate the property of another is common both in theft and misappropriation.***

33. Misapplication and misappropriation distinguished. -Where the funds of a society have been misapplied, but there was no intention to derive any personal benefit, the misapplication of the money, though illegal will not amount to misappropriation and hence no criminal action will lie against the wrong-doers, even though loss has been occasioned to the society. Thus, for example, when loans have been advanced in excess of the limits specified in the byelaws or loans have been made to non-members or against inadequate security, no offence is committed. The remedy in such cases is to invoke the provisions of section (88) and not institute criminal proceedings. Similarly, when transactions have been entered into in a negligent manner or against the provisions of the Act, Rules or the byelaws of the society, the remedy is to institute proceedings under section (88) and claim damages.

A person can be **held liable for criminal misappropriation, only if he dishonestly misappropriates or converts for his own use, money, goods or other moveable property, which has come into his possession. As in the case of theft, dishonest intention to appropriate illegally is the basis for institution of criminal proceedings.** To sustain a charge of misappropriations, therefore the prosecutions has to prove that *the accused deprived the complainant of his property and wrongfully misappropriated it or retained it with dishonest intention.* However, mere retention of money would not warrant a conviction unless there is evidence to prove that the accused used or retained the money dishonestly.

It is, no doubt, impossible for the prosecution to follow the money in the hands of the accused person and to prove that he spent certain specific amount in any particular manner. The prosecution must stop when it is proved that the accused has received the money, has acknowledged the receipt of the money and has failed to pay it to his master or show it in his master’s account. Where it is the duty of the accused to pay the moneys received by him, this non-payment is prima facie evidence that he has wrongly appropriated them for himself. **Non-payment coupled with false account either as to the receipt of the money or its disposal is conclusive evidence.**

On a charge of misappropriation, it is sufficient for the prosecution to prove that some of the money mentioned in the charge has been misappropriated by the accused even though it may be uncertain as to what is the exact amount so misappropriated. Evidence has accordingly to be led that the accused retained, misappropriated or converted for his own use, money, goods or other property of the society and that he did so dishonestly. Evidence may have to be led to establish that the accused received the money, but did not

credit the amount in his cashbook or pay it over to his society and was in financial difficulties at the time.

The mere fact that the accused was given time to make up his account and pay the balance due, does not vitiate a conviction for criminal misappropriation or show that the matter is one for a Civil Court only.

Separate offences. -Misappropriation of separate items of money on different dates constitutes distinct items and the facts connected with each item should be subject matter of separate inquiry.

Where moneys are dishonestly misappropriated and false accounts or vouchers are prepared for the purpose of screening the misappropriation, the offence of falsification becomes part and parcel of the offence of misappropriation and the whole transaction must be practically considered as one offence consisting of criminal misappropriation according to the Mumbai High Court.

34.Criminal breach of trust. -Section 405 defines criminal breach of trust and section 406 prescribes punishment for criminal breach of trust. Under section 407, criminal breach of trust by carriers, wharfingers, warehouse keeper, etc., who have been entrusted with goods for transport or for other purposes is punishable with seven years' imprisonment and/or fine. Section 408 deals with criminal breach of trust by clerk or servant, while section 409 groups together public servants, bankers, merchants, factors, brokers, attorneys and agents for purposes of prescribing higher punishment of ten years.

Section 405 defines criminal breach of trust as, *whoever, being in any manner entrusted with property, or with any dominion over property, dishonestly misappropriates or converts to his own use that property, or dishonestly uses or dispossesses of that property in violation of any direction of law prescribing the mode in which such trust is to be discharged, or of any legal contract, express or imply, which he has made touching the discharge of such trust, or willfully suffer any other person so to do, commits "criminal breach of trust"*

To constitute the offence of criminal breach of trust, *there must be dishonest misappropriation by person in whom confidence is placed as to the custody or management of the funds or property, in respect of which the breach of trust is alleged. There must be an entrustment; there must be misappropriation or conversion to one's own use or use in violation of any legal direction or of any legal contract and thirdly, the misappropriation or conversion or use must be with a dishonest intention.*

Trust: Section 3 of the Indian Trust Act, 1882, defines **trust** *an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner.*

The word trust is comprehensive expression and has been used in section 405 as covering not only the relationship of trustee and beneficiary but also that of bailor and bailee, master and servant, pledger and pledgee and all other relation which postulate the existence of a fiduciary relationship between the complainant and the accused. (J.R.D. Tata Chairman T.I. and S. Co. Ltd. V. Payal kumar, 1987) Directors of a Company are not only agents but they are in some sense to some extent trustees or in the position of trustees. (R.K. Dalmiya v. Delhi Administration.(AIR 1962)

35.Criminal misappropriation and criminal breach of trust distinguished. -In a criminal misappropriation, the property comes into the offender by some causality or otherwise and he afterwards misappropriates it. In the case of criminal breach of trust, the offender is

lawfully entrusted with the property and he dishonestly misappropriates the same of willfully suffers any other so to instead of discharging the trust attached to it.

36.Misfeasance, misappropriation and breach of trust distinguished. - Every breach of trust gives rise to a suit for damages, but it is only when there is evidence of a mental Act, or intention of fraudulent misappropriation that the commission of any embezzlement of money becomes a penal offence punishable as a criminal breach of trust. Every offence of a criminal breach of trust involves a Civil Court, but every breach of trust in the ***mens rea*** (*mental Act, or intention of fraudulent misappropriation*), cannot justify a criminal prosecution.

The terms of the section are very wide. It applies to one who is in any manner entrusted with property or dominion over property and provides inter alias that if such a person dishonestly misappropriates or converts to his own use, the property entrusted to him, he commits criminal breach of trust. This part of the definition is complete in itself and has no reference to the provisions as to disposal in violation of a directive of law or of a legal contract. A necessary element of criminal breach of trust is that there should be entrustment of property to the accused. The entrustment may be in any manner.

Section 405 embraces the cases of all offences, which are not covered by sections 407, 408 and 409. Offences committed by trustees with regard to trust property and of directors of companies and committee members of co-operative societies, who do not come within the purview of section 408, are covered by this section.

37.Dishonest Intention: To establish a charge of criminal breach of trust, the prosecution is not obliged to prove the precise mode of conversion, misappropriation or misapplication by the accused of the property entrusted to him or over which he had dominion, where the entrustment of money is admitted or proved. The principal ingredient of the offence being *dishonest misappropriation or conversion* which may not ordinarily be a matter of direct proof, entrustment of property and failure in breach of an obligation to account for the property entrusted, if proved, may, in the light of other circumstances, justifiably lead to an inference of dishonest misappropriation or conversion. Where the accused is unable or fails to account for the money or property received by him or interested to him or renders an explanation of his failure to account, which is untrue, an inference of misappropriation with dishonest intention may readily be made.

Dishonest intention is a necessary element for criminal offence under Section 406. Subsequent conduct in repudiating the transaction during the trial has no bearing on dishonest intention at the time of the alleged transaction (Kaushalya V. State AIR 1964) IN case of criminal breach of trust, failure to account for the money proved to have been received by the accused or giving a false account as to its use is generally considered to be a strong circumstance against the accused. This however, is a piece of evidence pointing to dishonest intention and is not conclusive. (Puran Chandra v. State AIR 1966) Mental act of fraudulent misappropriation is the essential ingredient of the offence of criminal breach of trust, the prosecution must prove the existence of the dishonest intention beyond reasonable doubt, it will not suffice for the prosecution merely to prove the circumstances which may be consistent either with the dishonest intention of the accused or the absence of such intention. Dishonest intention cannot be directly proved and has to be inferred from the conduct of the accused both before and after the date of alleged entrustment. Mere difficulty in proving is no excuse. (Amrutlal v. Bajaranglal, 1963 CR.L.J.)

38.Entrustment:The word “***entrustment***” when used in respect of money means that the money has been transferred to the accused under circumstances which show that

notwithstanding its delivery to be accepted, the property in it continues to vest in the prosecutor and the money remains in the possession or control of the accused as a bailer and in trust for the prosecutor as bailer, to be restored to him or applied in accordance with his instructions. The terms of this section are wide enough to include trustees of every kind, i.e. those who are employed and receive remuneration for acting as trustees, but also by reason of some trust constituted by express deed or even by implication of law, though the office (as in the case of membership of committees of co-operative societies) may be gratuitous and they may not be receiving any remuneration for the services rendered by them.

If there is no trust, there can be no offence under the section. Thus, a person who takes a sum of money by way of loan is not entrusted with the property. However, where an officer of the society having custody of the cash balance retains large sums of money for considerable period and subsequently enters them as an advance or loan taken by him, he commits criminal breach of trust. Similarly, when a servant receives large sums of money, which he has obtained from his employer on the false pretext that they were required to pay wages, it was held that he was guilty of criminal breach of trust although the criminal intent to misappropriate was present at the time of receipt of the money by him.

Where a public servant entrusted with money for purchasing certain articles, purchases the articles, he does not commit any offence under section 406 merely because he does not produce the supporting vouchers along with the bills for the purchase of the articles. (State of H.P. v Nandlal 1983 Cr. L.J.). Where accused person not legally entitled to carry on banking business. Fail to repay the amount deposited with them by the members of the public; they are guilty of the offence of criminal breach of trust. (A.G. Abhidham v. State of Kerala 1987 Cr. L.J.). Where the Secretary of a Society was dealing with the cash and did not make over the cash to the President of the Society while handing over the charge of the post, he was held guilty of misappropriating the amount and convicted under section 406 (Uday Narayan Panda v. State 1978 Cr. L.J.) Where entrustment of the property is proved, burden lies on the accused to account for the money/property, burden does not lie on the prosecution to prove how the accused misappropriated the property. (Uday Narayan Panda v. State 1978 Cr. L.J.)

The word ‘entrusted’ itself conveys and includes that the person handing over the property must have confidence in the person taking the property so as to create a fiduciary relationship as between them. If the property is obtained by trick or by any other unlawful means, then there cannot be any entrustment. ‘Entrustment’ means the handing over of the property by lawful means. Where the property is acquired by trick or ‘in any other manner’ by false representation to the owner thereof offence under Section 420 is committed. Where the goods were pledged by the complainant debtor with the accused creditor as security for payment of the debt and the agreement further provided that if the debt was not paid within the stipulated period with the 15 days clear notice, and accused disposed of the goods pledged without notice to the debtor, the accused was held guilty of the offence of criminal breach of trust. (Jaswantraji Maniclal Akhney v. state of Bombay, AIT 1956)

39. Property: As regards the meaning of the term “*property*”, it has been held that it includes the sale proceeds of the goods entrusted to the accused and also goods purchased with the moneys provided by the employer and entrusted to the accused for making the purchases.

The property in the section 405 includes the property, purchased with the money entrusted in view of the words “in any manner” occurring in Section 405. The offence of

criminal breach of trust cannot be committed in respect of one's own property; the property must belong to another person. The worked property is not restricted to movable property; the funds of a company do amount to property within the meaning of section 405. The section does not contemplate that the property in respect of which the offence of criminal breach of trust is committed must belong to the complainant.

40. Dominion over property-The accused hypothecated to the complainant under a written contract, all his claims against Government in respect of work done and materials supplied to the Executive Engineer and undertook regularly to make over to the complainant all cheques drawn by the Executive Engineer in his favors and subsequently in violation of the said contract cashed two such cheques and appropriated the proceeds. It was held that the accused had committed criminal breach of trust.

Even where a person has not been entrusted with the property comes to have a dominion over it can be guilty of misappropriation, in order to establish entrustment of dominion over property to an accused person, the mere existence of that person's dominion over property is not enough, it must be further shown that his dominion was the result of entrustment. Directors of a company are not trustees of the due to the company, and any wrongful dealing by the director with the funds of the company does not amount to criminal breach of trust.

41. Hire Purchase Agreement. -One 'C' agreed to purchase a motor lorry, paying the price by installments. Meanwhile, he signed an agreement with the owner by which describing himself as the hirer, he undertook to pay certain installments, to ensure the vehicle hired and not to deal with it, to allow owners to recover possession in case of default and admitted to lorry would remain the property of the owners until all the installments due were paid. It was held that when 'C', in spite of the agreement, sold the lorry before the installments were paid, was guilty of criminal breach of trust. In a criminal breach of trust, the property remains with the person entrusting and the person entrusted does not have any right in the property.

The second ingredient in a case of criminal breach of trust is dishonest intention. It has to be established that the accused dishonestly misappropriated or converted to his own use the property. Temporary retention of money would not by itself amount to criminal breach of trust. The mere failure to deposit the money would not, therefore, prove dishonesty, there must be other circumstances to prove the element of dishonesty and unless the element of dishonesty is proved, the mere retention of money would not by itself constitute the offence. False explanation is sufficient to prove the element of dishonesty. The mental act of appropriation must be established, but actual expenditure of the money is not the only proof. Mere retention of goods by a person without misappropriation does not constitute criminal breach of trust.

42. Willful omission to account. -If a person receives money, which he is bound to account for, and does not do so, he commits the offence although no precise time can be fixed at which it was his duty to pay the money. Where an employee fails to render accounts and to deliver up the moneys realized by him in spite of repeated demands, he uses the property entrusted to him in violation to the legal contract made by him with his master and is guilty of an offence under section 408.

As already stated, it is not necessary or possible in every case of criminal breach of trust to prove in what precise manner, the money was spent or appropriated by the accused, because under the law even "temporary retention" is an offence provided it is dishonest. The essential thing to be proved in such cases is whether the accused was

actuated by dishonest intention or not. (Queen Empress vs. Kellie) The failure to account for the money proved to have been received by the accused or giving a false account as to its use is generally considered a strong circumstance against him. The mental act or intent to deprive the master of his property is the gist of the offence. If a servant immediately on receiving a sum for his master enters a smaller sum, he may be considered to be embezzling the difference at the time he makes the entry. It will make no difference, though he received other sums for his Master the same day and in paying those and the smaller sum to his master together he might have given his master every piece of money or notes he received at the time he made the false entry. It is not necessary to prove that any particular sum or sums were an amount forming the balance of a large number of receipts and payments; this was held to be sufficient.

43. Willfully suffers any other person: The second part of section 405 says that whoever willfully suffers any other person “to misappropriate or convert any property commits criminal breach of trust. Willfully suffering makes a man liable. ”Willful” means deliberate or intentional and not accidental or by inadvertence. Where a person willfully suffers to misappropriate the money entrusted to him, he commits the offence of criminal breach of trust under section 405 in as much as if he himself had misappropriated it. His plea that he did so under the instructions of his superiors can afford him no protection.

44. Evidence –to make out a case of criminal breach of trust, which is the commonest offence relating to the funds of a co-operative society, it has to be established that not only the accused has retained the money, but that he has disposed off the same in some way other than that in which he was bound to apply it and that he did so dishonestly. The mere fact that the accused did not at once apply the money to the purpose for which it was intended does not amount to criminal breach of trust. There must be some dishonest use of money to constitute the offence. Although mere retention of money does not necessarily raise a presumption of dishonest misappropriation to one’s own use dishonest misappropriation may sometimes be inferred from the circumstances without due evidence. Thus, when cash is drawn from for making small disbursements such as payment of wages of staff when a very large amount is held as cash on hand, in utter disregard to the provisions of the byelaws of the society, a presumption can be made that the cash on hand has been misappropriated. Nearly establishing that false entries have been made to be led that the accused attempted to suppress all traces of his embezzlement by manipulation of the accounts, or evidence of the financial circumstances of the accused will have to be led which would render probable a case of misappropriation.

45. Section 408. - Criminal breach of trust by clerk or servant –Clark- In modern usage, the term would mean a writer in an office, public or private, for keeping accounts or entering minutes.

46. Servant, Master and servant – A relation whereby a person calls in the assistance of other where his own skill and labor are not sufficient to carry out his own business or purpose.

Bring the accused within the purview of section 408; it will have to be proved

[1] That accused was the clerk or servant of the person reposing trust;

[2] That he was in such capacity entrusted with the money or property or entrusted with dominion over it

[3] That he committed criminal breach of trust in respect of such money or property. Actual conversion need not be proved. A mental Act, of fraudulent appropriations will however, have to be proved.

47. Violation of legal contract. -Where a person taking goods on approval under an agreement that the property therein was to pass on approval, only if he exercised his option to take them and paid cash in full for certain articles and in part for others, the trust continues till the option is exercised and cash payment made and he commits criminal breach of trust, if he sells them without such payment.

The manager of a bank received G. P. notes from a customer as security for an overdraft granted to him. Before the overdraft was cleared, the Manager returned the promissory notes without showing them as returned in the books of the bank, which continued to show that they were still deposited with it. The customer having got back his G. P. Notes repledged them with another banker. It was held that the Manager was guilty of criminal breach of trust and the constituent of the abetment thereof.

Where the secretary of a Cooperative society converted the money of the society in his hand to his own use or expended the same for purpose other than those of the society, and falsified account books to cover up his embezzlements, the secretary was guilty of offences under Sections 408 and 477. (Joy Shankar V. Sushil Kumar 1969 cr. J.) Where the accused, Secretary of a cooperative Society was entrusted with the amount, gave that amount to the president of the society and purchased wheat for another member of the society. The president did not return the amount, the member also did not for the wheat, the accused dishonestly misappropriated and willfully suffered these two persons to convert to their own use the property of the society, was guilty of criminal breach of trust. (Kundanlal v. state 1976 cr. J.) Where the accused representing himself as manager of a Gram Sahakari Samiti collected loan amount from the subscribers of the Samiti, did not deposit the collected amount in bank, he was held guilty of offence under the section. The president and Secretary of a Cooperative Society are not public servants and when they commit embezzlement, section 408 applies to them. When a Secretary of a Cooperative Society entrusted with the surplus funds of the society, utilises the same for his own purpose, he is guilty of misappropriation of funds. Where the Secretary of a Cooperative Society returned a certain amount of the society, a direction by him to accountant of the society to make a wrong cross entry was only susceptible of the inference that he wanted to misappropriate the amount. (Kantilal v. State of Gujrat AIR 1974) Mere entry in books of account unsupported by any oral evidence cannot prove entrustment.

48. Section 409. -This section clubs together public servants, bankers, merchants' factors, brokers, and attorneys. The word "banker" in this section has not been used in the technical sense of the Banking Regulation Act, but any person or firm doing the customer business of banking, is a banker for purposes of this section. Merchant is a person who traffics in goods in remote countries, i.e. an importer or exporter and in the ordinary sense also any one engaged in the purchase and sale of goods. Factor is an agent to sell goods, for a commission. Broker is an agent employed to make bargains and contracts between other persons in matters of trade, commerce and navigation. A factor is entrusted with the disposal of the property while a broker is employed to contract about it without being in possession of goods. Attorney is one who is appointed by another to do some thing in his absence and who has authority to Act, in place and turn of the person by whom he is delegated.

To establish a charge of criminal breach of trust the prosecution is not obliged to prove the precise mode of conversion, misappropriation or misapplication by the accused

of the property entrusted to him or over which he has dominion. The principal ingredient of the offence being dishonest misappropriation or conversion which may not ordinarily be a matter of direct proof, entrustment of property and failure in breach of an obligation to account for the property entrusted if prove, justifiable lead to inference of dishonest misappropriation.

To justify conviction under Section 409, the prosecution must prove factum of entrustment and factum of misappropriation. Mere an audit report of inconclusive nature cannot form basis of conviction.

Office bearers of a society are not public servant within the meaning of Section 21 of the Indian Penal Code and they cannot be prosecuted under section 409 of the Indian penal code. (Hanumant Patil Vs. State of Maharashtra, 1993(2) Bom. C.R. 286 and state of Maharashtra Vs. Laljit Shah, 1994 Mah L.J.)

49.Cheating. -Section 415 defines cheating. This is a very wide section and deals with almost all the aspects of cheating. A dishonest concealment of fact is also deception within the meaning of the section. Unlike in other offences, in the case of cheating, the offender obtains not only possession of the property, but also sustains property in it. Cheating, criminal breach of trust and criminal misappropriation are all distinct offences. ***Cheating differs from the last two offences in the fact that the cheat takes possession of the property by deception. There is wrongful gain or loss in both the cases and there is inducement to deliver the property.***

50.Deceiving means causing to believe what is false or misleading as to a matter of fact leading to error. *It is not sufficient to prove that a false representation has been made, but it is further necessary to prove that the misrepresentation was false to the knowledge of the accused, and was made in order to deceive the complainant.* It is not necessary that the false pretence should be made in express words; it can be inferred from all the circumstances attending the obtaining of the property or conduct of the person. If a person obtains goods on credit promising to pay for them on a particular day, knowing that it was impossible for him to pay, or draws cheques knowing that the bank balance was insufficient and the cheque would not be honored, it would amount to cheating.

Under section 417, punishment for cheating is one year. *Cheating with knowledge that wrongful loss may ensue to person whose interest the offender is bound to protect invites higher punishment under section 418.* This section applies to cases of cheating by guardians, trustees, solicitors, agents, managers of Hindu Joint families, directors and managers of joint stock companies, and of co-operative societies, in fraud of the members or shareholders. It is the abuse of trust that is met with a more safer punishment. Presenting a false balance sheet by the directors and managers of the bank to induce depositors to renew their deposits which they would not have otherwise done or putting a false balance sheet in material respects, before the share holders or members which they knew to be false and likely to mislead the public as to the condition of the bank and concealed its true condition, would constitute offences under this section and the directors and mangers have been held liable

51.Wrongful lossand gain: the Section 23 of the Indian penal Code defines ‘wrongful loss as. “Wrongful loss” the loss by unlawful means of property to which the person losing it is legally entitled. It further defines that. A person is said to lose wrongfully when such person is wrongfully kept out of any property, as well as when such person is wrongfully deprived of property.

This section also defines wrongful gain, as “Wrongful gain” is a gain by unlawful means of property to which the person gaining is not legally entitled. A person is said to gain wrongfully when such person retains wrongfully, as well as when such persons acquires wrongfully.

A person can be said to have dishonest intention if in taking the property it is his intention to cause gain, by unlawful means, of the property to which the person so gaining is not legally entitled or to cause loss, by wrongful means, of property to the person so losing is legally entitled. The gain or loss need not be a total acquisition or a total deprivation, by it is enough if it is a temporary retention of property by the person wrongfully gaining or a temporary keeping out of property from the person legally entitled. Wrongful gain includes wrongful retention and wrongful loss includes being kept out of the property as well as being wrongfully deprived of property.

52. Dishonestly: The section 24 of the Indian penal code defines it as, “ whoever does anything with the intention of causing wrongful gain to one person or wrongful loss to another person, is said to do that thing “dishonestly”.

Dishonest intention has got to be proved. A dishonest intention may be presumed only if an unlawful act is done or if lawful act is done by unlawful means.

53. Cheating: Section 420, which deals with ***cheating and dishonestly inducing delivery of property***, is an important section and quite a number of offences in co-operative societies come within the purview of this section. Simple cheating is punishable under section 417, but when there is delivery or destruction of any valuable security, resulting from the act of the person deceiving, this section comes into operation. *For conviction under this section, it must be proved that the complainant parted with his property, acting on a representation, which was false to the knowledge of the accused and that the accused had a dishonest intention from the outset.* Where a person whose duty it was to report the current rates in the market by arrangement with persons in the market reported rates higher than those really current and in consequence of which higher rates were paid to the sellers, than they were entitled, it was held that he was guilty of offence under this section. Assisting to obtain larger advances against a consignment sent by rail, which was made to show a higher quantity by tampering with the railway receipts, has been held to be an offence under this section.

In a case the accused executed a hypothecation bond in respect of property representing that the property belonged to him and there were no encumbrances on the property, and succeeded in getting money from the complainant but in fact the property did not belong to the accused, a fact which was in the knowledge of the accused from the very beginning, the accused is guilty under section 420.

When the accused by making fraudulent representations obtained loan from the Bank, they were held guilty of the offence of cheating. Where the accused Manager of the bank passed a certain cheque which resulted in loss to the bank, the accused was negligent in the sense that he had not observed that the specimen signature card of the drawer had not been authenticated by any bank official and the drawer had not been introduced by any one, the accused was negligent in the performance of his duty, but was not guilty, of cheating.

Section 423 deals with dishonest or fraudulent execution of deeds of transfer containing false statement of consideration. Under this section, dishonest execution of a Benami deed is punishable. Where the consideration for the sale of immovable property was with the consent of the purchaser exaggerated in a deed of sale in order to defeat the claim of the presenter, it was held that the purchaser was guilty of this offence.

Section 424 deals with dishonest or fraudulent removal or concealment of property. This section covers cases, which do not come within the purview of sections 421 and 422. ***It contemplates such concealment or removal of property from the place where it is deposited as can be considered fraudulent. It also covers dishonest or fraudulent release of any demand or claim to which the offender is entitled.***

54.Forgery. -Forgery is defined in section 463, as making of a false document or false electronic record or part of a document or electronic record in the next section, section 464, deals with the making of a false document or electronic record. It will be seen that the definition of forgery given in the Code is not as simple or clear as the definition of forgery in common law. *Forgery as is commonly understood means fraudulent making or alteration of a writing to the prejudice of another man's right.*

The simple making of a false document would not amount to forgery as defined in the section. What amounts to making of a false document is explained in section 464, to constitute the offence of forgery under section 463, the following ingredients are necessary: -

- 1) The making of a false document or false electronic record or part of it;
- 2) Such making should be with intent to-
 - a) Cause damage or injury to public or and person; or
 - b) To support any claim or title; or
 - c) To induce any person to part with any property; or
 - d) To cause any person to enter into any express or implied contract; or
 - e) To commit fraud or that fraud may be committed.

The essential ingredients of Section 464 are: a) that fraudulently signing, making, executing, making seal on, transmitting any electronic record or part of any electronic record, affixing any digital signature or any electronic record, making any mark which denotes the execution of the document or authenticating any digital signature. A document or a part of a document, electronic record or digital signature with an intention of causing it to be believed that such document or part of a document electronic record or digital signature was signed. Sealed, executed, transmitted or affixed by another or under his authority.

(b) Making such a document with an intention to commit fraud or that fraud may be committed.

Secondly if any person without lawful authority, dishonestly or fraudulently, by cancellation or otherwise, alters a document or an electronic record in any material part thereof, after it has been made, executed or affixed with digital signature either by himself or by any other person, whether such person be living or dead at the time of such alteration;

And thirdly, if any person, causes any person to sign, seal, execute or alter a document or an electronic record or to affix his digital signature on any electronic record knowing that such person by reason of unsoundness of mind or intoxication cannot, or that by reason of deception practiced upon him, he does not know the contents of the document or electronic record or the nature of the alteration, commits forgery under section 464.

55.Fraudulently: Section 25 defines “ fraudulently” as, A person is said to do a thing fraudulently if he does that thing with intent to defraud, but not otherwise.

The expression defraud involves two element, namely, deceit and injury to the person deceived. Injury is something other than economic loss that is, deprivation of property, whether movable or immovable, or of money and it will include any harm

whatever caused to any person, mind, reputation, or such other. It is a non-economic or non-pecuniary loss.

56.Document: A writing is a document. However, it is not necessary that in every case a document should be in writing or contain the signature or facsimile of any person. It includes what is done by way of printing.

Section 29 of Indian penal code defines document as, it denotes any matter expressed or described upon any substance by means of letter, figures or marks, or by more than one of those means intended to be use, or which may be used, as evidence of that matter.

The Evidence act also defines document in section 3 as, “Document means any matter expressed or described upon any substance by means of letter, figures or marks, r by more than one of those means, intended to be used, r which may be used, for the purpose of recording that matter. As per illustration given under the section it includes;

- a) a Writing is a document.
- b) Words printed, lithographed or photographed are documents.
- c) A map or plan is a document.
- d) An inscription on a metal plate or stone is a document.
- e) A caricature is document.

Section 470 defines *a forged document or electronic record as a false document or electronic record made wholly or in part by forgery* and section 471 lays down that whoever fraudulently or dishonestly uses as genuine, any document, or electronic record, which he knows or has reason to believe, to be a forged document or electronic record, shall be punished in the same manner as if he had forged such document or electronic record. What is required to be proved is-

- 1) Fraudulent or dishonest use of a document or electronic record, as genuine; and
- 2) Knowledge or belief on the part of the person that the document or electronic record is a forged one.

57. Forgery of valuable securities: **Section 467** deals with *forgery of valuable securities*, wills, etc. An extremely sever punishment, viz., imprisonment for life, 10 years and fine, has been prescribed for the forgery of the following types of documents: -

- 1) A document which purports to be a valuable security;
- 2) A will;
- 3) An authority to adopt a son;
- 4) A document which purports to give authority to any person-
 - a) To make or transfer any valuable security, or
 - b) To receive the principal or interest or dividends thereon, or
- 5) To receive or deliver any money, moveable property or valuable security:
- 6) Any document purporting to be-
 - a) An acquaintance or receipt acknowledging the payment of money,
 - b) An acquaintance or receipt for a delivery of any moveably property or valuable security.

58. Forgery for Cheating: **Section 468** prescribes punishment for *forgery for purpose of cheating*.

Having possession of a forged document or electronic record, knowing it to be forged and intending to use it as a genuine document constitutes an offence under section

477-A- This section, which deals with *falsification of accounts and making of false entries in books is a very important section*. The section deals with two distinct offences: -

- 1) Falsification of accounts; and
- 2) Making or abetting the making of false entry or omitting or altering or abetting omission or alteration of an entry.

This section makes falsification of accounts punishable although there is no evidence to prove misappropriation, of any specific sum or on any particular occasion. The section requires the falsification of accounts with intent to defraud and does not require any deprivation of any property. In an old case decided by the Madras High Court, the officers of a co-operative store, who made false entries in the accounts, were held guilty under this section even though no one lost eventually by such false entries.

To establish a charge under this section, the following essentials will have to be fulfilled: -

- 1) The person coming within its purview must be a clerk, officer or servant or acting in the capacity of clerk, officer or servant;
- 2) He must willfully and with intent to defraud-
 - (a) Destroy, alter, mutilate or falsify any book, electronic record, paper, and writing, valuable security or account which-
 - (b) Belong to or is in possession of his employer; or
 - (c) Has been received by him for or on behalf of his employer; or
- B) Make or abet the making of any false entries, or omit or alter or abet the omission or alteration of any material particular from or in, any such book, electronic record, paper, writing, valuable security or accounts.

59.Clerk or servant: The words ***“acting in the capacity of a clerk or servant”*** are very wide terms and included a person who undertakes to perform and does perform the duties of a clerk or servant, whether in fact, he is a clerk or servant or not and although he is under no obligation to perform such duties and receives no remuneration. The Chairman or a committee member of a society, who writes the cashbook and other books of accounts, or issues receipts, although these are no part of his duties, comes within the purview of this section, since he has undertaken to do these duties and has done them. A person who voluntarily performs the duties of a clerk, officer or servant and falsifies the accounts also commits offence under this section. (Abdul Aziz vs. Emperor 1953). It has to be noted that the falsification can only be committed in respect of books of the employer. The Cashier’s Diary, Rough Cashbook or Counter Cashbook maintained by the cashier in a bank belongs to the employer as it is maintained in the ordinary course of business and the Cashier cannot claim it as his own or in any way belonging to him.

60.Willfully and with intent to destroy, etc, -Willfully means that the act is done deliberately and intentionally, not by accident or inadvertence, but so that the mind of the person who does the act, goes with it. Even if the intention with which the false entries are made is to conceal fraudulent or dishonest act, previously committed, the intention will be to defraud (Emperor vs. Ragho Ram (AIR 1933). Making a false document with a view to prevent persons already defrauded from ascertaining that misappropriation has been committed and thus enabling the persons who had committed the misappropriations to retain the wrongful gains which they had secured, amounts to the commission of a fraud and brings the case within the purview of this section. The issuing of a false statutory report of a company calculated to deceive the public and intended to induce them to invest their money in the company, which they would not otherwise have invested, is an act, done with intent to defraud. Promoters of bogus co-operative housing societies, who offer

residential flats, shop office premises or garages on attractive terms and given assurances of loan facilities, knowing that neither Government nor the Housing Finance Society have agreed to lend, can be hauled up under the provisions of this section.

It has been held that where alterations have been made not with any intent to defraud, but merely to comply with the requirements of departmental rules, no offence is committed. It has also to be noted that the alteration should be in the handwriting of the accused in order to convict him.

61.Falsification. -The expression “falsification” applies to the preparation of an entirely new document containing false information is correctly described as a false document and the act of preparing such document is called falsification of the document.

62.Accounts. -The offence is completed when accounts are falsified with intention to defraud. An alteration in the accounts made after embezzlement will come within this section, if it is part of the scheme to deprive another of his money. But the alteration of accounts without intention to commit fraud is not an offence under this section. Making false entries in books of accounts of a society by a person in order to conceal fraudulent or bogus transactions falls within the purview of this section and deprivation of property either actual or intended is not a necessary ingredient to defraud as contemplated in this section. The secretary of a co-operative society, who has misappropriated a large cash balance, in order to conceal the misappropriation, makes a bogus entry debiting the loan account of a member and forges his signature on the loan bond, commits an offence not only under section 408, but also under section 477-A. If the intention with which a false document is made is to conceal a fraudulent or dishonest act, which had been previously committed, the intention cannot be other than intention to defraud. The concealment of an already committed fraud is a fraud.

63.Electronic Record: Section 29 A of the Indian penal code defines the electronic records, as definition given in the clause (1) of sub-section (1) of the section 2 of the Information Technology Act, 2000. The definitions is explained in chapter describing InformationTechnology Act, provisions.

64. Fabricating false evidence Section 192. -Section also deals with a similar offence, viz., *fabricating false evidence*, but with a different intention. *This section refers to the making of any false entry in any book or record or electronic record, or making any document or electronic record, containing a false statement, intending that such false entry or false statement may appear in evidence in a judicial proceeding or in a proceeding taken by law before a public servant as such or before any arbitrator and that such false entry or false statement so appearing in evidence may cause any person, who, in such proceeding, is to form an opinion upon the evidence, to entertain an erroneous opinion touching any point material to the result of such proceeding.* Auditors and officers appointed under section 83 and 88 of the Maharashtra Co-operative Societies Act have been declared to be public servants. Accordingly proceedings before these officers are proceedings before public servants and as such act specified above done by office-bearers and employees of co-operative societies come within the purview of this section. Thus, entries intentionally made to reduce the cash balance such as fictitious debits, bogus advances, benami loans etc. Would come within the purview of this section. ***Intention is the gist of the offence of fabricating false evidence.*** The false evidence must be material to the case. As soon as the evidence is fabricated or false statement made, the offence is

committed. It is not necessary that such evidence is actually used. However, the fabricated evidence must be admissible evidence.

65. Acts done by several persons Section 34. -Many times, offences are committed by two or more persons acting jointly. Several persons may come together and commit an offence. In such cases, it may be difficult to distinguish between the acts, of individual members of a party or to prove exactly what part was taken by each of them in furtherance of the common intention of all. Section 34 *deals with acts, done by several persons in furtherance of the common intention of all, each of such persons is liable for that act, in the same manner as if it was done by him alone.* The section embodies the principle that if two or more persons intentionally do a thing jointly, it is just the same if each of them had done it individually. However, before a person can be held liable for an act, done by another, the section requires that it should be established that, firstly, there was a common intention in the sense of a pre-arranged plan, secondly the person sought to be held liable had participated in some manner in the act, constituting the offence. Both common intention and participation have to be present before the section can apply.

66. Criminal Conspiracy: Acting on a common intention also constitutes criminal conspiracy and is the subject matter of section **120-A**. to constitute criminal conspiracy, it is necessary to prove-

That there was an agreement between two or more persons-

- 1) For doing an illegal act, or;
- 2) For doing by illegal means an act, or which may not itself be illegal.

However, no agreement except an agreement to commit an offence shall amount to criminal conspiracy unless some act, besides the agreement is done by one or more parties to such agreement in pursuance thereof. It is immaterial whether the illegal act is the ultimate object of such agreement, or is merely incidental to that object.

The gist of the offence is the bare engagement and association to commit an illegal Act, or offence.

Section 34 and section 120-A contain similar provisions. There is not much substantial difference between criminal conspiracy defined in section 120-A and acting on common intention as contemplated in section 34.

SPECIAL REPORT

C- Report Writing

67. Need to submission of Special Report: As per Section 81 (5B), if auditor finds that there are apparent instances financial irregularities resulting into losses to the society caused by any member of committee or officer of society or by any other person, then he shall make special report and submit it to the Registrar along with audit report. Failure to file special report would amount negligence in the duties of auditor and he shall be liable for disqualification for appointment as an Auditor or any other action as the Registrar thinks fit.

Circumstances in which Specific report is required to be submitted :-

Sr.no.	Particulars	Instances / Examples which requires reporting	Auditor's remarks
1	Fraud	1) Debiting excess amount than the voucher amount / bill amount. 2) Withdrawing the amount from bank but not crediting in	During the period under audit fraud of Rs.----- is detected. The said fraud has been committed by using ----- modus operandi (without

		<p>cash book</p> <p>3) Debiting the bank account without depositing the amount in bank</p> <p>4) disbursing loans without sanction / without security / without loan documents / using forge documents</p> <p>5) any other transaction with the intention to defraud the society by any person.</p>	<p>security / fabricated documents / false security, etc.). The following persons are responsible for fraud.</p> <p>1....</p> <p>2...</p> <p>3...</p>
2	Misutilisation of funds and properties	<p>When the funds are not used by following due procedures E.g.</p> <p>1) purchasing / constructing building without inviting the tenders</p> <p>2) purchasing the computers without inviting the tenders.</p> <p>3) selling the movable / immovable properties without inviting bids</p> <p>4) selling the movable / immovable properties below Reserve Price (Upset price)</p>	<p>During the audit period, funds and properties of societies are misutilised as under :-</p> <p>1...</p> <p>2...</p> <p>3...</p>
3	Misapplication of funds	<p>If the society raises the fund for the particular purpose but uses them for another purpose, then there is misapplication of funds. E.g.</p> <p>1) State Government has granted loan for construction of go-down, but use for payment of salary or other regular payments.</p> <p>2) Use of sinking fund for day to day maintenance without passing required resolution in General Body.</p> <p>3) Use of revenue reserve / general reserve for creating Reserve for Bad and Doubtful Debts.</p> <p>4) Not using Government share capital redemption fund for repaying Government debt / capital on due date.</p>	<p>During our audit period, we have found following misapplication of funds.</p> <p>1...</p> <p>2...</p> <p>3...</p>
4	Manipulation of accounts	<p>1) Crediting interest received account without being amount actually realized In</p>	<p>We have found following manipulation / window dressing of accounts during</p>

		contravention of Income Recognition Asset Classification (IRAC) norms. 2) Loans showing to be recovered without actually being recovered by debiting new loan account. 3) Window dressing of accounts. E.g. loan account debit deposit account credit without deposit actually being received.	our audit period. 1... 2... 3...
5	Falsification of accounts	1) Amount recovered from one party and credited to other party there by showing incorrect position of state of affairs. E.g. A's account has become NPA. B's account is in PA category. Amount received from B is credited to A's account to conceal NPA. 2) Showing stock items and value of stock when there is no stock is in existence.	We have found the following falsification of accounts during our audit period. 1... 2... 3...

IX-8. FOLLOW-UP AUDIT: RECTIFICATION OF ERRORS POINTED OUT IN AUDIT

1. Legal provisions. -As we have seen, co-operative audit is not merely critical, but curative. The duties of the auditor of a co-operative society do not end merely by pointing out errors and irregularities noticed by him, but he has also to suggest ways for avoidance of their repetition. It is, therefore, necessary that the society follow-up the suggestions made by the auditor and takes due steps to remedy the defects pointed out by him in his audit memo.

Section 82 of the Maharashtra Co-operative Societies Act, requires every society to explain to the Registrar, within three months of the receipt of the audit report in 'O' Form, the defects or irregularities pointed out by the auditor and take steps to rectify the defects, remedy the irregularities and report to the Registrar the action taken by it thereon. The Registrar may also make an order directing the society or its officers to take such action as may be specified in the order to remedy the defects within the time specified therein.

Since the federal society to which the society is affiliated is also interested in its development and improvement, the section requires that where a society is a member of a federal society, an order under section 82 shall be issued after consulting the federal society. Federal society shall communicate its opinion to the Registrar within a period of 45 days from the date of receipt of communication, failing which it shall be presumed that such federal society has no objection to the proposed action by the Registrar. If the committee of the society fails to submit the audit rectification report to the Registrar and to Annual General Body Meeting, all members of committee shall be deemed to have committed offence under Section 146 and liable for penalty as provided in Section 147.

It shall be the responsibility of the auditor concerned to offer his remarks on the rectification report of society item wise, till entire rectification is made by society and submit his report to the Registrar.

The Registrar or the person authorized by him shall scrutinize the audit rectification report and inform the society within six months from the date of receipt thereof.

Sub-Section (4) of section 87 provides that if a society fails to rectify the defects disclosed in the course of or as a result of audit under section 81 or fails to rectify the defects as directed by the Registrar, the Registrar may himself take steps to have the defects rectified and may recover the cost from the officer or officers of the society, who, in his opinion, has or have failed to rectify the defects.

Sub-Section (1) of section 79 also empowers the Registrar, among other things, to submit to him such statements and returns as he may require from time to time; and the officer or officers of the society shall be bound to comply with his orders within the period specified therein. Sub-section (2) further provides that where any society is required to take any action under this Act, the Rules or the bye-laws or to comply with in order made under the foregoing sub-section (i.e. sub-section (1) of section 79 quoted above) and such action is not taken within the time provided in this Act, the Rules or the bye-laws, or the order as the case may be, or (b) where no time limit is so provided within such time, having regard to the nature and extent of the action to be taken, as the Registrar may specify by notice in writing, the Registrar may himself, or through a person authorized by him, take such action at the expenses of the society; and such expense shall be recoverable from the society as if it were an arrears of land revenue.

6. Action to be taken by the District Deputy Registrars and the Divisional Joint Registrars. -The importance of follow-up of audit requires no emphasis. It needs hardly be pointed out that ***unless prompt action is taken to remove the defects noticed in audit, audit would loose much of its efficacy.*** It should, therefore, be impressed on the societies that the defects pointed out by the auditors are to be promptly rectified and the suggestions made by them implemented as early as possible. The societies should also be told that avoids their recurrence. As such, vague and non-committal replies, such as “Noted”, “Necessary action will be taken in due course”, “will be placed before the Committee”, etc., should not be accepted. The society should have taken definite action to rectify the irregularity and offered satisfactory explanation. It has to be noted that the responsibility of the District Deputy Registrars and the Divisional Joint Registrars does not end merely by calling attention of the society to the points contained in the audit memos. Section 82 of the Maharashtra Co-operative Societies Act empowers the District Deputy Registrars and the Divisional Joint Registrars to issue directives to the societies and their office-bearers and compel them to take specific action to rectify the irregularities within a specific time. It is, therefore, necessary that the audit memos of all societies received by them are carefully reviewed and necessary action taken thereon. It has been noticed that a number of frauds and embezzlements could have been avoided. In cases of serious irregularities, frauds and misappropriations, auditors have been asked to submit special reports. Where frauds and embezzlements have been reported, the Deputy Registrars and the Divisional Joint Registrars should take immediate action and institute criminal prosecutions against the culprits. In some cases, action under provisions of section 88 will have to be taken. Wherever necessary, a further report or additional information may be called for from the auditors. As regards launching of criminal cases, instructions issued by the Registrar and Government should be strictly followed.

The Administrative Officers have also been armed with adequate powers to deal with defaulting societies, which pay no attention to the irregularities pointed out by the auditors. Wherever necessary, proceedings should be instituted under section 146 of the Maharashtra Co-operative Societies Act. Where serious irregularities have been reported, inquiry under section 83 may have to be ordered and the defaulting office-bearers made to pay the cost of inquiry. In extreme cases, action to supersede the committee under provisions of section 78 may also have to be taken. The financing Agency may also have to be asked to stop credit to the society or recall the loan sanctioned to it, unless the society agrees to take necessary action to mend its ways. Where, however, no serious irregularities have been reported and the societies have taken due steps to rectify the defects pointed out, no review may be necessary. However, in all cases, where serious irregularities have been reported or the societies have not been attending to the suggestions of the auditors, the administrative officers should review the audit memos, and the audit rectification reports and communicate their observations to the societies concerned.

IX-9 Remuneration of Auditor :-

1. Historical retrospect. - The rates are revised for various types of societies by the Registrar as mentioned below. Section 81 (f) states that, "Remuneration of auditor shall be borne by society and shall be at such rates as may be prescribed". Considering this Rule 74 reads as follows :- "Remuneration of auditor shall be borne of society and shall be at such rates as may be notified by Government.. Considering this legal provision, Government of Maharashtra has vide its notification dated 29/10/2014 issued revised structure of audit fee for all types of societies which is applicable from Financial Year 2014-15. Before this rates of audit fees were decided by the Commissioner for Co-operation and Registrar for Co-operative Societies, Maharashtra State, Pune vide circular dated 15/05/1992. Previously audit of some bigger societies was carried out by departmental auditors on current and concurrent basis like MSC Bank, DCC Bank, Marketing federation, etc. Audit fee of these societies was decided on the basis of pay, travelling allowance and dearness allowance of the departmental auditors who were carrying out current and concurrent audit. After amendment in Co-operative Societies Act in 2013, system of current and concurrent audit is dispensed with. Therefore, the rates of audit fees of these societies are also decided by above Government notification. The Government notification regarding audit fee dated 29/10/2014 is reproduced in Annexure s