

**KERALA CO-OPERATIVE
AUDIT MANUAL**

VOLUME-1

FOREWORD

THE NEED FOR AN 'Audit Manual' for the use of the Co-operative Departmental Officers particularly the audit personnel has been felt for a long time. During the last two decades, the Co-operative Movement in the State has assumed greater importance and recorded steady progress. Now there is hardly any sector of human activity which is not covered by the movement. There has also been tremendous increase in the number of Co-operative Institutions and their volume of transactions. Accounting techniques have also undergone various changes during this period and developed considerably. The State and Central Government's patronisation of Co-operative Institutions by way of liberal financial assistance year after year has also cast added responsibilities on the auditing personnel. The organisations of special type of Co-operative Institutions like Sugar Factories, Spinning Mills, Housing, Dispensaries, Group Hospitals, Autorickshaw Societies etc. having peculiar type of transactions also really pose of problem to the auditing staff. The above factors persuaded the department to prepare this comprehensive handbook giving practical and useful guidelines to the Audit Personnel in the day to day performance of their duties. It is hoped that this manual will be of considerable assistance in the task of equipping those engaged in the audit and supervision of Co-operative Institutions and consequently ensure the efficiency and effectiveness of audit.

THE CIRCULAR issued by the Reserve Bank of India and the department pertaining to audit along with extracts of important enactments which are relevant to audit of Co-operative Institutions will be consolidated and published as 'Audit Manual Volume-II', shortly. Similarly, uniform sets of forms and registers to be maintained by the various types of Co-operative Institutions will also be prescribed under Rule 29 of the Kerala Co-operative Societies Rules and will be published as Volume-III of the Audit Manual.

ANY SUGGESTION FOR the improvement of the manual will be quite welcome.

Trivandrum,
29-3-1983

K.M. Balakrishnan,
Registrar of Co-operative Societies

PREFACE TO THE SECOND EDITION

The Audit Manual, first published in 1983, is being republished. At this moment we are much aware of those inevitable changes to be made in order to incorporate latest developments in this field. It is true that wide ranging revision in the Manual is imminent in view of the speedy automation of co-operative institutions. We have already taken steps to republish the manual with necessary modifications to enhance the standard of Audit at the national level. Yet we decided to republish the existing Manual without changes as it contains some of the fundamental rules and regulations related to auditing and also because copies of the same is not available in print. We hope that this will be a basic text useful for Auditors.

We would very much appreciate your valuable suggestions for the forthcoming revised edition.

Thiruvananthapuram
05-7-2012

K.G. Raju IAS
Director of Co-operative Audit

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AUDIT MANUAL

PART 1

CHAPTER I

GENERAL

1. *introduction.*-The last two decades have witnessed a rapid growth and vast expansion in the activities of Co-operatives in the State. There was a steep rise in the number of co-operatives of different types as well as marked diversification in their activities and substantial rise in their business operations.

The State Government was always patronising Co-operatives with liberal financial assistance like share capital, loans, subsidies, guarantees etc. In due course, the State acquired heavy financial interest in the working of Co-operatives. Therefore, the Auditors of the Department have to shoulder added responsibilities for safeguarding the interest of the State also. They have also to ensure that Government funds are properly utilised by the Co-operatives. All these necessitated that the Auditors should equip themselves with the required knowledge so that they can perform their duties with due skill and diligence.

Over a period of years, the techniques of accounting have also undergone thorough changes and developed considerably. Therefore, the Auditors have to assist and guide the societies to maintain systematic accounts and also in introducing latest techniques, practices and procedures in accounting. This, required that the Auditors should have a thorough knowledge of the latest developments in Accountancy and Book-keeping.

Of late, with the emergence of a variety of Co-operative institutions like Sugar factories, Spinning mills, banks, housing societies, dispensaries, group hospitals, autorickshaw societies etc. the Auditors have to audit complicated transactions. This required practical and authoritative guidance on many important points.

Thus, the need for a comprehensive handbook giving practical and useful guidelines in the day-to-day performance of the Auditors' duties, was keenly felt. This Manual is an attempt towards that end: This manual will be of considerable assistance in the task of equipping those engaged in Audit and management of Co-operative institutions with a knowledge of co-operative auditing.

2. *Objectives of the Manual.*-The objectives of the Manual are:-

- (i) To serve as a ready handbook of practical guidance to the Auditors of Co-operative Societies and to those who are responsible for maintenance of accounts.
- (ii) To serve as a certified handbook of Departmental instructions relating to co-operative accounts and audit, and
- (iii) To help to improve the quality of audit work and to maintain a high standard of audit.

3. *Scope of the Manual.*- In this manual, an attempt has been made to bring out the general principles and practices of audit and the procedure to be followed during the course of audit with special reference to the various Departmental Circulars and instructions issued by the Registrar from time to time. The procedure to be adopted in auditing the accounts of different types of co-operative societies is also mentioned in the Manual. Besides explaining the general procedure of work, such as verification of cash, verification and valuation of assets and liabilities, examination of business transactions etc. the methods to be followed in assessing the operational efficiency, financial soundness and co-operative character of different types of co-operatives are also dealt with. Necessary instructions are also incorporated to ensure uniformity in drafting the audit reports, preparation and submission of special reports summary of defects filling in the schedules and other accompaniments to the audit note, preparation of audit programme, charging of depreciation, creation of reserves, Audit Classification etc. Wherever possible legal decisions relating to audit are also quoted. Every effort has been made to make the manual exhaustive wherever possible.

4. *Audit - Definition.*-The word "audit" is derived from the latin word "Audire" which means "to hear". In the middle ages whenever the owner of a business suspected fraud he appointed

certain persons to check up the accounts. The details of the transactions were narrated to a third party who, by hearing, tested the correctness of accounting. The evolution of the principles of double-entry book-keeping which was first published in 1494 in Italy, gave a filling to the growth of the science of auditing.

Spicer and Pegler have defined audit as “such an examination of the books, accounts and vouchers of a business as shall enable the auditor to satisfy himself whether or not, the balance sheet is properly drawn up, so as to exhibit a true and correct view of the state of affairs of the business, according to the best of his information and explanation given to him and as shown by the books, and if not in what respect it is untrue or incorrect” .

Audit in its general sense is an intelligent and critical examination of accounts of a business and - verification of correctness of accounts with relevant documents for the purpose of ascertaining the financial position of the business at the end of a particular period, by an independent agency. Audit is not a mere verification of records maintained, but involves also an exhaustive verification of supporting vouchers and documents to ensure that the entries in the books themselves have been correctly made so as to form a true record of the transactions. The concept of audit has come to mean such a close and careful examination of the account books, documents and other records of a business or other organisation 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 account and the balance sheet of an organisation have been drawn up, in order to enable him to report that they present a true and fair view of the summarised transactions for the period under review and of the financial position of the organisation as at the end of the period.

Section 63 (2) of the Kerala Co-operative Societies Act 21 of 1969, lays down that “audit shall include an examination of overdue debts, if any, the verification of the cash balance and securities, and a valuation of the assets and liabilities of the Society”.

5. *Main objects of audit*- The main objects of audit are:

- (i) To detect clerical errors and errors of principle.
- (ii) To detect fraud, if any exists and
- (iii) To prevent fraud and errors.
- (iv) To ascertain a true and correct state of affairs of the institution/organisation.

1. *Detection of errors*:-Errors are generally innocent. But sometimes errors which might appear at first sight innocent are ultimately found to be due to fraudulent manipulation.

Errors can be classified into the following groups:

(a) *Errors of omission*.-This arises when a particular transaction is omitted from entry either wholly or partly in the books. Eg:

- (i) The rent for last month of the year and not shown as due.
- (ii) An item of credit purchase omitted to be entered in the purchases day book.

(b) *Errors of commissions*:- An error of commission arises as a result of incorrectly recording a transaction either wholly or partly. In the case of whole omission, the Trial Balance will not be affected. In case it is partially and incorrectly, recorded, the result will be that the Trial Balance will be affected to that extent. Ex:-

- (i) Credit sales for Rs. 400 wrongly entered in the sales day book as Rs. 450.
- (ii) Rs. 250 received on A's account wrongly posted in debit side of A's account.

(c) *Compensating error*:- This type of error is one which is compensated by another error or errors. The result is that such an error is not disclosed by the Trial Balance. Ex:-While A's account was to be debited with Rs. 100, it was actually debited with Rs. 10 and at the same time, B's account which was to be debited with Rs. 10 was actually debited with Rs. 100.

(d) *Errors of principles*:-Such errors arise when entries are not passed according to the fundamental principles of accounting. Errors of principle will affect the accounts considerably.

The following are a few examples.

- (i) Ignoring outstanding liabilities.
- (ii) Incorrect allocation of expenditure.
- (iii) Wrong treatment or calculation of accrued assets.
- (iv) Valuation of assets against the principles of book keeping.
- (e) Errors of duplication:-Such a type of error arises when an entry in a book of original entry is made twice and posted twice.

The examination of accounts by an outside agency will no doubt create a moral check and will also facilitate early detection of frauds or errors. Fraud may take place either in the form of misappropriation of cash or goods, or falsification of accounts, unaccompanied by misappropriation. While the former can be detected by a careful checking of accounts, the detection of the latter is not easy. 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 arithmetical accuracy of the accounts can be tested by drawing up the Receipts and Disbursements statement or Trial Balance.

(2) Location of differences or errors:-The following methods are adopted to locate an error if the trial balance does not agree:

- (i) Check the totals of the trial balance.
- (ii) Compare the names of the accounts in the ledger with the names of the accounts given in the trial balance. It is possible that the balance of some accounts might not have been transferred to the trial.
- (iii) Total the lists of debtors and creditors and compare them with the Trial Balance.
- (iv) If books are maintained in the self balancing system, examine whether the totals of different accounts agree with the totals of these accounts and the balance of accounts, as recorded in the trial balance.
- (v) Examine whether any debit balance has been put on the credit side and vice versa.

In spite of the above methods, if the error cannot be located, it may be due to the following causes:

- (i) An error of say Re. 1 or Rs. 10 or Rs. 100 etc. i.e. a round sum may be due to wrong totalling. If the difference is in Rupees or Paise it may be due to wrong postings or extracting a wrong balance.
- (ii) An error which is divisible by '9' may be due to misplacement of figures i.e. 32 for 23, 52 for 25 etc.

6. *Advantages of audit* - Apart from the detection of errors and fraud, a regular audit would help to keep the books of accounts of a business concern up-to-date. The fact that audit is being done at regular intervals will act as a moral check and prevent fraud and errors to a certain extent. It also helps to provide an independent opinion to the members' general body about the management of their committee and the institution. Audited accounts are usually relied upon for the purpose of assessing the income tax and sales tax and also for disbursement of Government assistance. An efficient audit is a safeguard to the creditors whose investments enable the institutions to conduct its business. The audit helps to ascertain the correct and true state of affairs of the business, which consequently enables the institution to secure necessary finance on the certificate of the audited balance sheet.

7. *Different types of audit.*-The different types of audit now in vogue are the following:-

- (i) (a) Concurrent or continuous audit:

A concurrent or continuous audit is one where the auditor visits the institution daily/regularly or periodically and completes the examination of accounts up-to-date. In other words the audit is concurrent with the period of maintenance of accounts. This kind of audit is adopted by Societies having large volume of business and which have huge daily transactions. To conduct concurrent audit, individual societies or groups of societies can get the services of Departmental Auditors at their cost on request.

- (b) Advantages of concurrent or continuous Audit:

(1) Mistakes and frauds can be discovered easily and quickly and rectified then and there during the course of audit itself.

(2) As the auditor visits the society daily/regularly or periodically, he will be in touch with the business which helps him to gain technical knowledge of business. He will also be in a position to view critically the accounts.

(3) The final audit of accounts of the institution can be completed as soon as the year ends and certified Balance Sheet made available.

(4) The daily or regular or periodical visits by the Auditor will create a moral effect on the staff to maintain the accounts up-to-date.

(ii) Interim audit;

Interim audit is one performed between two final audits. It helps the auditor to get the final audit done easier and quicker. Interim audit report has to be submitted with copy of receipts and disbursement statements for the period with the summary of defects if any.

(iii) Final audit:

Final audit is the statutory annual audit. It is taken up at the close of the financial or trading period when all the accounts are balanced and a trading and profit and loss account and Balance Sheet prepared. The valuation and verification of assets are also done by the Auditor. Final audit of societies is generally taken up from 1st July every year. "Year shall ordinarily mean the period commencing on the first day of July of any year and ending with 30th of June of the succeeding year. With the previous permission of Registrar any registered society or class of societies may change its year to any other date. For example: the accounting year of School/ College Co-operative Stores is from 1st January to 31st December".

Societies are expected to prepare the balance sheet and profit and loss accounts every year and keep them ready for audit. These statements are to be checked by the Auditor with reference to the audited figures arrived at by them. Later on, the auditor forwards his certified Balance Sheet and his report in the prescribed form to the issuing authority, viz. the Deputy Registrar, Assistant Registrar, as the case may be. The Deputy Registrar/Assistant Registrar will scrutinise the audit report, make necessary modifications, if any, require and issue certificate to the society concerned together with

a copy of the Auditor's report and summary of defects, if any, on the working of the Society.

(iv) Test Audit:

Test audit is one special to the Co-operative field. The Deputy Registrars/Assistant Registrars are expected to test audit a few Societies to ascertain whether the auditor has done the audit correctly or not. This is called "Test Audit".

This involves a re-audit of the accounts of the Society, the audit of which is tested. At least one Society audited by each Auditor should be selected for test audit. If such test audit reveals serious defects the work of the Auditor concerned should be checked up by test auditing an additional Society audited by him.

While selecting societies for test audit, care should be taken to select those with sufficient transactions. The effectiveness of test audit to a certain extent depends up on the careful selection of Societies. In the case of Societies with heavy transactions, it is enough if one month's transactions are test audited. Wherever possible, test audit should be done in the presence of the Auditors concerned. The audit certificate of the Society selected for test audit should not be issued before it is test audited. The auditors should not be informed of the societies which the Deputy Registrar/Assistant Registrar would be test auditing. Test audit is to be conducted side by side with the final audit.

8. Approach to Audit.-(i) Co-operative Auditor.-Audit normally means an examination of accounts of an institution with a view to testify their accuracy. Co-operative audit is a statutory obligation of the Registrar of Co-operative Societies. The accounts of a Co-operative Society are to be audited annually. Co-operative audit is more comprehensive than any other kind of audit and includes an examination of overdue debts, if any, the verification of cash balance and securities and a valuation of the assets and liabilities of the society. Unlike any other kind of audit, the Co-operative Auditor has to go beyond the books and records and make personal enquiries in order to investigate the actual state of affairs of a particular issue, if he deems fit.

(ii) Audit by the Accountant General.-Accountant General's audit is mainly audit of expenditure. It aims at safeguarding the financial interest of the tax payer and also to assist the State

legislature in exercising financial control and discipline over the Executive. Audit by the Accountant General may be described as an audit against provision of funds, regularity (ie. against Rules and orders) scrutiny of Rules and orders, sanction of expenditure, propriety etc.

(iii) Inspection by the Finance Department.-The examination of accounts by the Finance Department is in the nature of an inspection and not an audit. They examine whether the controlling officers, maintain proper accounts in respect of all financial transactions and submit -the prescribed returns to the Government and the Accountant General. Proper collection of revenues and loans and advances are also watched through the inspection. They also ensure whether the loans and subsidies sanctioned by Government to various schemes are properly utilised. However it is not an annual obligation.

(iv) Audit by the Local Fund Audit Department.-Like Co-operative Audit, Local Fund Audit is a statutory one. They audit the accounts of institutions which are maintained wholly or partly from Government Grants. Local Fund audit examines the financial position of the Local bodies and bring to notice wastefulness in administration and infructuous expenditure. As in Co-operative Audit, the Local Fund Auditor is not bound to make independent enquiries from private individuals or members of the general public. In other words, this audit should strictly confine itself to calling upon the Executive to furnish any necessary information as may be required by the audit. Like the Co-operative Auditor, the Local Fund Auditor is also bound to verify the cash balance in hand of the institution at the time of audit and to record a certificate of verification.

(v) Chartered Accountants.- (a) As per Section 63 of the Kerala Co-operative Societies Act, it is the statutory duty of the Registrar to Audit or cause to be audited by a person authorised by him by general or special order in writing in this behalf the accounts of every co-operative society at least once in each year.

(b) Co-operative audit is basically different from commercial Audit; which is done by Chartered Accountants appointed by share holders. The audit of a Co-operative Society is to be done and its affairs viewed specially bearing in mind the Co-operative Principles and guidance to be given to the institution for improvement. The

Chartered Accountants need not necessarily view its affairs and accounts with this outlook.

(c) Co-operative audit involves Administrative audit also. As chartered Accountants are not in touch with Administrative matters and problems of Co-operative Institutions, they may not be able to do justice in auditing these institutions. Moreover, in the case of Chartered Accountants, no effective control or supervision can be exercised by the Department over them since they are outside the Department.

CHAPTER- II

CO-OPERATIVE AUDIT

1. Definition-(i) Co-operative audit is a close examination of financial transactions, maintenance of Books of Accounts, documents and other records of a business and includes an inquiry into the affairs of the society in order to ascertain the correctness of accounts and the extent to which its activities were useful in promoting the economic welfare of its members in accordance with co-operative principles.

(ii) Co-operative audit is a more comprehensive enquiry than a mere financial audit. It is also an administrative audit.

(iii) In the words of the Macleagan Committee “The terms of the Act expressly require that the audit shall include an examination of overdue debts and a valuation of assets and liabilities. By this latter we understand not merely the preparation of balance sheets of societies, but also a sufficient check, in accordance with such rules as the Registrar may lay down, of the list of material assets of the members. The audit, in our opinion, extends somewhat beyond the bare requirements of the Act, and should embrace an enquiry into all the circumstances which determine the general position of the society. It would, for instance, be the duty of the Auditor to notice any instances in which the Act, rules or bylaws have been infringed, to verify the cash balance and certify the correctness of the accounts to ascertain that loans are made fairly for proper periods and objects and on adequate security, to examine repayments in order to check book adjustments and improper extensions and generally to see that the society is working on sound lines and that the committee, the officers and the ordinary members, understand their duties and responsibilities”.

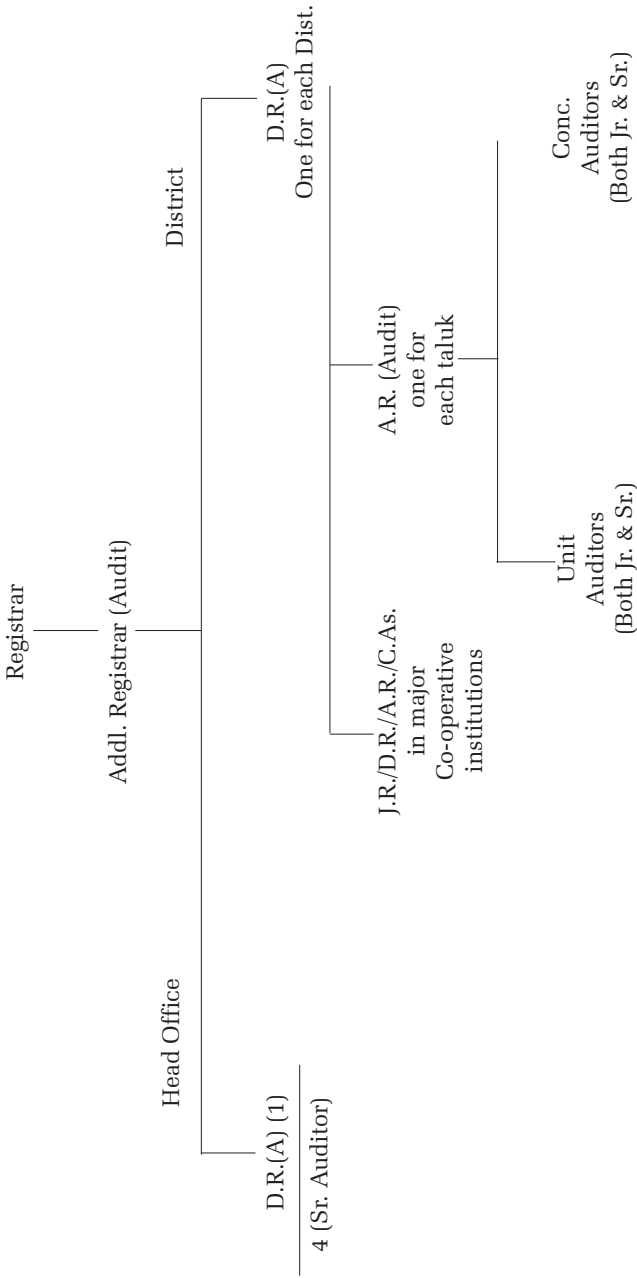
(iv) The above views of the Maclegan committee highlight the scope and duties of a Co-operative Auditor. The Co-operative Auditor cannot confine himself to the books of accounts, but should go beyond the books and make enquiries about the working and general affairs of the society. Co-operative Audit may also be described as a critical examination by an auditor, of the documentary and other evidence from which the profit and loss account and the balance sheet of a Co-operative Society/Bank have been drawn up, in order to enable him to report that they present a true correct and fair view of the summarised transactions for the period under audit and of the financial position of the society as at the end of the co-operative year.

2. Statutory provision.-As per section 63 of the Kerala Co-operative Societies Act 21 of 1969, audit of Co-operative Societies, has become the statutory responsibility of the Registrar. Subsection (1) of section 63 lays down that “the Registrar shall audit or cause to be audited by a person authorised by him by general or special order in writing in this behalf, the accounts of every society at least once in each year”.

3. Audit at headquarters or at branches of society.- The Auditors should conduct the audit at the headquarters or branches of the society and should not remove the books or records from there.

4. Arrangement and set up for audit.-For the efficient and timely audit of Co-operative Societies there is a separate set of staff who are not concerned with the administration of societies in the department. The audit of societies other than those under the control of the Registrar of Co-operative Societies (viz. Industrial, Fisheries, Dairy etc.) is also attended to by the above audit staff in the Co-operative Department.

The following is the present set up of the audit wing in the State:-



Additional Registrar (Audit) at the Head Office is in overall control of the audit staff and exercises all powers of the Registrar, as far as audit is concerned. Under him, there are Deputy Registrars (Audit) one for each District. At taluk level there are Assistant Registrars (Audit) one for each taluk (except in Tellicherry Taluk where there are 2 Assistant Registrars (Audit). These Assistant Registrars, who are controlled by the respective Deputy Registrar (Audit) closely supervise and guide the work of the unit/concurrent auditors (other than Assistant Registrar/concurrent Auditors) working in the respective taluks. In almost all major Co-operative Institutions, Deputy Registrar/Assistant Registrars of Co-operative Societies are working as concurrent Auditors. Unit Auditors, concurrent/ Group Auditors in other institutions, are of the cadre of Senior Inspector/ Junior Inspector of Co-operative Societies.

5. *Co-ordination between the concerned Administrative Department and Audit Wing of the Co-operative Department -* Close Co-ordination between the concerned Administrative Departments and Audit Wing of the Co-operative Department assumes importance in the context of expeditiously conducting the audit and rectifying defects pointed out in audit. Every Co-operative Society shall prepare for each co-operative year in such form as may be specified by the Registrar, a statement of receipt and disbursement, for the year, a profit and loss account, a balance sheet and such other statements as may be specified by the Registrar. The administrative wing, during the course of supervision and inspection can give directions and guidance to the societies in the proper upkeep of accounts, maintenance of records, books and registers in connection with the business of the society. It can also give suitable directions to the societies for the strict adherence to the provisions of the Act, Rules and the bylaws in its day to day transactions. On proper guidance, the society can prepare and keep ready the audit statements and can also obtain confirmation statements of balances in respect of its assets and liabilities in advance for the purpose of audit. This will facilitate easy and expeditious audit of accounts.

Defects disclosed in audit will be brought to the notice of the society, as well as to the administrative wing in the form of "*Summary of defects*". The administrative wing can persuade the society to rectify the defects and to avoid recurrence in future. Thus, close liaison between the concerned administrative departments

and audit wing of the Co-operative Department will help in a long way to improving the working of the societies and for the timely completion of their audit.

6. *Difference between the audit of Co-operative Societies and of Joint Stock Companies.*-(i) Section 63 of the Kerala Co-operative Societies Act, 1969. lays down that the Registrar shall audit or cause to be audited by a person authorised by him by general or special order in writing in this behalf, the accounts of every society at least once in each year. The audit of a joint stock company is conducted as per sections 224 to 234 of the Indian Companies Act, 1956. Thus the Co-operative *audit is State Controlled*, while audit of a joint stock company is an annual or obligation left to the company itself.

(ii) The appointment of auditor of a Co-operative Society is made by the Registrar while in a joint stock company it is made by its shareholders. The auditor of a Co-operative Society is primarily and directly responsible to the Registrar while the auditor of a joint stock company is responsible to the shareholders. As observed by Maclean Committee "it is through audit alone that an effective control can be exercised over the movement and it is clear that it was never intended that the audit should be merely an arithmetical one and that the Registrar's activities outside audit should be confined to the inspections and enquiries. 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". It is thus clear that whereas in a Co-operative Society the auditor carries out the audit on behalf of the Registrar and submits his reports to him, the auditor of a joint stock company, is appointed by the share holders and makes his report to them.

(iii) A joint stock company being an association of capitalists is mainly a profit seeking concern. The important result of audit they normally expect is the disclosure of the net profit available for distribution as dividend, But in a Co-operative Society, the primary objective is to find out how far the society has been carrying on its business on sound co-operative lines and aiming at the material and moral improvement of its members. The mere fact of declaration of dividend in a Co-operative Society is not the criterion of its successful working.

iv) Usually in a joint stock company the statement of accounts are prepared by the ,Company themselves, whereas in a Co-operative Society the auditor may have to prepare all the statements of accounts, which will be signed by him. Even though the societies are bound to file the annual accounts in such form as may be specified, by the Registrar, such statements are made use of for compiling the state statistics. Such statements are subjected to scrutiny by the Auditor, during audit of accounts of the society.

(v) In a Co-operative Society, interest accrued and fallen overdue and interest accrued after an item of interest has fallen overdue is excluded for arriving at the net profits whereas in a joint stock company, both these items are included in calculating the net profits.

(vi) As per section 63 of the Kerala Co-operative Societies Act, the Co-operative Auditor is expected to examine the overdue debts, if any, and also to value the assets and liabilities. But in a joint stock company, the auditors simply check the valuation made by the management. Thus Co-operative Audit entails a more comprehensive enquiry than is usually made in the case of Joint stock companies.

7. Scope and special features of Co-operative Audit.- The auditor of a Co-operative Society has not only to conduct his audit according to the normally accepted principles, but has also to follow the instructions issued by the Registrar from time to tune.

The special feature of audit of a Co-operative Society is to safeguard the interests of its members and the creditors including Government in their finance. The duties of a Co-operative Auditor 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 profit and loss account.

(i) *Examination of overdue debts-* Examination of overdue debts involves a careful assessment of chances of their recovery and their classification into good bad and doubtful. The auditor has also to examine in detail whether the society has taken effective and prompt action for recovering the overdues.

(ii) *Valuation of assets and liabilities.-* One of the important duties of the auditor is to verify the assets and liabilities appearing in the balance sheet. Verification of assets is a process by which the

auditor substantiates the accuracy of the figures at the right hand side of the Balance Sheet. After ascertaining the assets in the books of accounts of the society, the auditor has to see that all those assets are correctly valued and included in the Balance Sheet. The duty of an auditor with regard to the verification of assets as disclosed in the Balance sheet will be complete only when he satisfies that those assets are in the possession and enjoyment of the institution on the date of the Balance Sheet. The auditor has also to see that such assets are free from any charge or mortgage. The verification of assets should be done also by physical verifying the documents of titles, such as negotiable instruments, share certificates, securities, debentures etc., etc.

The accuracy of the Balance Sheet and the profit and loss account depends upon the correct valuation of assets and liabilities. The valuation of an asset has to be made taking also into consideration the original cost, the probable working life of the asset and the chances of the asset becoming obsolete. The duty of the Auditor here is to see that the basis of valuation and calculation is correct and provision made for all contingencies.

With regard to the valuation of liabilities, the auditor has 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.

(iii) *Adherence to Cooperative Principles*- In conducting business operations the Co-operatives are expected to observe certain well defined principles. A Co-operative Society is an association of members who have joined together not to earn profits on their investments but to secure resources and services required by them. The important result expected in audit is to ascertain how far the society has achieved the objects for which it has been organised and how far it has succeeded in improving the material and moral well being of its members.

(iv) *Personal verification of members' accounts and Examination of their pass book* - Personal verification of members' accounts is a safeguard to prevent manipulation of accounts by dishonest employees and office bearers of societies. In order to ascertain whether the books of accounts of the society show the correct position, the auditor has not only to compare the entries in the book- with the receipts, vouchers and other documents, but also to

make enquiry by calling for explanation and personal verification of the accounts of a good number of members selected at random. In the case of rural and agricultural credit societies, the auditor has to examine the entries made in their pass books, with reference to the books of accounts of the society and has to confirm the balance in their presence.

Section 63 of the Kerala Co-operative Societies Act 1969, gives the auditor ample powers to summon members to furnish such information relating to the transactions with the society.

(v) *Assessment of damages due to negligence.*- If any deficiency or loss has occurred to the society due to negligence, want of proper care, misfeasance or misconduct on the part of the employees or members of the committee, or of the society, the auditor, after careful examination of the relevant records, has to assess such deficiency or loss. He is thus vested with the responsibility of safeguarding the interests of the members and creditors of the society.

(vi) *Certification of bad debts.*- Rule 62 of the Kerala Co-operative Societies Rules, lays down that such of the dues to the society including loans and advances and interest thereon which are found irrecoverable can be written off only after they are certified as such by the auditor appointed under Section 63 of the Kerala Co-operative Societies Act 1969.

(vii) *Awarding of audit classification to the society.*- On completion of the statutory audit, the authority competent under Section 63 of the Act has to award an audit classification to the society, in accordance with the instructions issued by the Registrar from time to time.

An elaborate procedure has been laid down in the method of classifying primary credit societies and noncredit societies. The societies are classified under A, B, C and D classes. Classification is made depending upon their general performance for which marks are awarded in each item. For details of classification refer to chapter No. II of part IV.

8. *Auditor's duties and responsibilities.*- Section 63 (2) of the K. C. S. . Act 1969, lays down that the audit shall include an examination of overdue debts, if any, the verification of cash balance and securities, and a valuation, of the assets and liabilities of the society.

Therefore the auditor should:

(i) Verify the cash balance on the date of his visit and record the result of verification with his signature, date and designation. If on verification, the cash balance agrees with the book balance the result of verification may be recorded in the following form:—

*“Cash balance of Rs (in words.....)
was verified by me and found to agree with the book balance on / at
the close/opening etc. of.....”*

The auditors should study the bylaws of the society and ascertain as to whether the cash balance is actually kept by the person authorised to do so under the byelaws. He may also verify the manner in which it is kept. To ensure that the cash balance has been correctly noted in the cashbook and that no bogus payments are entered therein, the auditor before verifying the cash balance should vouch the cash book up to date. In bigger institutions, if it is not possible to conduct the mechanical checking up to date, the auditor may vouch the transactions of a day or two prior to the date of verification. If the cash balance is not forthcoming readily, he should take action as mentioned in Para No. 9.

(ii) Verify whether all the books and registers prescribed in the Kerala Co-operative Societies Rules made under the Act and as prescribed by the Registrar from time to time are maintained properly and kept up-to-date;

(iii) Verify the genuineness and adequacy of all personal security, mortgage and other bonds and ascertain as to whether any of them is time barred;

(iv) Ascertain whether the personal sureties are good for their undertakings and whether the mortgage securities are sufficient;

(v) Submit a detailed report on all overdue debts, and state whether he considers them good, bad or doubtful. He should also state in detail the steps taken by the committee to realise them;

(vi) Verify the outside liabilities with Central Bank's statements of outstanding balances, and other creditors like depositors, Government and other agencies and reconcile difference, if any;

(vii) State whether any of the byelaws has been infringed or instructions of Registrar violated;

(viii) Examine whether the expenditure incurred by the societies under establishment and contingencies is within the budget allotment and whether such expenditure is reasonable;

(ix) State whether all the defects brought to light in previous audit have been fully rectified;

(x) Enquire into the details of corrections, overwritings etc. in receipts, vouchers, records and registers to ensure that there is no fraud in the transactions concerned;

(xi) State whether in his opinion and to the best of his information and according to the explanation given to him, the Balance Sheet and profit and loss account exhibit a true and fair picture of the affairs of the society; and .

(xii) State in the audit memorandum, whether he has obtained all the information which to his knowledge are necessary for the purpose of audit.

The Auditor has also to examine many other things before arriving at the correct balance sheet and profit and loss account. For eg., in the case of:-

1. 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 conditions for Co-operative finance. He has also to examine the repayments in order to ascertain book adjustments, improper renewals etc. and also to verify whether timely action has been taken in the recovery of dues and overdues.

(2) Marketing Societies- In the case of marketing societies, the auditor has to see whether the society has undertaken pooling, grading, sale of produce of members etc.

(3) Farming Societies-In the case of farming societies, the Auditor has to see that the lands have been pooled and cultivated jointly.

(4) With regard to other societies the auditor has to see that the business is conducted properly in accordance with the Co-operative principles and propriety observed in respect of financial aspects.

9. Powers-The powers given to the auditor under subsection (3) and (4) of section 63 of the Kerala Co-operative Societies Act 1969 are the following:-

“The Registrar or the person authorised by him under subsection (i) shall at all reasonable times have access to all the 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 of, 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.”

“Every person who is, or has at any time been, an Officer or employee of the society, and every member and past member of the society shall furnish such information in regard to the transactions and working of the society as the Registrar or the person authorised by him may require”.

When the records or cash balance of a society is not forthcoming when requested for verbally by the Auditor, he can issue summons under the provisions of section 63 of the K. C. S. Act for immediate production of books and cash and serve it on the person responsible to produce the same. In the event of failure of the Officer/office bearer to comply with the terms of the summons, the matter should be reported immediately to the Deputy Registrar with evidence of the Service of summons. An offence under section 63 is punishable under section 94 of the Act. As soon as a case of such offence is reported to the Deputy Registrar, he should take appropriate action to prosecute the delinquents concerned.

No auditing can be efficient where the auditor is not able to critically analyze the accounts so as to reveal the total picture of the institution. Mere checking of figures, however carefully done, does not and never can constitute audit. The auditor must not only be familiar with the routine work of Co-operative Accounts, but must thoroughly understand the principle and purpose of the accounts that is involved by the figures from which they are built up. He must also have knowledge of and sympathy with the objects and aims of the society.

The auditor acts as a representative of the members and, as such, is entitled not only to examine the books, vouchers and accounts for the purpose, but also to make inquiries and to receive satisfactory explanation upon all points connected with the business which seem to be material to his duty.

The status and dignity of the auditor will grow in proportion to his fitness to fill the position and to perform adequately his duties and responsibilities. The auditor should use his position, and power by advice given to the committee and if necessary, to the general body with a view to have a sound business policy being adopted. He should be courageous as well as courteous, considerate as well as strong in character and cautious in judgment as well as tenacious in exposing wrong doing.

10. *Liability of Auditor:-(i) Criminal liability:-* Under section 628 of the Indian Companies Act, an auditor can be held criminally liable if he certifies a balance sheet, profit and loss account or any other statement, knowing it to be false. There is no such provision in the Kerala Co-operative Societies Act. The Auditor of a Co-operative Society can be held criminally liable only if his acts constitute an offence under the Indian Penal Code. He can be hauled up before a Criminal Court, if he has certified a balance sheet or statement knowing it to be false.

(ii) *Civil Liability:-* There have been several instances in which the auditor has been sued for damages. The following are a few of such instances:-

(1) An auditor certifying the profit and loss account and the balance sheet, does not merely guarantee the arithmetical accuracy of the statements, but also expresses his opinion that the statements reveal a true and fair view of the financial position of the business concern and its earnings.

(2) In the case of London Oil Storage Co., Ltd., 1904, it was held that an auditor was liable for damages if he failed to verify the existence of assets shown in the balance sheet.

(3) In the London and General Bank Case 1895, it was held that “an auditor is guilty of misfeasance if he knows that the balance sheet fails to disclose the true state of affairs and does not report the fact to the shareholders.” The Departmental auditors appointed to audit the accounts of Co-operative Societies are Government servants responsible to the Registrar and are not officers of the societies, as has been held about the, Auditors of commercial concerns.

(4) In regard to stock in trade it has been held in Kinnton Cotton Mills Case 1896, that it is no part of the Auditor’s duty to

take stock or *as a Valuer* he has to be satisfied not only about the arrangements made for stock taking, but also about the correctness of the valuation by testing a few of the stock sheets.

(5) In *Irish Woollen Co., Ltd., 1904*, it has been held that the Auditor has to see that all liabilities incurred, particularly in respect of purchases made and expenses incurred, are duly brought into account and are not under stated.

CHAPTER III

AUDIT COMMENCEMENT

I. Preparation for audit and framing of audit programme

1. *Intimation of audit.*-- Every auditor, except those attached to the institution itself for continuous and/or concurrent audit, is likely to have in his charge a number of societies for audit. In order to complete the audit work of all societies efficiently and in time the auditor should have a monthly programme fixing up priorities and get the programme approved by the Assistant Registrar/Deputy Registrar. Then the probable date on which he would commence his work may be intimated to the concerned societies well in advance, say, at least a fortnight back. The intention in giving prior notice is to enable the society to bring up its accounts upto date and also to prepare the required statements and schedules for audit well in advance, if not already done. Previous intimation would also help the society to obtain confirmation of balances of outstanding.

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 by him, before completion of his audit and thereafter they will form part of his office record.

When audit of a society is to be taken up urgently due to any extraordinary circumstances and as per special directions from competent authority, the auditor can modify his programme and take up the audit of that society without prior notice. Likewise, where from any sources he comes to know about the existence of any fraud or misappropriation or other serious irregularity in any society under his charge, he should with the approval of

his controlling officer, visit the society and commence surprise checking of the accounts with special reference to the suspected fraud, misappropriation or serious irregularity. He has also to conduct surprise checking of cash, stocks, securities etc. of the society.

In case of societies, whose continuous and concurrent audit is being conducted no previous intimation would be necessary as the visits of the auditor are frequent.

2. *Procedure to deal with complaints*- Sometimes, the Auditors may receive complaints, alleging mismanagement or serious irregularity etc. in the working of a society in his charge. In such cases, the auditor has to go through the complaint letter and see whether the allegations are of a serious nature warranting immediate action. He should acknowledge receipt of the reference and inform the complainant that the point mentioned therein have been taken note of and that they would be examined during the course of next visit to the society. If the complaint is of a serious nature warranting immediate action by the administrative wing, it should be forwarded to the Deputy Registrar, with his observations.

3. *Preparation of Statements of accounts and information required for audit* - Every Co-operative Society shall prepare for each (Co-operative) year the following statements and schedules in the prescribed form and keep them ready as soon as intimation of audit is received.

- (1) List of account books and registers maintained by the society.
- (2) List of files relating to audit including Rectification report on the previous audit/inspection memo of the Department, Financing bank, other agency etc.
- (3) Statement showing the consolidated receipts and disbursements for the year.
- (4) Trading and profit and loss accounts for the audit year.
- (5) Balance sheet as at the close of the year (In case of audit for a specified period, a tentative balance sheet on the date upto which the audit is to be carried out).
- (6) Bank reconciliation and confirmation statements as on the last day of the year. (The confirmations of bank balances should, as

far as possible, be obtained directly from the Banks by the Auditor himself. The society may also be asked to request the banks to furnish the confirmation certificates direct to the auditor).

(7) List of members of the Managing Committee/Executive Committee, Sub Committee etc. salaried officers and other members of the staff of the society.

(8) List of overdue debts in the form prescribed by Reserve Bank of India classifying them as good, doubtful or bad and details of action taken for their recovery.

(9) Schedules of all types of personal ledger balances such as:-
(a) Shares and subscriptions.

(b) Deposits of all types such as Current, Savings, Fixed, Call, Recurring, cumulative etc.

(c) Loans, cash credits, overdrafts and all other types of advances. Separate statement indicating the loans and advances due from committee members including office bearers.

(d) List of sundry debtors and creditors, suspense payable or receivable, income received in advance, income accrued but not received, prepaid expenses, deferred expenses, preliminary expenses to be written off, provisions made for outstanding liabilities etc.

(e) List of unpaid interest on all types of deposits, unclaimed dividend on shares and purchases and bonus payable (year-wise lists should be prepared).

(f) Inventories of stock on hand including stores, spare parts, raw materials, semi finished and finished goods in the case of processing and industrial societies.

(g) List of dead stock articles, furniture and office equipments, machinery, tools, implements etc. showing their purchase price, depreciation charged year after year and written down value.

(h) Lists of shares, bonds, securities, other investments etc., including receipts for fixed deposits held by the society giving their face value, Book value and Market value supported by market quotations as on the date of preparation.

(i) Particulars of immovable property held by the society, agricultural land, plots, buildings, godowns etc.

(j) Lists supporting balance sheet figures which are not mentioned above.

(k) Any other statement or schedules as may be required by the auditor for audit purpose.

4. *Production of records and statements for audit and procedure to be adopted in the event of non-production of records on demand.*- As per subsection (3) of Section 63 of the Kerala Co-operative Societies Act, 1969, summons can be issued by the Assistant Registrar (Audit)/Auditors of Co-operative Societies for production of records for audit. They can issue summons to all societies including those societies under the administrative control of other Departments such as Industries, Dairy, Fisheries etc.

The form of summons may be as follows:-

“Whereas you were called upon to make available the accounts and Registers required for audit for the year/s as per this office letter No..... dated..... and whereas you have failed to make available the records on the dates specified therein, you are hereby called upon to show cause in writing within fifteen days from the date of receipt of this notice as to why further steps should not be taken, including *liquidation*. If you fail to send your written objections on the date specified above, or if your objection is found unsatisfactory, appropriate action according to the provisions of the Kerala Co-operative Societies Act, 1969 (Act 21 of 1969) will be taken.”

Place: Assistant Registrar of
Date: Co-operative Society (Audit)

If the society or the person responsible does not produce the records within the time-limit specified in the summons issued, the Assistant Registrar of Co-operative Societies (Audit) will send an intimation through the Deputy Registrar (Audit) concerned to this effect to:

- (a) The Joint Registrar of Co-operative Societies in respect of societies under the administrative control of the Co-operative Department.
- (b) The Director of Industries and Commerce/District Industries Officer, in respect of Industrial Societies.

- (c) The Director of Coir Development, in respect of Coir Societies.
- (d) The Secretary, Khadi and Village Industries Board, in respect of Khadi and Village Industries Societies.
- (e) The Director of Fisheries, in respect of Fisheries Societies; and
- (f) The Director of Dairy Development, in respect of Milk Societies.

For instances where audit is held up for want of records, see Registrar of Co-operative Societies Circular No. 56/74 dated 21-11-1974 (ADL2-16551/74) .

1. Records/in court or under Police custody.
2. Records destroyed.
3. Records not written up. .
4. Non co-operation of the Management in production of records.
5. Defunct nature of the institutions.
6. Records with the Ex-committee.
7. Non-availability of the custodian of records.
8. Records lost or missing.
9. Whereabouts of the society and records, not known.
10. Societies unstarted.

5. *Additional information to be obtained in respect of some special types of Societies.*- Examination of overdue debts being one of the important responsibilities of the Auditor, he has to get full details of all overdues and the action taken for their recovery. Depending upon the nature of business operations of the societies, the Auditor will have to obtain additional statements and information. For example, in the case of a Credit Society, details required for classifying all overdue debt into good, doubtful and bad will have to be obtained. In the case of urban banks etc., information regarding their loan policy, collateral security for advances, maintenance of fluid resources etc., is to be obtained. Detailed information regarding arbitration cases filed by the society and suits filed in

Civil Courts and its recovery etc., will have to be obtained by the Auditor. Since the Auditor has to certify that he has obtained all the information and explanation required for his audit, statements, schedules and information on all items mentioned above will have to be obtained by the auditor before the completion of his audit and those records will be kept in his office.

6. *Account books and records to be maintained by Co-operative Societies.*- Rule 29 of the Kerala. Co-operative Societies Rules lays down that every Co-operative Society shall keep the following account books:-

- (i) Minutes book for recording proceedings of committee and of the General Body of members.
 - (ii) Share application register.
 - (iii) Admission register.
 - (iv) Nomination register.
 - (v) Day book and cash book.
 - (vi) Receipt book and voucher files.
 - (vii) General ledger and Personal ledger.
 - (viii) Ledgers of borrowings showing deposits, loans and other borrowings.
 - (ix) Register of monthly receipts and disbursements.
 - (x) Register of dividend.
 - (xi) Suspense account register.
 - (xii) Register of audit objection and Rectification Register.
 - (xiii) Property Register.
 - (xiv) Suspense Register.
 - (xv) Such other accounts and books, as are specified by Government from time to time by special or general order for any society or class of societies.
- (b) In the case of societies issuing loans, the following account books are also to be maintained.
- (i) Loan application register.
 - (ii) Loan ledger showing the loans issued to members.

- (iii) Liability Register indicating the indebtedness of each member.
- (iv) Register of immovable property of defaulted members.
- (v) Register of closed loans.
- (vi) Register showing progress of applications for arbitration and execution.
- (vii) Register of declaration made under section 36.
- (viii) Register of lands cultivated by members.
- (ix) Credit limit statement.
- (x) Decreed Loan Register.
- (xi) Register of liquidated societies.
- (xii) Demand, collection and balance Register.

Societies which have undertaken trading or manufacturing activities, such as Consumer Societies, Marketing and Processing Societies, Handloom and Industrial Societies etc. are required to maintain purchase and Sales journals and stock Registers. Where the number of securities held by a society are many and varied, an "Investment Register" will have to be maintained. Processing and Industrial Societies will also have to maintain separate cost accounts, which will have to be reconciled with financial accounts. If the Society has undertaken distribution of Controlled Commodities, also, additional books and Registers as prescribed by the Civil Supplies or other concerned Departments are also required to be maintained.

The auditor will also see that, besides the statutory books prescribed, societies having different objects/activities maintain other types of books required according to the nature of their business. If any society is not maintaining any of the special account books or registers required due to ignorance, the auditor should guide the office bearers in writing up such books or registers.

7. Powers of Registrar to direct accounts and other books to be written up- procedure to be followed when accounts are incomplete.- When any society has failed to maintain proper and complete accounts as specified under Rule 29 of K. C. S. Rules; the auditor should report the matter to the competent authority through his immediate superior.

The officer competent will then issue an order under Rule 30 directing the society and its office bearers to bring the accounts up-to-date and to furnish necessary statements and information required by the Auditor. If, after a reasonable time, the directions are not complied with, orders will be passed invoking Rule 30. In such cases Registrar is competent to authorise any person to write up the accounts at the expense of the society through a person/ persons authorised by him. The cost will be determined taking into account the time involved and the emoluments of the officers deputed to attend to the work (Rule 30).

8. *Period for which the account books are to be maintained by the societies.*- Rule 31 of the Kerala Co-operative Societies Rules, specifies the period for which the societies are to keep their records after they are audited by the Department.

9. *Auditor not to pass entries in audit without proper understanding.*-In the course of audit, the auditor has to get him self satisfied of the genuineness of the transactions recorded in the books of accounts of the society. Before commencement of audit of the accounts the auditor should be acquainted with the nature of business transactions undertaken by the society and the various aspects connected with it. It may not also be possible that the auditor is fully familiar with the type of business conducted by the society. He may also be not knowing the technical aspects of the transactions of different types of societies in his charge. Therefore, it is necessary that he should supplement his knowledge by obtaining additional information about the nature of transactions. For this, he should not hesitate to elicit information for the technical details on items about which he has no sufficient experience. An honest admission of ignorance of technical matters will always win more respect than an assumption of knowledge which he is not in fact possessed of. An auditor is not, therefore, expected to pass on entry unless, he understands the full implications of the transactions recorded in the books of accounts of the society.

10. *Internal Check.*- Internal check is a system under which the accounting methods and details of an establishment are so laid out that the accounts and procedure are not under the absolute and independent control anyone person, but on the contrary of the work of one employee is complementary to that of another. In other words, it is a system of arrangement of accounts to facilitate

distribution of work in such a manner that the work of one person is automatically checked/rechecked by another. The system of internal check facilitates speedy detection of omission, frauds, errors etc.

11. *Internal Audit.*- Internal audit means audit of accounts of the institution by the employees of the very same institution (audit wing of the institution deputed for the work). The work is done by a separate section of the staff, who may or may not be qualified auditors. This is a type of continuous audit by the staff. In institutions where internal audit wing is functioning efficiently and independently, the auditor can depend on their checking to a certain extent. The existence of internal audit wing will minimise chances for committing frauds and errors.

12. *Difference between internal audit and statutory audit.*-(1) On accounting matters, both internal audit and statutory audit operate in the same field. Each of them aims at ascertaining whether internal check and accounting systems are good and serve the purpose.

(2) The internal auditor/auditors is/are being appointed by the Board of management/general body of the society, whereas the appointment of statutory auditor is according to the statute.

(3) The internal auditor checks the accounts to ensure whether the accounting system is perfect and it discloses material facts. On the other hand, the statutory Auditor has also to satisfy himself that the final accounts exhibit a true and fair view of the state of affairs of the business transactions of the society and the position of its assets and liabilities as on a given date (30th June).

(4) The internal auditor is primarily responsible to the Board of Management/General body and thus he has only a less independent status when compared to the same enjoyed by a statutory auditor.

(5) Both of them have more or less the same field of work and, therefore co-ordination between them may result in achieving best results.

13. *Internal Control.*- By internal control it 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". The basic principles of internal control are explained below:-

- (i) All remittances received should be immediately acknowledged. Official receipts from the printed receipt book should be issued to the parties by the person authorised under the bye-laws. In cases where official receipts are not necessary, viz., for withdrawal from bank, encashment of cash certificate, etc., the correct recording of the transactions should be ensured.
- (ii) All payments should have been properly authorised and the vouchers should bear the signature of the payee and the details required.
- (iii) The byelaws of each society should contain provision regarding the maximum amount of cash that can be retained and the designations of the officers responsible for its custody. The closing balance of cash on hand should be mentioned in words and in figures.
- (iv) The Day Book and other subsidiary ledgers should be written up-to-date.
- (v) Monthly statements of accounts viz., a statement of receipt and disbursement, a provisional trading and profit and loss account etc. should be prepared and placed before the managing committee meetings for approval.
- (vi) The duties and responsibilities of paid employees and matters to be attended to by the committee members should be clearly defined. Necessary subsidiary byelaws in this regard should also be got framed and got approved by the competent authority.
- (vii) Cash, stocks, fixed assets, furniture and fittings, machineries, tools, equipments, vehicles, raw materials, stores, finished goods and other properties etc. of the society should be adequately insured in time.

14. Reconciliation of Bank accounts.-Bank reconciliation statements have to be prepared at regular intervals by the Cashier or the officer who receives the cash. During the course of audit, the auditors should compare the debits and credits shown in the Bank

statements/pass books with the entries in the book and counterfoils of the pay-in-slips/cheques issued. Contra items either in the cash book Or in the pass book should also be enquired into in detail. Items pending reconciliation at the end of each period should be traced out and reconciled in the following period. Any abnormal variation in the dates should also be specially taken note of.

15. Test of percentage checking - During the course of audit, the auditor has to trace a transaction through various stages from the origin to its conclusion, examining at each stage the vouchers, records and authorities relating to it. Where the business transaction is of a voluminous nature this sort of detailed checking may not be possible. In such cases the auditors have to make a careful evaluation of the system of internal control in operation. If their appraisal proves satisfactory, they may, in appropriate cases, rely on a test or percentage checking of records/transactions. It is needless to point out that selection of the period for test/percentage checking in should be made in carefully and the examination of the transactions of that period should be sufficiently detailed. But where frauds and serious irregularities are suspected or noticed, a more exhaustive checking/verification should be carried out.

16. Preparation of programme of audit.-Audit, to be methodical and efficient, it is necessary that it should be carried on regularly according to a definite programme. Audit programme is a scheme setting out in detail the different phases of work to be done in the course of audit within a fixed time. The programme, to be effective, has to be based on a standard model, which would contain all the necessary items. It will not only record the exact nature of work to be performed by the Auditor and his staff, but will also have columns for the initials of the persons performing each part as and when they complete it. Audit programme will give the auditor a clear idea as to what has been done and how he has carried out his work and how he has to finish the remaining work logically and efficiently. It will also guard against any possible omission and ensure thorough and systematic checking.

17. Revision of audit programme- The programme of audit has to be drawn up after careful examination of the nature of transactions of the society, so that all important items should receive due attention. The programme thus drawn up enables the auditor to carry on his work in a methodical and planned way. It

is however not a rigid programme. It may have to be revised often during the progress of audit and according to the volume of work in each society.

18. Maintenance of working sheets.-Working sheets properly drawn up and with details of work done in respect of every society might prove to be of great value to the auditor later on. Therefore the auditor should maintain the working sheets. The working sheets may contain the following particulars.

- (i) Various questions raised during the course of audit.
- (ii) All important errors/omissions that are detected.
- (iii) Explanations and information received for the queries raised,
- (iv) Details of all missing vouchers, receipts, invoices etc.
- (v) Points which need discussion with the office bearers of the society.

From the working sheets maintained by the auditor the progress and stage of audit can be easily ascertained.

19. Use of ticks or check marks -While carrying out checking for the mechanical audit, the Auditor has to make “ticks” or “check marks” for every entry in an account book/register/record examined by him and also initial or cancel vouchers. Cancellation of voucher can be done by putting the initial of the auditor on the face of the voucher. It is desirable that there should be some distinctive character in the ticks or check marks used by the Auditors, indicating the different processes and procedures of audit.

The following are a few examples of ticks or check marks used by auditors.

Type of ticks

- | | |
|---------------------------|---|
| (i) Posting | - On the right hand side of the figure close to the last digit. |
| (ii) Casting of totalling | - On the left hand side of the figure checked. |
| (iii) Carry forward | - Same as above with an additional posting tick across the tick line. |

- (iv) Calling over or comparing - At the bottom of the figure
- (v) Vouching - On the left side of the figure
- (vi) Bank pass book or statements - The posting tick on the right hand side of unticked items i.e., items appearing in reconciliation would have the letter "C" place on the right hand side
- (vii) Contra or transfers - On the right handside

These ticks or check marks should be distinctive and be indicative of the particular process or procedure carried out or the test applied for. Particular care should be taken to see that the significance of these ticks is not known to the staff of the society whose accounts are being audited.

20. Use of coloured inks or pencils for audit- For marking of the ticks or check marks, the auditors are required to use coloured inks or pencils where checking of accounts is carried out through clerks or assistants of the auditors, they should be required to use inks or pencils of a different colour than is used by the auditor. The staff of the society should be requested not to make use of these coloured inks or pencils for their internal checking

21. Entries in pencils to be inked before checking- Quite often the auditors come across entries/totals recorded in pencil. As there are more chances for altering the figures written in pencil, the auditors are warned against accepting entries in pencil. They have to instruct the accountant or the officer in charge of writing the accounts to ink out the figures and authenticate them and see that it is done before checking is commenced.

22. Accounts to be got written before commencement of audit- As far as possible, the auditor should commence the checking of account books only after they have been written up completely for the period of audit. Each stage of work should be completed in one sitting, if possible.. While checking Day Book with vouchers for a month or other specific period, the entire vouchers relating to the period should be checked and notes made about the missing vouchers and irregular payments.

Similar is the procedure with regard to the checking of loan bonds, postings etc. The suggestions are of special importance to the Auditors who work as continuous or concurrent auditors.

II. Preliminaries to be gone through by the Auditors

In commencing the actual work of audit, the Auditor should not plunge into his work straightaway. As Co-operative Audit includes administrative audit also, it can be done usefully and effectively only if the Auditor is well prepared before commencement of the work.

1. He should be thorough with the provisions of the Co-operative Societies Act and Rules.
2. He should be well conversant with the directions issued by the Registrar of Co-operative Societies from time to time.
3. He has to examine the byelaws of the society with special reference to the value of shares, restrictions on holding of shares by a member, the credit limit of the society and of the individual members, the person or persons authorised to receive and pay money, rate of interest etc. It has also to be examined whether the byelaws framed and registered are in consonance with the provisions of Kerala Co-operative Societies Act and the Rules.
4. He should also obtain a list of the books and registers maintained by the society and study the relationship of each book or register to another.
5. He will examine whether the society has maintained all the books and registers prescribed under the Kerala Co-operative Societies Rules.
6. The auditor should see that the person who writes/verifies the books/records etc., invariably attest the same in token of the correctness of entries.
7. He has also to ascertain the nature of the duties and responsibilities of each member of the staff and find out whether those have been defined in an office order or by a detailed resolution of the Board of Directors.
8. The Auditor should also examine the opening balance sheet and previous years audit report together with the summary of defects, if any, to understand the nature and working of the institution.

He can then chalk out a programme of work and do the work in a methodical way. To facilitate correct compilation of audit report it is always desirable that the auditor maintains a complete and permanent record of work done viz. “working sheets” during the audit of each society. This will be more helpful for purpose of reference later, if necessary.

In the case of large sized societies where concurrent audit is done, the audit programme is to be chalked out in such a manner to complete the audit as prescribed. If there are more than one society in the group, the programme should be such as the auditor could visit all the societies simultaneously

III . Various stages of practical work

The practical work of an auditor can be divided into three main parts.

i) Mechanical audit (ii Administrative Audit. (iii) Preparation of final statement and the Audit report.

(i) Mechanical Audit

Mechanical audit aims at ensuring the accuracy of accounts recorded in the Book of the society. It consists of vouching receipts and payments in the Day Books with special reference to the receipts and vouchers The Day Book is checked also to assess the correctness of the daily balancing. As the Day book is the book of original entry in a Co-operative Society and forms the basis of all other books and accounts, the auditor should begin his work with the Day book. After the entries in the Day Book are checked completely with the receipts and vouchers, the auditor should verify them with the entries in subsidiary corresponding ledgers (viz admission register, deposit register, loan ledger etc.) so as to ascertain whether all the receipts and payments found in the Day Book have been duly entered in the respective ledgers. This kind of checking may bring to light errors of omission or commission in the ledger or in the Day Book.

Finally, the entries in the general ledger should be checked direct from the Day book. When all the ledgers have been checked with the Day books, a list of outstanding under various heads viz., share capital, loan borrowings, deposits, advances, suspense etc. should be drawn up from the concerned ledgers. He should

then examine whether the totals arrived at by him agree with those balances in the general ledger etc.

(a) *Cash Book*:-Cash book is usually maintained in Apex, Central, major and large sized societies. Only cash transactions are noted in the Cash book. But in the Day book all transactions (cash and adjustment) are entered.

(b) *Daybook and Checking of receipts*:-

The items in the receipt side of the day book should be checked at first with the Counterfoils of receipts. The auditor should verify whether the receipts are authenticated and all the items of receipts have been properly brought into account then and there.

To prevent possible misappropriation of amounts received by the society under loans etc., it should be verified whether the signatures of the borrowers, depositors or of their agents paying money on their behalf are obtained in the counterfoils of receipts/chalans, In case of doubt, the auditor should call for the originals of receipts issued and compare them with the counterfoils kept in the society and also take note of the result of such verification in the audit report. In Cases where the persons remitting the money are illiterate, their certified thumb impression (L. T.) should be obtained on the counterfoils of the receipts/chalans. For receiving money, societies should use only printed and machine numbered receipt books. There should not be any missing number of counterfoil left blank or incomplete. In such cases explanations are to be obtained and verified with the evidences available. In the case of cancelled receipts the originals should remain tact or attached with the counterfoil. As far as possible separate receipts may be issued for two accounts paid together. After verification, if the auditor is satisfied, a tick should be given against the corresponding entry in the Day Book, and the counterfoil cancelled with the auditor's initials with date. The dates of the counterfoils should be scrupulously compared with the date of corresponding entry in the Day Book and checked whether there is delay in crediting the amount.

There may be withdrawals from financing banks, post office savings account, deposit accounts. etc. or adjustment entries not supported by counterfoil of receipts. In the case of withdrawals from bank, post office savings account etc. the certified counterfoils

in the cheque book should be checked. For adjusting entries, the existence of proper vouchers for the corresponding payments will suffice.

(c) *Day Book and verification of disbursements:-* The vouchers should relate to the transactions of the society, and specify the number, amount, date, purpose and nature of payment to whom and by whom paid etc. They should be filed in the order of the entries in the day book. Acceptance of signature or thumb impression or mark of the payee in the Day Book itself is not allowable. Separate and complete vouchers should be obtained and posted in the voucher file book. Petty payments may be passed if found reasonable, and supported by the certificate of the disbursing officer even if no proper voucher is available.

Separate receipts from payees for sums sent by money order are not necessary. If the remittance is made at the request of the party, the postal receipt showing commission paid, acknowledgement of the party for the net sum and his written requisition are enough for the auditor. But if the amount is sent without the request of the party, then copy of the notice of the society asking the party to receive the amount within a specified period with the intimation that in case of failure, the amount will be sent by Money Order at his cost, together with his postal acknowledgement are enough. If the postal acknowledgement is found to be defective/doubtful the society should address the postal authorities and ascertain whether the recipient of the money order had been duly authorised to receive it. A perusal of the postmaster's reply will enable the auditor to decide passing or objecting of the expenditure.

Vouchers furnished by the members of a Co-operative Society and those coming under the business of the Co-operative Society, are exempted from stamp duty. Those vouchers exceeding Rs. 20 and representing any kind of payment to non-members should bear revenue stamp worth 20 P. Vouchers for disbursement of pay and allowances (including T. A.) and acquittance of employees are also not exempted from stamp duty. For payment of advances like salary advance, T. A. advance, bonus advance, onam advance etc. exceeding Rs. 20 also requires stamp. A cash memo (cash bill) exceeding Rs. 20 does not require a stamp (or stamped receipt) as it is not a receipt within the definition of the stamp Act. A cash memo or cash bill without any proper indication of the number

and name of the society should not be taken as a valid voucher. In such a case a stamped receipt in proper form should be insisted. The vouchers checked should be cancelled as in the case of counterfoils of receipt books, with the initials of the auditor with date. The object of initials is (1) in respect of a counterfoil to see that all items received are accounted and brought into the cash book and (2) in respect of a voucher to disfigure it so that it cannot be used again in support of another entry.

(d) Besides collecting information by means of personal enquiries whenever necessary, the auditor should also obtain particulars from available records such as receipt book, Day Book, Loan, Ledger, Borrowing Ledgers etc. duly examined.

1. *Receipt Books*:-The auditor should see whether there are any folios missing or any receipts without his initials or any counterfoils left blank. In case of doubt regarding any miscredit, he should call for some of the receipts and pass books from the members and compare them with the entries in the concerned books of the society.

2. *Day Book*:-The Day Book should be written in the chronological order as the transactions took place. It should be closed on all days having transactions and the closing cash balance recorded both in words and figures. It should be signed by the Secretary and any other person authorised under the byelaws. In the case of retention of heavy cash balances, the Auditor should obtain the explanation of the officers concerned and examine whether they are satisfactory. Reloaning from out of the collection from members or repayments to Central Bank from fresh loans obtained therefrom, should not be done in any circumstances. No transactions suggestive of book adjustments, should also be resorted to at any cost.

3. *Loan Ledger*:- The auditor should verify whether any of the items is not initialled by him. If any such case is detected he should examine them in detail and take note of. He should also ascertain whether prompt and effective action has been taken to realise the overdues. He has also to examine whether there are any time barred loans against which no action is taken.

4. *Ledger of Borrowings*:-When societies remit their dues to the Central Bank through transmitting agencies, differences may occur in the dates between entries in the books and those in the receipts.

The auditor should scrutinize each and reconcile the difference. In the case of fixed deposits etc. the Auditor should see whether they are repaid or refunded on maturity. The maximum borrowing power fixed in the byelaws, may be compared with the actual borrowings.

5. *Admission Register:-* The Auditor will verify whether the dates of admission and withdrawal are correctly entered and the signatures of the members obtained in the appropriate column at the time of admission/Withdrawal. Arrears of share capital should also be taken note of. It shall also be seen whether there is proper sanction of committee for admission of members, allotment of additional shares or refund of shares. Collection of entrance fees should also be noted. It has to be ensured that provisions of byelaws and Act and Rules are observed in collection, transfer and refund of shares.

6. *Minute Book:-* The auditor should see whether periodical meetings are held as per provisions in the Bye-laws and resolutions are properly recorded in the Minute Book and duly attested by the Directors. He should also verify the relevant resolutions with his dated initials.

7. *Property statement:-* In a society with unlimited liability, the Auditor should arrange for the assembly of as many members as possible and read out to them the assets and liabilities together with their net assets, so as to verify the correctness of the particulars noted. He should also make independent enquiries, satisfy himself and also compare the maximum credit limit of the society with the net assets.

8. *Register of investment:-* The auditor should see that all investments such as share in other institutions, K. S.D. loans, cash certificates etc. made by the society are entered in this register and interest thereon is worked out and collected periodically. The auditor should check the investments with reference to the share certificates/bonds/other documents relating to such investments.

9. *General Ledger:-* The auditor should see that every entry/total of each head, in the day book is posted into the general ledger under proper head of accounts. Omissions, commission and wrong postings in the general ledger should be rectified then and there.

The casting of each head of account in the day book and in the general ledger should be checked before striking the daily monthly balance in the general ledger.

10. *Inspection report:-* The auditor should verify some of the inspection reports and see whether the supervision was adequate, efficient and effective. He should as far as possible, try to get the errors and commissions duly rectified during his stay in the society. Defects that could not be rectified then and there should be reported to the Deputy Registrar (Audit).

(ii) Administrative Audit

This is the special feature of Co-operative audit. The duty of the Co-operative Auditor is not merely to find out the errors and omissions and/or commission, but also to ensure the accuracy of the maintenance of accounts and also to arrange for the rectification of defects pointed out in the earlier audit certificates and inspection reports. He is also expected to go beyond the books and records and also to gather as much detailed information as is required to understand fully the implication of the transactions of the society. For this purpose, the auditor can collect information by personal enquiries, wherever necessary, and obtain particulars from available records in order to expose any fraud or misappropriation. The Co-operative Auditor should, as far as possible, endeavour to see that the errors of commission and omission are rectified before the audit of that society is finalised. Such of the defects, which are serious and cannot be rectified on the spot should be reported to the competent authority together with his suggestions for further action and improvement.

Recent thinking on management and management principles has brought about a change in the concept of audit and widened its objectives. Emphasis of audit is now being shifted to the examination of administrative policies and its effects on the financial morality of transactions, the efficiency with which the schemes have been implemented and the level of performance achieved by the institution as a whole. Thus the conventional form of audit has been changed to a more dynamic system with a view to enabling the auditor to lay emphasis on certain important and essential aspects viz., (i) Propriety audit, (ii) Management audit, (iii) Efficiency audit, (iv) Performance audit and (v) cost audit.

They are briefly explained as follows:-

(a) *Propriety audit*.-The auditor should examine the various transactions involving expenditure, with the aim of ascertaining their economics, necessity and reasonableness. All improper/and irregular decisions and expenditure thereon resulting in the waste of public funds and loss of stores should be brought to light.

(b) *Management audit*.- The auditor should see whether the management has followed sound lines of business policy or there has been any lapse on their part. In case of lapses are noticed it should be examined in detail whether the management has dwindled the business or made the society to run into loss. Management decisions which have resulted in loss to the society should be specifically reported. The policies and decisions adopted by the management should be in conformity with the rules and regulations. The various aspects of planning, control and co-ordination should be examined by the auditor with reference to the results. The auditor should suggest better forms and methods if the existing methods are found inadequate or ineffective. The interest that the management takes in its development, fixing up individual liabilities and responsibilities of staff and watching their adherence, streamlining the administration etc. have to be examined in detail.

(c) *Efficiency Audit*.-The auditor should examine the results of various schemes implemented with reference to its plan and economics of expenditure incurred. For this purpose the auditor should examine the efficiency with which the schemes were implemented, the economics of expenditure with reference to the results achieved, the rate and scale of expenditure in conformity with the plan and estimate already prepared etc.,. The auditor may work out ratios of each item vis-a-vis the budgetted or targetted figure or figures of the previous years by purchase, sales; trade profit, net profit etc of the audit year can be compared with those of the previous year by taking the latter as the base year and working out the percentage of ratio.

(d) *Performance audit*.-The auditor has to probe into the various aspects of the transactions and investigate the performance of the society to highlight on the resultant progress or failure in the business. The efficiency achieved or lost under different business ratios will provide the basis for performance audit.

(e) *Cost audit.*-(i) Cost Accountancy is defined as the application of costing and cost accounting principles, method and technique to the science, art and practice of cost accounting and the ascertainment of profitability. It includes the presentation of information derived therefrom for the purpose or managerial decision making.

The main objects of cost accounting are (1) cost control (2) ascertainment of profitability (of each activity) (3) assistance to management in its task of making decisions.

The aims are achieved by a purposeful analysis and classification of data and thorough compilation of reports which enable the management to locate causes of wastage and losses and to decide upon the proper course of action.

(ii) Cost audit aims at perfecting the cost accounts maintained by societies besides examining whether the policy laid down by the management has been or has not been followed strictly. It is the detailed checking of costing system technique and accounts to verify their correctness in order to ensure the adherence of the objectives of “cost accountancy”.

(iii) Preparation of final Statements

After completion of the mechanical and administrative audit the preparation of the consolidated statement of receipts and disbursements should be taken up from the general ledger. If general ledger is not maintained, the statement should be drawn up directly from the day book and subsidiary ledger. While checking the general ledger and preparing receipts and disbursement statement from the day book, the auditor should be very careful in grouping the various items under appropriate heads. Negligence in doing so may affect the profit of the society seriously. From the receipts and disbursements statement the auditor should prepare Trading Account and profit and loss account and the balance sheet. Thereafter the audit memorandum is to be prepared in the prescribed form and submitted to the competent authority for further action.

(IV) Reconciliation of Bank Accounts

(I) Bank Reconciliation statements should be prepared regularly by the office who receives cash bank statements or the pass book.

During the course of audit the auditor should compare the debits and credits shown in the bank statements (or the pass book) with the entries in the cash book/day book, the counterfoils of the paying in-slips and the cheques issued. Contra items either in the cash book or the pass book should be enquired and satisfactory explanations obtained. The items in the Reconciliation at the end of the period should be traced through the following period.

2. *Verification of Schedules.*-Since the auditor has to certify that he has obtained all the information and explanation required for his audit all statements and schedules and other information will have to be obtained and checked by him before completion of his audit. They will form part of the records of his office.

The Auditor has to obtain the statements such as "Sundry Debtors" "Advances outstanding" etc. and got agreed with the figures appearing in the balance sheet. Schedules of different types of advances 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. Differences if any should be given special attention the details should be ascertained and reconciled.

While checking ledger balances with the schedules, notes should be prepared 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 as to 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 him.

During the course of verification of schedules with the ledger balances, if the auditor suspects the correctness of any account he should send the debtor a statement of his account as per society's records and request him to communicate the discrepancies, if any. Where pass books are issued to members and other constituents who have dealings with the society, the same may be called for and returned with a request to confirm the outstanding balances in their accounts.

V. Management Accounts

Management accounting helps the Management to control the activities of the institution and to employ its available resources with a view to attaining its objections and to achieve better results in the given circumstances.

The accounts of Co-operative Institution also are to be maintained in such a way that they should readily exhibit the financial results of the business transactions. The system of accounting should also be conducive for attainment of its objectives. On the basis of working results, the Management should be able to think in terms of corrective measures and development activities such as cost reduction, accelerating rotation of money, maximising profits, extending more services etc. For planning the future programmes of the institution and forecasting results, the management require classified, processed and detailed data with comparative figures. For this, and also to examine reasons for failure, if any, the Management should have a good accounting system. In short the accounts should, interalia, guide the Management to take timely and proper decisions and to function effectively. Through the accounts, the Management should also be able to assess the strength or weakness of the institution in a realistic way. A good system of management accounting will enable the Management to analyse the financial and working results, overall performance etc. of the institution within a short time.

The auditor should ascertain whether the system of accounting followed by the society meet with the above requirements. If not, he should guide the institution properly and ensure that a good system of accounting on the above lines is followed by the institution.

CHAPTER IV

VOUCHING OF RECEIPTS

I. (a) *What is vouching.*- A voucher may be described as a documentary evidence in support of an entry in the books of accounts. It may be a receipt, a counterfoil of receipt book, an agreement, an invoice, a paying-in-slip, bills bought note, sold note, wages book, statement of accounts, minutes of meeting etc.

Vouching may be described as an examination of every transaction of a business with relevant, valid, documentary and other evidences with a view to find out whether it is genuine and bonafide. Vouching is the very essence of auditing and the whole success of an audit depends upon the intelligence and thoroughness with which this part of audit work is carried out. It aims at ascertaining whether a transaction is in order, has been properly authorized and is correctly recorded in the books. It traces an entry to its source and explores its implications and circumstances. It has however to be understood that vouching does not mean merely comparing the receipts and vouchers with the cash book/day book.

A careful comparison of the entries in the cash book, and other books of prime entry with the supporting documents would ensure:-

As regards receipt.- (i) that all moneys due to or receivable have been duly brought into account and there has been no impropriety or irregularity in the realization of money due to the business.

(ii) All moneys received by the business have been properly accounted for and credited to the proper accounts.

As regards payments.- (i) that all payments made and liabilities incurred are regular, properly authorized and payable out of the funds of the concern. All payments have to be shown under correct heads of accounts, distinguishing between revenue and capital expenditure and in particular the expenditure incurred and liabilities contracted were necessary and incidental to the business of the society.

(ii) No fraudulent or unauthorised payments have been debited which reduce the cash balance of the society, and

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

While examining the vouchers, the following points should be borne in mind:

(1) All the vouchers should be consecutively numbered and filed in the order of occurrence.

(2) Particular care should be given to see that the date of voucher correspond to the date noted in cash book, the name of the party

from whom it is received, the party to whom it is addressed and the amount.

(3) All vouchers should be cancelled as passed by the Auditor with all documents attached to it by putting his initials with date preferably in the middle of the voucher by a special tick. This is done in order to prevent the production of the same voucher again in support of a subsequent fraudulent or fictitious payment.

(4) Every voucher should be passed by a responsible officer of the society. This may be done preferably on the original voucher itself. If original vouchers are not available this may be done in the voucher obtained in the voucher form of the institution. This will ensure the genuineness of the vouchers produced for audit. ,

(5) The auditor should ensure that vouchers over Rs. 20 are properly stamped.

(6) He should see whether the amount in figures and in words agree.

(7) Lastly, the auditor should list out all the missing vouchers and explanation for the same obtained from the responsible officer.

To sum up, the auditor should endeavor to satisfy himself the threefold requisites of vouching, namely:

- (a) Proper sanction by a competent authority.
- (b) Validity of the documentary evidence and
- (c) Bonafide or genuineness of the transaction.

(b) *Internal check with regard to cash.*-In institutions having large cash transactions, the auditor should see whether there is any proper and efficient system of internal check. No hard and fast rule can be laid down on this. The set up of the system depends on the availability of sufficient number of staff and the volume and frequency of cash transactions. The best system is one which provides no loop-holes to suppress receipt of cash or to create fictitious payments.

The following is the general outline:-

(i) Cashier should not have any control over any ledgers of original entry, except cash book.

(ii) The unused receipt books should be under the custody of a responsible officer other than the person authorised to sign the receipt. Stock register for the receipt book should be maintained, Fresh book should be issued only when the receipt book in use has been completely exhausted.

When different books are simultaneously in use for different classes of receipts, the receipt should be of different colours or sizes so as to distinguish them easily.

(iii) Daily Tappals should be opened by a responsible officer and all cheques, postal orders etc. should be crossed 'Account payee' only.

(iv) All receipts should be banked daily.

(v) Receipts prepared by cashier should be countersigned by another responsible person.

(vi) Cash book balance should be reconciled with pass book at regular intervals.

(vii) An efficient system of internal check should be maintained as regards cash sales.

(viii) Monthly statement of accounts of customers must be under the control of some responsible officer other than the cashier.

(ix) Inward invoices should be verified with the corresponding orders.

(x) Cheques issued must be crossed preferably "Account Payee".

(xi) Receipts received from parties to whom moneys are paid should be examined by a responsible person.

2. *Vouching of cash transactions-Control over cash.*- In order to avoid misappropriation of funds, there should be an efficient and scientific system of internal check as regards receipt, disbursement and remittance of cash, and for the safe custody of cash balance. Where a cashier is appointed, the responsibility of receiving and disbursing of cash, remittances to and from bank, preparing of cheques, etc. should be entrusted to him. The 'Day book' or the 'Main Cash Book' should be written by the Accountant and not by the Cashier. The cashier may maintain a rough cash book or cash diary and the cash summary book.

3. *Vouching of receipts*- Internal control over receipts.-Vouching of receipts is always difficult than vouching payments, since in a majority cases, no direct evidence as regards regularity and correctness of the amount received would be available.

To ensure proper control over receipts, the following arrangements are necessary. All incoming tapals should be opened by the Manager or other responsible officer. Cheques, drafts, postal orders, 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 books should be compared with the entries in the Cash Diary or Rough Cash book maintained by the Cashier.

(i) All remittances made should be acknowledged. Printed receipt books with duplicate, serially numbered receipts to facilitate retention of the Carbon copy, should be used for acknowledging remittances received, either in cash or by cheque. Counterfoil receipt books are not to be recommended. Since the outer receipts and the counterfoil are to be written up separately and it is likely that unscrupulous employees might write different amounts in them. The practice of acknowledging on the invoices, bills or statements issued to the members should be discouraged. The employees should be strictly forbidden from acknowledging remittances or in the ledger account of the society kept by the customer or in the copy of the invoice or bill sent to him. Notice should be given to all members and customers showing that no receipt would be valid unless issued from the printed receipt book of the society and countersigned by the authorized person. All the receipts in the receipt book should have been prenumbered and the accuracy of serial numbers examined before a new receipt book is brought into use. In the case of banks, paying-in-slips in the signature of remitter is recommended.

(ii) Spoiled and cancelled receipts should be pinned to the carbon copy a evidence of what has taken place. Cancellation should be made under initial of the officers authorized to sign the receipts. While checking receipts it should be seen that serial numbers run consecutively and that no receipts are missing.

(iii) Where remittances are received, the signature of the remitter must invariably be insisted upon.

(iv) In the case of withdrawals from Bank, passbook entries or counterfoil, of cheques have to be verified before obtaining confirmation certificate from the bank.

(v) Material alterations in the receipt should be initialled by the persons authorized to sign the receipts.

4. Method of checking receipts.-The receipt side of the Day Book should be vouched with reference to the duplicate of the receipt book, paying-in-slips etc. and see that the following particulars correspond:-

1. Date of the receipt.

2. Name of the person paying in the amount and on whose behalf remittance is made.

3. Amount received (should have been mentioned both in words and figures)

4. Mode of remittance (in the case of the receipt by cheque the name of the bank should be specified. In the case of Money Order, Postal order, insured post etc. the mode and purpose of remittance should be specified.)

5. Head to which the amount is credited.

Carbon copies of the receipt issued to the remitter retained in the receipt book only provides for indirect evidence. But there are different types of documents to be examined for verifying such receipts.

5. *Shares and entrance fees*:- Printed receipts are issued for amounts received towards shares and entrance fees paid by members and prospective members. Since the share amount and entrance fees are to be paid along with the application for membership and the admission takes place only after approval of the committee, the amounts received would therefore be credited to a share suspense account till admission is granted by the committee. After admission the amount under suspense shall be adjusted towards share and entrance fee. The member will be issued a share certificate bearing distinctive number. His name will also be entered in the admission -register. Counterfoils of share certificates issued will be made available for audit, and the auditor has to check the details contained therein with the entries in the share ledger, (admission

register) and the member's register. In cases where additional shares are to be allotted on the specific resolution of the Managing Committee the auditor has to verify the minutes of the committee meeting also.

6. *Recovery of shares by instalment.*- Except in the case of some types of societies such as spinning mills, sugar mills etc. where the value of a share has been fixed high, the full value of the share is recovered in a lump. As such, except in a few cases mentioned above, there is no system of making calls towards balance share money due from subscribers (members). In the case of employees credit societies, monthly subscriptions at rates specified in the byelaws are collected from members along with other dues to the society. In such cases share is allotted to them when the full amount of share is collected. In consumer stores, 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 members and the undisbursed bonus payable to them is credited to their share account.

7. *Share capital of newly registered societies.*- For the registration of a new Co-operative Society the promoters of the proposed society are required to collect initial share deposit from its prospective members under the head 'share suspense'. This amount has to be deposited in the nearest branch of the District/Central Co-operative Bank, or in any other Bank approved by the Registrar. The account so opened shall be in the name of the proposed society and operated jointly by the Chief promoter and one or two other promoters duly authorized. 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 with the approval of the Department. If the society is not registered, the registering authority can issue orders permitting withdrawal of the amount and refund to the promoters of the proposed society. The newly registered society at its first General Body meeting should resolve and intimate the Bank and Registrar regarding the registration of the society and also request to transfer the amount in the name of the society. In the first General Body Meeting the promoters will be admitted as members and the amount already paid by them will be credited to their respective share accounts and entrance fee account and the share suspense account debited as per contra.

8. *Audit of accounts of societies prior to their formal starting* - The promoters of the proposed society are required to maintain proper accounts in respect of moneys received and payments made by them prior to the registration of the society. If the transactions prior to the registration merely relate to collection of share capital and incurring of normal expenditure for getting the registration, viz expenses over printing of bylaws, postage, conveyance charges etc., they are generally entered in the cash book of the society to be checked by the auditor. If the promoters have already started business before registration of the society and considerable period elapsed, the auditor should get a statement of receipts and disbursements made by the promoters on behalf of the society and the transactions checked in detail. If the auditor finds any difficulty in checking these accounts, he may seek instructions of his higher officers for auditing the accounts by himself or by certified auditor. In other cases, the receipt and disbursement statement prepared by the promoters and duly signed by the Chief promoter is to be passed in the first General Body. The receipts and disbursements in respect of the pre-started period may be incorporated in the Receipt and Disbursement statement of post-started period and the miscellaneous expenses (initial expenses) charged to the loss account. However, if the society is to implement a major scheme incurring huge amounts under pre-operation expenses, such expenses may be capitalised with the sanction of the Registrar and to be written off within a specified period.

9. *Admission of members*. - While checking the applications for membership, the auditor should examine the qualifications of the prospective members prescribed under the Co-operative Societies Act, Rules, bylaws and the circular instructions issued by the Registrar from time to time; for example:-

(i) In the case of a farming society members should execute an agreement authorising the society to borrow funds on the security of the lands pooled by them.

(ii) In taxi drivers' Co-operative Societies and Auto Rickshaw Drivers' Co-operative Societies, the members should have valid driving licenses.

(iii) In a society formed for the promotion of the economic interest of its members through a specified activity, or in a society formed exclusively for the benefit of persons engaged in any

particular industry, no person other than one who is likely to be benefitted directly by such action or an actual worker in the industry, as the case may be, shall be admitted in excess of the limit that may be specified in the bylaws or in any case in excess of 10 percent of the total number of members in the society.

(iv) In the case of admission in two credit or housing societies, necessary precaution has been made with regard to the prohibition of dual membership.

(v) Undertakings to be furnished by members of salary earners, societies authorizing their employers to deduct from their salaries, or wages, dues of the society as communicated by the society.

(vi) Declarations furnished by members of housing societies regarding building plots, houses, or tenements already owned by them should be verified. Compliance of the provisions of the bylaws regarding purchase of shares in proportion to acreage under specified crops held, loans borrowed etc. will also have to be verified. The auditor should also check whether the society has maintained a share application register as contemplated in Rule 29 (2) (b) of the Kerala Co-operative Societies Rules.

10. *Checking of admission register.*- The entries in the admission register have to be checked with the application for membership, resolutions of the committee day book relating to receipt of share capital, entrance fees etc. In case of refusal of membership, the date of committee resolution and reason for refusal should be ascertained and see that they are recorded in the 'remarks column' of the share application register. As regards resignation of membership or transfer of shares, relevant resolutions of the committee accepting the resignation or approving refund or transfer of the shares held should be verified and satisfied. It should be ensured whether the provisions of the Act, Rules and the byelaws have been complied with in the refund/transfer. It should also be seen that the resigning member has repaid all his outstandings to the society in the capacity of principal debtor or surety. If the auditor is satisfied after checking he should put his dated initials in the column specified in the register in token of having verified the entries.

11. *Receipt of Government assistance, Share capital, loans and subsidy.*

(a) *Receipt of share capital.*- Government contributes either directly or indirectly to the share capital of certain types of societies. Only those societies which satisfy the terms and conditions laid down by Government in this regard would be eligible for the contribution. Therefore while vouching the receipt of share capital contribution, the auditors should study the terms and conditions specified in the sanction order for the grant of assistance. The pattern of assistance differs from type to type. As Government is entitled to receive dividend on the shares held by them like any other share holder, the auditor has to verify whether the society has issued necessary share certificate in favour of Government.

(b) *Receipt of loan and subsidy.*-As regards receipt of Government loan and subsidy, the auditor should verify the order sanctioning the loan or, subsidy. He should also see whether the terms and conditions subject to which the loan/subsidy has been sanctioned are duly complied with. During the course of audit, the auditor should ascertain the proper utilisation of the loan/subsidy by the society and indicate in his report cases of non compliance of conditions, if any.

Loans are sanctioned to the village credit societies, Rural banks and marketing societies for construction of godowns. In such cases, the auditor should verify the original sanction order and also the intimation of withdrawals together with the receipt. He should also see whether the proceeds of the bill is immediately deposited in the district/central Co-operative Bank and utilised the amount properly as specified in the sanction order.

Joint Registrars, Deputy Registrars and other Officers sanctioning loans and subsidies have directions to forward to the auditor concerned a copy of the order sanctioning loan and or subsidy. When loans and subsidies are sanctioned by other departments of Government [Industries Department, Fisheries, Harijan Welfare, Dairy Development etc. or by the Central Government or other authorities (NCDC) etc] the Joint Registrar or the Deputy Registrar to whom a copy of the order has been received has to communicate the same to the auditor concerned to enable him to note compliance of the conditions of the loan or subsidy. Even if he was not supplied with copies of such orders he should ascertain the terms and conditions from the copy of the order received by the society and point out non-compliance, of the conditions, if any noticed by him.

Institutions which are receiving assistance like grants, subsidy etc. should maintain registers in the form prescribed. The societies are also required to furnish an undertaking to the sanctioning authority not to misutilise such assets or not to dispose of or mortgage the assets without the prior concurrence of Government/authority. The Auditor should also verify as to the proper maintenance of the prescribed registers and also see whether the conditions laid down are adhered to by the institution.

(c) *Accounting of Subsidies granted by Government.*-Managerial subsidies received towards the cost of Secretary or other management expenses may be taken to Profit and Loss account except in cases where specific instructions are given for its treatment. Where any conditions have been laid down or special instructions have been issued by the Registrar for the utilisation of Government assistance, it should be seen that these conditions or instructions are complied with.

All the societies receiving grants-in-aid are required to furnish an undertaking agreeing to abide by the conditions attached to the grant-in aid. Such societies are also required to maintain a register, in the proforma, prescribed and also not to dispose of, encumber, or utilise them for other purposes without prior concurrence of Government.

In case of all societies, which receive loan or subsidy under special schemes, orders sanctioning the loan or subsidy will contain specific instructions as regards treatment in accounts of subsidies granted to them. The conditions specified in the sanction orders should be carefully studied by the Auditor and their compliance watched. Subsidies granted by Government towards capital cost of a scheme, should invariably be taken to capital Reserve.

(d) *Small Farmers' Development Agency.*- S. F. D. A. give subsidy for Various approved schemes to the identified beneficiaries (viz. potentially viable Small Farmers, Marginal Farmers and Agricultural Labourers). The schemes are financed through Co-operative Societies/Banks and Commercial Banks. Advance subsidies are given by crossed cheques to be adjusted within a period of 3 months. They are not paid direct to the borrowers / beneficiaries, but given to the financing institutions, for adjustment to the loan accounts of the borrowers in order to reduce the interest burden on the credit extended to them. The Auditor should therefore, verify

whether the subsidies sanctioned for any programme are correctly and properly accounted and promptly adjusted in full to the loan principal of the beneficiary.

The Agency also gives Risk Fund to Co-operative Societies at the rate of 4% on medium term loans issued to S.F.D.A. beneficiaries each year. Similarly Risk Fund is given at the rate of 4% on the additional quantum of short term loans issued to S.F.D.A. beneficiaries each year. The District Co-operative Banks are paid Risk Fund at the rate of 2% on short term and Medium term loans issued to primary Co-operative Societies. Risk Fund is also paid to the Primary Co-operative Land Mortgage Banks at the rate of 2% on the long term loans issued to S. F. D. A. beneficiaries.

As per Rules governing the assistance, the amounts of such contribution to Risk Fund shall be credited to the Bad Debt Reserve of the Society/Bank. The Risk Fund sanctioned is allowed to be treated as part of the Societies/Bank's owned Funds to be utilised in their normal business.

Since the Agency is making all payments by way of crossed cheques only, the pass books with the District/Central Co-operative Bank/other Banks have to be verified by the Auditor. They should also go through the approved schemes of S. F. D. A. before audit and ensure that the conditions stipulated in the rules are strictly complied with.

12. *Receipt from financing agencies.*- While vouching the receipt of loans from financing agencies, like the District/Central Co-operative Banks etc. the loan application, loan sanction order, disbursement statement etc, should be verified. The auditor should also verify whether there is proper resolution of the Board of Directors for applying for the loan and whether the society has borrowed funds in excess of the limits prescribed under the bylaws. Duplicate copies of the loan bond or agreement and promissory note should also be examined.

13. *Repayment of loans by members.*- For acknowledging repayment of loan made by members, printed receipts from the official receipt book are generally issued. Entries in the cash book/day book should be verified with the duplicate or counterfoils of receipts in which the respective remitters have put their

signatures. Where pass books are issued to the borrowers, a few of the pass books at random should be called for and checked with the account in the ledger.

The auditor should be careful to locate instances of book adjustment. In order to get themselves eligible to receive fresh loans from the District/Central Co-operative Banks, certain societies indulge in the undesirable practice of book adjustment with a view to show a reduced percentage of overdues. This sort of clearing of overdue loans simply by book adjustment, if allowed to continue will ultimately, result in the debts becoming bad.

14. *Cash Sales.*- This item of receipt provides great scope for misappropriation of money, unless there is a definite system of internal check. Cash memos showing particulars of goods sold, such as quantity, rate etc., and amounts received, should be checked with the daily sales register. (The procedure for checking cash sales has been discussed under "Vouching of trading transactions").

15. *Receipt from debtors.*- As regards receipt of cash from debtors, one of the important precautions to be taken is to see that the cashier has no control over the preparation or of despatching of the monthly statements to them. Particular attention should be paid with regard to the payment of discount. The method of granting discount should be enquired into and any deviation from the normal rate should be noted and pursued further. Wherever possible, the auditor should get confirmation from debtors, preferably a statement of accounts may be obtained and the balances get confirmed.

16. *Sale proceeds of Government Securities and other Investments.*- Since purchase and sale of Government securities and other investments are made through brokers of bank, the amount received on account of their sale should be vouched with the brokers' sold note. The auditor should also see that necessary adjustments are made for interest included in the sale proceeds and income-tax deducted therefrom. The auditor will verify the resolution of committee/Board for the sale of the assets. The auditor may also verify the sale rate with reference to the market value quoted in the relevant Share Market reports from the State Bank of India.

17. Capital receipts.-

(a) *Sale of immovable property and other fixed assets.*-In order to vouch the receipt on account of sale of immovable property the auditor has to satisfy whether proper sanction of the Registrar has been obtained for the sale. If the property is sold on public auction, the auctioneer's report will be available in order to ascertain the sale proceeds. On the other hand, if it is sold on private negotiation, the agreement for the sale, the sale deed and other correspondence should be verified.

In the case of sale of fixed assets, the auditor's duty extends to the verification of connected records and calling for detailed information in order to ascertain whether the amount of sale proceeds was reasonable.

(i) Sale of fixed assets should be authorised by the Committee and General Body and sanction from Department should be obtained. Where fixed assets are sold, the value of such assets shown in the books of accounts should be removed from the balance sheet. In the case where a register of fixed assets is maintained, the accumulated depreciation pertaining to the items disposed of should be ascertained and written off against the original value of the items and the remaining net book value, if any, charged against the proceeds of the sale. If the sale proceeds 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 value should be written off against the profit and loss account. The profit or loss incurred on disposal of the fixed assets should be clearly disclosed in the accounts. When 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 positions in the society. For eg. When a vehicle/plot/ building is sold to a relative or friend of a Director or an employee of the society and the price realized is below the market rate, further investigation is called for.

(b) *Sale of movable properties.*- The auditor has to examine whether the sale of movable property has been authorized by the committee and that sufficient publicity has been given for the

sale. He should also verify the auctioneer's report if it was sold on public auction and the agreement for sale and sale deed etc. if sold on private negotiation. The net value of the asset is to be arrived at by deducting the 'depreciation reserve' charged already then the surplus or deficit remaining after adjusting the sale proceeds should be ascertained. If the sale proceeds are in excess of the net book value arrived at as above, or as shown in the Balance Sheet, the surplus should not be taken to the profit and loss account, but should be credited to the "Capital Reserve" or similar other funds. Deficit, if any, remaining after adjusting the sale proceeds against the net book value should be written off charging the loss account. Profit or loss found on disposal of the assets should be clearly disclosed in the accounts.

18. *Miscellaneous receipts-* (i) *Interest and dividend.*- Interest received on account of deposits with banks will be vouched with the corresponding entries in the pass book. In the case of fixed deposits and other investments the rates of interest can be ascertained from the deposit receipts and thus interest can be checked by calculating interest on the deposits or securities. Interest and dividend on investment and shares should be checked with the counterfoils of the dividend warrants. When register of investments have been properly maintained, the auditor can make use of this register for checking the receipts. In the case of interest on securities the concerned bonds themselves should be inspected.

Occasional receipts such as sale of scraps, unused stores and spare parts, unused materials, waste papers etc. and also receipts from insurance companies and railways in respect of claims should be vouched from the receipts issued, correspondence, minutes and relevant documents.

(ii) *Rent receivable.*- The lease deeds and agreements should be examined to ascertain the amount of rent and the due dates. If the Society/Bank has maintained a Rent Roll, the rent received as shown therein should be checked with the Day Book. He should also see whether all arrears have been accounted for properly and action taken for recovering them in time. Where properties or tenements are shown as assets, enquiries should be made as to why and how long they are vacant. Housing Societies, Co-operative Industrial estates and other societies which hold large properties should maintain "Property Register", Demand Register,

Rent Register etc., and the Auditor should verify the same and ascertain whether all the particulars showing the lands acquired by the society are there.

(iii) *Hire charges of vehicle and machines.*-Societies which own vehicles should maintain log book and trip sheet in respect of each vehicles. In the case of machinery and other costly equipments, proper accounts should be maintained with regard to the hiring out of the machinery or equipments. When these are hired out to the members of the society, necessary applications should be obtained from the hirers regarding the nature of service required, period for which they are hired out etc. Hire charges due to the Society will be verified, with reference to the log book, trip sheet and other records. For hire charges received printed receipts should be issued. The auditor can check the amount received with reference to the counterfoils of the receipts and other records mentioned above. The rates of hire charges should be fixed by the Committee. Hire register is to be maintained by the society. When the number of such vehicles or machinery is large, daily reports should be obtained from the officers in charge. The auditor will see whether the performance of the vehicle has been periodically tested by some approved workshop and the rate of fuel consumption of each vehicle got certified.

(iv) *Bills receivable.*-Bills receivable Register has to be verified with the Day book and Pass book. The auditor has to examine in detail, the bills matured but amount not received. It should be particularly examined whether all bills that have become due are accounted for.

(v) *Commission.*-Commission received will be checked with the commission accounts of the parties from whom it is received. In order to ascertain the rate of commission, the agreements have to be verified.

(vi) *Interest received on loans and advances.*-Interest received on loans and advances to members will be checked from the counterfoils of the printed receipts issued to them. Calculation of interest will have to be checked while checking the postings into the loan ledger.

(vii) *Sale of forms, newspapers and periodicals.*-Usually these items can be charged to Establishment and Contingencies

under stationery and printing. But sometimes these items may be purchased/printed for more than a year to achieve economy, in some other cases, there will be purchase/printing for re-sale also. In such circumstances the expenditure should be capitalised and shown as other assets in the Balance Sheet. The value of stock issued should be charged to loss account every year and the sale proceeds should be taken under Miscellaneous Receipt.

The following points also should be borne in mind in accounting the above:-

(1) The stock should not be included under Trading A/c.

(2) As the purchase/printing/sales etc and re-sale to members are not done to make any profit, no separate trading account need be prepared for the same.

The above instruction will not apply to societies whose object includes purchase and sale of stationery articles (like consumer Stores) printing societies etc. In their cases these purchases will come under trading account except those required for their own purposes.

(viii) *Suspense Assets and Liabilities*.-“Suspense Account” is an account to which items of receipts or payments are temporarily posted pending ascertainment of specified heads of account. When a loan is disbursed to a member the payment can straight away be classified to “Loan account” in the Day Book. But when money is paid in advance to a clerk for purchase of some articles for the society, the amount so paid cannot straightaway be debited to “Purchase Account” or “Materials Account” as it will not be supported by any cash bill or invoice. In such cases the payment or entrustment of the money to the clerk can only be treated as an advance to be recouped when the articles are actually purchased and cash bill/invoice are produced. Such payment in advance will be booked under “Suspense Asset Account”. It is an “asset account” because like any other advance these amounts are “due to” the society.

Similarly when a prospective member remits money towards share capital before he is actually admitted to membership, that amount cannot straightaway be credited to ‘share capital Account’ till he is admitted by the Board as per rules, In these case the receipt of money will be treated as an item of advance and booked

under “Suspense Liability Account”. When he is actually admitted as a member, the amount is refunded to him by “book adjustment” (transfer entry) and credited to his share capital account.

From the above, it will be seen that “suspense Assets Account” and “Suspense Liability Account” will have both, a receipt and a payment entry when the transactions are completed.

Separate subsidiary ledgers have to be maintained for both these accounts in which separate folios are provided for each person for his transactions with the society. These ledgers have to be balanced at least once in every month and the total balances tallied with that arrived at in the General Ledger, under the respective heads. So also at the close of the year, a list of all outstanding items under these heads should be prepared and the balances got agreed with the General ledger balances. The auditor should, close all accounts recording the total receipts, payments and balances in each account at the end of the year. The balances under each item should be confirmed at the end of the year and if any difference is noted that should be reconciled.

While checking the accounts under ‘suspense assets’ the auditor should ensure the following, that:-

(a) the payment is supported by a proper voucher and is for a genuine purpose and made by a competent authority.

(b) the payment is correctly recorded and posted in the suspense assets ledger and in the account and folio of the concerned person.

(c) the balance struck in the suspense asset ledger whenever a transaction takes place is correct.

(d) the amount was utilized for the purpose for which it was taken and accounts settled immediately after the amount was utilised.

(e) when the advance is recovered by “adjustment”, care should be taken to see that corresponding (contra) payment entry is also made by “book adjustment” and ‘not by cash’ as such a wrong entry will have the effect of reducing the cash balance which will tend to falsification of accounts and eventual defalcations.

The following are some of the points to be borne in mind by the auditor while checking the accounts under “suspense liability Account”.

(i) The receipt of the amount was genuine and properly accounted in the books of the Society.

(ii) Each item of receipt from different persons is recorded in separate folios in the Suspense Liability register and the balance correctly struck.

(iii) There are no over payments or false payments and that vouchers are obtained from the same persons in whose name the amount was received.

(iv) The original receipt given to the party should be got surrendered and kept with the voucher for refund of the amount.

(v) When refunds are recorded by “adjustment” care should be taken to see that there is corresponding receipt entry by “adjustment” to the *correct account*.

Apart from these, it is a common practice to exhibit all objected payments and sometimes receipts also, in suspense accounts. When a payment is objected by the auditor, that amount is rounded off in the General ledger and deducted from the payment side, the total of the account concerned, and transferred to “suspense asset account” in the General ledger at the same time recording the transactions as an item of objected payment in the suspense assets ledger. In such case the account and folios to which the amount was deducted and transferred and vice versa should be noted in the General Ledger.

19. *Deposits.*-(i) *Fixed Deposit.*- The auditor has to verify the byelaws and to examine whether the receipt issued for this kind of deposit is in conformity with the bylaws. For fixed and call deposits, printed receipts from the counterfoil receipt books specifying the terms and conditions of deposits such as rate of interest, period, due date etc. are to be issued to depositors. Counterfoils of receipts should be checked with the entries in the Day Book and the fixed deposit register.

(ii) *Recurring deposits.*- Here a fixed amount of Re. 1 or multiple thereof is paid every month for a fixed period, say 12, 24, 48 months etc. to the society. The paying-in-slips or chalans would be available for checking the amounts received. The auditor may also call for a few pass books and verify them. Daily /weekly /monthly deposits will also come under this head.

(iii) *Savings deposits*.- A member or a non-member can open a savings deposits account subject to the conditions prescribed under the bylaws or sub rules. Interest is usually paid on the lowest balance on any date in each month. The paying-in-slips, or chalans, which are filled in by the remitters, would be available for checking the amounts credited to their respective accounts. The auditor should call for a few pass books of depositors and compare them with ledger accounts.

(iv) *Current deposits* -Pay-in-slips or chalans which are prepared by the remitters, for remitting the amounts have to be checked with the deposit register. The auditor may also verify a few balance Confirmation Certificates from the depositors obtained by the society. Otherwise, he may call for the Confirmation statements of balances from a few account holders.

20. *Others*.- Occasional receipts and receipts which are not specified above should be vouched from the receipts issued, correspondences, minutes and other documents available in the society.

CHAPTER V

VOUCHING OF PAYMENTS

I. *General*.-(Propriety of expenditure etc.)

(i) After vouching the receipts side of the Day book, the auditor has to take up checking of entries in the payment side. It is his duty to ensure that every payment made is genuine, correct, proper and duly authorized and also supported by a valid documentary evidence viz. a voucher. Documentary evidence for payment will generally consist of acknowledgement of the payee receiving the amount, Cash bills, etc. In vouching a payment item in the day book, the auditor has first to examine the relative voucher. The name of payee, date, amount and other particulars in the voucher should be compared with the corresponding entries in the Day book. The object of scrutinizing the date is mainly to guard against the production of vouchers of previous months/years in support of fraudulent payments. The receipts from payees in their printed receipt forms and those bearing their rubber stamps are better evidences than an invoice or document merely receipted in ink or typewritten.

In addition to the regular voucher containing acknowledgement of the payee, the auditor has to examine other documentary evidences also such as minutes correspondence files and records of transactions etc. Therefore, before commencing vouching, the auditor has to get himself familiarised with the nature of supporting evidence that would be available to him and the types of documents that will have to be examined in connection with the payment.

(ii) Points to be noted while checking payments.-(a) The voucher should have been addressed to the society itself and not in the personal name of the Secretary, Managing Director, Chairman, or other Officers.

The nature and purpose of the transaction to which the payment relates, should be one which the society is normally expected to carry on as per its bye laws.

(b) The vouchers should be properly authenticated by the authorised officers of the society.

(c) Where payment has been made to an officer representing an institution the voucher should bear the rubber stamp of the institution.

(d) Where payment has been made to a person other than the payee, a valid letter of authority from payee should be obtained and filed.

(e) All payments in excess of Rs. 20 should have been duly stamped.

(f) The vouchers should have been properly checked as regards arithmetical accuracy of the amount and propriety of the payment by a responsible officer of the society.

(g) All thumb impressions should have been properly described and attested.

(h) All vouchers should be cancelled by the Auditor when he checks and passes entries in his audit. This is 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 the voucher should be initialed by the auditor in a prominent place, preferably in the middle.

It is necessary that all payments should have been regularly sanctioned by the committee or an officer properly authorized to do so. When the Managing Director, Manager or Secretary is authorized to sanction payments or incur expenditure, it should be seen that these officers do not exceed their authority. Resolution of the managing committee or the general body will have to be seen in the case of payments which are beyond the powers of the officer concerned. All extraordinary expenses which are 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. Again, purchases of immovable properties and investments of funds outside the business of the society which the Board or Committee is not competent to sanction, should have been sanctioned by the general body.

So also where the Secretary or the office bearer who is authorized to incur the expenditure upto a specified limit, all expenditures incurred by him and all disbursements made by him should be placed before the committee periodically for its approval.

2. What is Capital and Revenue Expenditure.- Capital expenditure means money spent on acquiring fixed assets or expenditure which tends to extend or improve the existing assets so as to enhance the revenue earning capacity of the business.

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

The correct allocation of expenditure between capital and revenue calls for the careful examination of the auditor; as it will affect the profit and loss account and Balance Sheet. Wages paid in the ordinary course of business, represents revenue expenditure. But when wages are paid for erection of building etc. they will be of capital nature.

Similarly, legal fees paid is normally a revenue expenditure but when it is paid for conveyance of the title deeds or in connection with acquisition of property it will come under capital expenditure.

When a new construction/additional work is taken up, the expenditure incurred is first debited to the advance account and then transferred to the capital head.

Improper treatment of expenditure between capital and revenue will have far reaching results on the accounts. If a capital expenditure is debited to the profit and loss account, that item will not come in the asset side of the balance sheet thus creating a secret reserve and reducing the profit or increasing the loss to that extent.

The distinction between Capital and Revenue Expenditure most vitally affects the fundamentals of accounting. It is highly essential, that proper adjustment of these items must receive close and careful attention at the time of preparation of final accounts. As such, in constructing the final accounts all revenue items would have to be included in the Revenue Account i. e. Profit and Loss account and all items of capital Expenditure will form part of the Balance Sheet. It follows that the distinction would need to be most rigidly observed, in as much as, any incorrect adjustment of allocation in this behalf would falsify the final results as disclosed by both the P&L account and the balance sheet.

All expenditure for acquisition of permanent assets and which is intended for continuous use in the business of the society earning revenue is *Capital expenditure*. Again any expenditure which tends to extend for improving the existing assets so as to enhance their revenue earning capacity by increasing production or reducing cost of production may rightly be treated as Capital Expenditure.

All expenses under Establishment and other expenses incurred in connection with the business of the society come under the heading of Revenue Expenditure. Further, all expenses under repairs, replacements, renewals of existing assets, which do not in any way add to their earning capacity but simply serve to maintain the original equipment in an efficient working order are chargeable to revenue. Thus, office salaries, rent, taxes, insurance, advertising and the expenses incidental to the carrying on of a business as also amounts expended on repairs to assets forming part of permanent equipment would be treated as items of Revenue Expenditure.

It is important to note that whereas all items of Capital Expenditure will be included in the Balance Sheet, all Revenue items will find their place in the Revenue account, ie. the profit and loss account.

(b) *Deferred Revenue Expenditure.*- When heavy expenditure of a revenue nature, such as exceptional repairs, expenses on removal of business, or abnormal advertising, is incurred, it is customary and legitimate not to charge the whole of such expenditure to the Revenue Account of the year in which it is incurred, but to spread it equitably over the number of years during which the benefit of such expenditure is likely to be left. A proportion of such expense, is then written off in the profit and loss account each year and the balance not written off will appear on the assets side of the Balance Sheet under the heading of "Deferred Revenue Expenditure". The whole underlying idea is to see that each Year's profit and loss account is charged only with expense that can fairly be attributed to that year. The following pre-operative expenses are to be treated as Deferred revenue Expenditure.

- (i) Establishment.
- (ii) Rent, rates and taxes.
- (iii) Trading expenses.
- (iv) Legal charges.
- (v) Postages, telegrams, telephone etc.
- (vi) Printing, stationery and advertisements...
- (vii) Miscellaneous expenses.

3. *Vouching of Capital and Revenue expenditure-Apportionment.*- The apportionment of expenditure between capital and revenue is of vital importance, as a wrong allocation, will directly affect the amount of profit or loss and the correctness of the balance sheet. Where the expenditure is incurred for capital items, the expenditure on that account can be vouched during the course of examination of the cash book, or purchase register. All capital expenditure incurred should be properly authorized. The resolution of the committee/Board authorizing the purchase should be seen. In the case of farming societies, the expenditure incurred for developing land, construction of bunds and providing irrigation facilities should be debited to deferred revenue expenditure. In housing societies the expenditure incurred for the development of land including construction of roads, drainage, provision for electricity and water should be capitalised. Expenditure incurred by newly organised societies, upto the date of commencement of trading may be allowed to be capitalised. In the case of processing

and manufacturing societies, the entire expenditure incurred including financial charges up to the date of commencement of manufacturing activities may be capitalised.

4. *Lands and buildings-Construction of building.*-In the case of erection of a new building the title deeds of the land on which the building is constructed, the agreement of the contractor, and the certificate from a qualified engineer must be verified. Where buildings are purchased the agreement of the sale of property/building, conveyance and title deeds and other records should be verified. On the other hand, if the building purchased is in the course of construction, the buildings account, running bills and receipt and certificates of the architects or qualified engineers, should be verified.

5. *Plant and Machinery.*- Where plant, machinery, furniture etc. have been newly acquired, invoices and receipts will be verified. Enquiry should be made to ascertain whether there is proper authorisation for the expenses. It should be seen that the expenses incurred in connection with the repairs, and maintenance are not added to the asset. However, the cost of direct expenses which are incurred in connection with the acquisition, like cartage, or cost of erection can be capitalised.

6. *Investments.*-Payments for the purchase of shares, securities etc. should be vouched with the broker's bought note, share certificates, bonds etc. The auditor should also verify whether the investment, have been made in accordance with the provisions of the Act, Rules and Byelaws.

7. *Loans to members.*-The auditor should verify the loan applications, security, if any, offered, sanction of the loan, bond executed, acknowledgement etc. If the loan is advanced against mortgage he should examine the mortgage deed, title deed and legal opinion.

8. *Salaries and commissions.*- The payment of salaries can be vouched with reference to the appointment file, acquittance roll, and with the order sanctioning the increments or allowances, if any. The auditor should also verify whether the incumbent in each post possess the required qualifications and satisfies other conditions stipulated in the service conditions of employees. Total salary paid during a month should be compared with the amount

paid in the remaining months. Reasons for any abnormal increase or decrease in the total amount disbursed as salary should be duly enquired into and satisfactory explanations obtained.

9. *Travelling expenses.*- Rules should be framed regulating payment of travelling allowance, Daily allowance etc., to the employees and office bearers of the society. The expenses incurred for payment of travelling allowances, are not usually passed with vouchers alone. The person incurring the same should have preferred the claim in accordance with the prescribed rates and within the limit fixed in the Rules. The auditor can pass the voucher if it is in accordance with the Rules.

10. *Postage.*-The cost of revenue stamps purchased is not included in postage charges. Postages are small amounts, but they provide ample scope for misappropriation, if no efficient internal check on the same exists. The entries in the postage book should be examined with the despatch register. The amounts drawn from the petty cashier by the despatch clerk should be verified and the balance on hand counted. The auditor should also ensure that some one responsible checks the postage account daily. For payment on postage under paid not paid envelopes etc., the envelope/Cover/wrapper on which the dues is marked should be seen. Similarly for V. P. P. charges the original wrapper on which the amount is mentioned should be seen. For payment of registration charges of articles sent by registered post, the Post Office issues separate receipts.

11. *Management expenses.*- Rule 48 of the Rules authorises Registrar to fix the maximum rates of travelling allowances and daily allowances or sitting fees payable to the member and committee members for attending the general body or committee meetings. Accordingly Registrar has fixed the T.A, D.A.etc. payable to the Directors of different categories of societies. Since fees to the committee members are payable for attending meetings, it is necessary that an attendance register is maintained in the society marking their attendance in the meeting and duly authenticated by the President/Chairman. Payment made to the Directors should be checked with reference to the Attendance Register also.

12. *Conveyance charges.*- When vehicles owned by the society are used by the Committee members or members of staff, no conveyance charges need be paid to the member.

13. *Maintenance charges of vehicles.*-All Co-operative Societies which possess trucks, motor cars or jeeps, should maintain log book and trip sheet for each vehicle in the prescribed form in order to record details of each operation. The societies must have also framed necessary sub-rules for the operation of the vehicles. The Rules should provide for the recovery of charges for private use of the vehicle. For each journey, duty slips should be issued to the driver. The person who had travelled in the vehicle should sign either in the Log book or in the duty slip.

Separate accounts are to be maintained for each vehicle for recording the expenses over its maintenance and repairs. The auditor should verify whether the expenses are reasonable and whether the society has limited the expenses within the budget allotment. He should also see whether monthly statements of expenditure incurred over the maintenance of the vehicles are prepared and submitted to the committee for approval. A register of unserviceable parts like tyres, tubes, spare parts etc., should also be maintained.

14. *Expenses over maintenance of guest houses.*- Every society/bank which possesses guest rooms should frame necessary sub-rules and obtain approval of Registrar of Co-operative Societies for letting them out. A register showing the name and address of the occupant, date and time of arrival and departure, charges, if any, recovered from them etc., should be maintained. The auditor should verify and ensure that the rates as prescribed in the sub rules are recovered from the occupants of the guest room, when let out. He should also see whether the expenses incurred over the maintenance of guest rooms is reasonable and limited to the budget allotment.

15. *Payment of honorarium.*-Payment of honorarium or remuneration to the members of the committee is governed by Rule 49 of the Rules under the Act. There should be provision in the byelaws permitting the payment and also scale of payment. Honorarium or remuneration can be given to the members of the committee based on the extent of business done by such members to the society or on the value of services rendered by them to the society. The extent of such remuneration is to be fixed by the general body, by specific resolution, and got approved by the Registrar.

16. *Donations.*-The auditor should see that provisions under section 56 (2) (d) are scrupulously followed in giving donations. Ordinarily donations are to be made only for purposes defined in the Charitable Endowments Act, 1890. If payments are made for purposes other than those provided in the Charitable Endowment Act, it should be made only from the Common Good Fund/Charity Fund created for the purpose. If such a fund is not maintained by the Society, donation should be debited to suspense or sundry debtors account in the first instance and then shown as recoverable. This can be written off against common good fund/charity fund when such a fund is created out of net profit in accordance with the byelaws.

17. *Electricity and water charges.*- Payments on account of electricity and water charges are to be checked with reference to the monthly bills issued by the competent authority. The receipted bills themselves would serve as vouchers, for payment made on this account, as no other receipts are generally issued. When expenses are incurred for delayed payment, the auditor should enquire about the reasons for penalty etc. and decide according to merits.

18. *Telephone charges.*- Register of trunk calls noting private calls also has to be maintained in respect of each phone. The expenses incurred should be checked with the monthly or quarterly bills issued by the Posts and Telegraphs Department. The bills of trunk calls can be checked with the 'Trunk Call Register'. Charges for private calls should be realized from the parties making the calls.

19. *Printing charges.*-When printing of forms, bills etc. is to be executed on a large scale, the auditor should see that, in placing orders for printing, the society has observed the normal canons of financial propriety, such as inviting of quotations and accepting of the lowest one etc. If on any reason the lowest tender/quotation is not accepted, the reason for the same has to be recorded. Payment for printing should be made only for the completed item of work and on delivery of printing materials. Payment on this account can be checked with reference to the bills received from the printing press. An inward register should be maintained for the receipt of items from the press. The stock register of forms or bills can be prepared with the help of the inward register. Issues and consumption of stationery articles should have been properly

controlled. The accounts of stationery and printed materials should have been maintained and checked by a responsible officer at frequent intervals.

20. *Payment of Insurance Premium.*- A register of insurance policies showing the particulars of assets insured, risk covered, policy number, period, date of expiry, premium paid, claims preferred etc. should be maintained. The payment made can be checked with the receipt issued by the insurance company acknowledging the payment. The amount of premium paid has also to be gathered from the concerned Insurance Policy or the cover note.

21. *Advertisement charges.*- Newspaper cutting of the advertisement and the bill received from the press should have been attached to the voucher. The date or dates on which the advertisement has appeared in the paper and as mentioned in the bill, should be checked with the press copy received.

22. *Vouching of Petty Cash book.*- In large undertakings, for recording small payments of Sundry nature, a petty cash book is usually maintained. A round sum, sufficient to cover the estimated petty expenses for a definite period, should be handed over to the Cashier. Petty cash should be kept on the imprest system. Only payments upto a specified limit should be made from the petty cash. The petty cash book along with the vouchers should be produced to the officers concerned to issue cheques for reimbursement. He should sign the petty cash book in token of having checked and approved the payments made. The auditor should check the receipt of money by the petty cashier with the cash book.

For payments made from the petty cash, proper vouchers should be maintained. The vouchers should be arranged and serially numbered. These vouchers should be duly cancelled at the time of re-imbusement of petty cash. In cases of petty expenditure, (like tea, cigaratte etc.) for which it is difficult to obtain proper voucher, a slip signed by any responsible officer of the institution may be accepted.

The auditor should test check the castings and postings and entries relating to the cheques drawn into the petty cash book. He should see that the petty cash book is signed by the petty cashier. Occasionally and without notice, he should count the cash in

hand. Surprise checks will be useful to bring to light any misuse of petty cash.

23. *Vouching of Bank Account.*- The receipts from Bank and the payments into it have to be vouched with reference to the Pass Book. Payments into the Bank should be vouched with the counterfoils of the paying-in-slips. Payments made by certain customers direct into the society's account in the Bank, can be checked with the advices received from the Bank. Payments out of the Bank can be vouched with the counterfoils of cheques issued. Payments of Bank charges, commission, interest etc. can be checked either by means of entries in the pass book or by the intimations received.

The auditor should not simply satisfy himself with the balance as disclosed by the Pass book, since it is likely that dummy pass books might be produced to him for checking. Therefore he should obtain direct from the bank a confirmation certificate of the balance shown in the books of the Bank as on the closing date of the period.

24. *Payment of Advances.*- Members of the staff and office bearers of the society are given advances for various purposes, such as for purchases, and also for meeting their expenses in connection with official work. Very often advance payments have to be made for services rendered, for works to be executed, for supplies to be made etc. Payment of reasonable amount of advances for genuine purposes and in the normal course of business of the society is to be admitted in audit. The vouchers in support of advance payments should be descriptive of the purpose for which advance is made. As far as possible all advance payments should be adjusted within a reasonable time. When advances are taken for making purchases or for meeting the expenses in connection with the travel, such advances are to be adjusted immediately after return to the headquarters. Advances given without authority or for unjustifiable purposes should be objected in audit. Such objected items should be shown in audit as recoverable from the persons responsible.

The auditor should prepare a list of all long outstanding advances on the date of audit and should enquire into the reasons for failure to recover the amounts.

25. *Refund of shares.*- While checking refund of shares, the auditor should ensure whether the refund has been made in

accordance with the provisions under the Act, Rules and the byelaws of the society. When refund of shares is made the society has to get back the share certificate issued to the member and the same attached to the voucher after cancellation. In the case of refund of shares consequent on the resignation of membership, the resolution of the committee accepting resignation and allowing refund of shares should be verified. The auditor should also check the entries in the share ledger. In the case of refund of shares and consequent cessation of membership, the fact should be recorded in the share ledger with the dated initials of the auditor.

26. *Refund of deposits.*-(i) Fixed Deposits:-Before refund of the Fixed deposit, the fixed deposit receipt issued while accepting the deposit should be called back and got discharged. In cases where no separate receipts are issued for fixed deposits, the original receipt issued for the deposit should be called back and a separate voucher obtained for the refund of the deposit with interest. The original receipt obtained back should be cancelled and attached along with the voucher.

(ii) Savings deposits.-Even though there is provision in the byelaws of agricultural Credit societies, to accept savings deposits, only a few societies have been mobilizing deposits. For payment of saving deposits withdrawal form should be supplied to the depositors and their signatures obtained thereon, in the presence of independent witnesses.

27. *Payment of interest on deposits and loans.*- Interest paid on deposits should be checked with the particulars furnished in the deposit ledger/ voucher. Usually the deposit receipts contain provision for recording payment of interest on deposits. If provision is not made on the deposit receipt itself for acknowledging interest, separate vouchers should be obtained from the depositor, indicating full particulars of deposit, interest secured, period in respect of which interest is paid etc. Interest on Savings Bank Accounts is usually credited to the account of the depositor and added to the principal. Therefore, for payment of interest in respect of Savings Bank Accounts, separate vouchers are not necessary.

With regard to the payment of interest on other borrowings, such as Bank loans, cash credit etc. the bank will debit the interest to the account of the society, either half yearly on 31st December and on 30th June or yearly. The Bank usually sends advice slips to

the society when interest is debited to the account. For checking payment of interest the auditor can make use of these advice slips and Bank Pass Books.

28. *Payment out of profit.* -(i) Dividend.-The auditor has first to verify whether general body has authorised the Payment of dividend. Dividend has to be paid in accordance with the provisions in the byelaws of the society. If dividend warrants are not issued, separate vouchers should be obtained from the members indicating the number of shares held, the period for which shares are held, and the rate of dividend. The dividend register can also be checked to ensure the correctness of calculations.

(ii) Bonus.-Bonus payable should be checked with the entries in the bonus paid register. If bonus warrants are not issued, separate vouchers specifying details of bonus paid should be maintained. As regards payment of bonus or rebate on purchases from or sales made through the society, a register showing particulars of the purchases made from the society or sales made through it and the rate at which bonus or rebate is paid or amount earned etc. should be maintained. In the case of bonus payable to the staff members of the society, the auditor has to verify whether payment has been made in accordance with the provisions of the Act, Rules and Byelaws and the instructions of the Reserve Bank of India.

(iii) Common good fund.-Contributions from common good fund are made only for purposes mentioned in the Charitable Endowment Act such as Medical relief, sanitation, Co-operative propaganda, maintenance of library education and relief to poor.

29. *Refund of Suspense accounts.*-Amounts credited to suspense account or Sundry Creditors' account are to be repaid only on getting proper vouchers indicating the particulars of the original advance. While refunding the amount, the original receipt, if any, issued at the time of receipt of the amount, should be called back and attached to the voucher duly cancelled. If the party signs on the back of the original receipt as having discharged the claim, separate voucher may not be insisted on.

30. *Repayment of Bank loans, cash credit and overdrafts.*-Repayment of Bank loan can be checked with the paying-in-slips issued by the bank. These slips usually indicate separately the amounts paid under principal and interest. In cases where Bank

loans are adjusted from the balance standing to the credit of the society under current account, payments can be checked through the entries in the pass book and the advice slips of adjustments.

Cash credit and overdrafts are generally operated by means of cheques. Repayment of cash credit/overdraft and other advances received from the Bank are checked with counterfoils of paying-in-slips and the entries in the Pass book or by means of the statements, if any, issued by the Bank.

31. *Contingencies-Payment of rent, rates and taxes.*- Payment of land revenue, rent, taxes and other fees to Government and local authorities has to be checked with the receipts issued by the concerned authorities. In the case of lands held on lease, the payment of rent has to be checked with the lease deed and the receipt issued by the landlord. It should also be seen that all the terms and conditions of the lease deed are properly complied with. Where payments are made into the Treasury, the receipted chalan can be checked. Hiring of premises and approval of rent or compensation should have been sanctioned by the committee. Deposits and advances paid towards rent or compensation should have also been sanctioned by the committee. The auditor should also see the terms and conditions of repayment of those advances.

32. *Miscellaneous-General charges, office expenses, affiliation fees, provident fund etc.*- Every expenditure should be covered by sanction of the general body. The expenditure incurred under each item should be within the budget allotment. In the case of amounts payable at regular intervals the scales have to be fixed by the managing committee. In the case of other expenditure, it should be incidental to the business of the society. The scales may vary in accordance with the business of the society, and the importance of the occasion.

The expenditure over publicity, advertisement etc. should have relation to the expected increase in the volume of business also.

33. *Expenses to be objected in audit.*- The auditors should object the following expenditure despite the fact it is covered by sanction to the committee or any other authority.

(i) Expenses which are not incidental in the ordinary course of business.

Eg. Personal expenses of directors, officers and employees of the society.

(ii) Abnormal expenditure over publicity, propoganda, advertisements etc.

(iii) Expenses which could have been avoided in the ordinary course of business.

(iv) Expenses which are considered heavy and disproportionate, considering the size of the institution and importance of the occasion.

(v) Fraudulent, false or fictitious expenses.

The auditor should prepare a list of all objected expenses and attach them with the audit certificate/note with his definite observations and reasons therefore. If required, the auditor may discuss the matter with the committee of the society and suggestions made to recover the amount involved from the person responsible. If no action is taken by the management the auditor should specify the same in the audit report.

34. *Checking of journal.*- All those entries which cannot be passed through any other book of prime entry are passed through the journal,. While vouching, entries in the journal or in the cash book, the auditor should not pass an entry in the journal until he is quite satisfied of the correctness and validity of the transaction. The following transactions are usually passed through the journal.

(i) Opening entries.

(ii) Transfers from one account to another.

(iii) Adjusting entries, such as making provision for bad and doubtful debts; outstandings, prepaid expenses, depreciation, rectification of errors and interest on capital.

(iv) Entries relating to depreciation, writing off of losses, preliminary expenses, deferred revenue expenses.

(v) Appropriation of profits.

(vi) Entries- relating to issue and allotment of shares.

(vii) Forfeiture of shares.

(viii) Allocation of expenses between capital and revenue and amongst the various departments of business.

(ix) Entries relating to consignments, dishonour of bills etc.

(x) Closing entries ie. transfer from the nominal accounts to the profit and loss account.

When transfer entries are passed through the cash book itself, both the debit and credit entries should be seen simultaneously. In order to distinguish the contra entries from other entries, such contra entries should be marked with the special tick. Since contra entries also create monetary obligations, they are as important as cash transactions. Therefore, the auditor should give due attention while checking these contra entries.

35. *Repayment of loans to Government.*- Repayments of Government loans are to be vouched with reference to the receipted chalan issued from the Treasury. The auditor has to ensure whether the principal and interest have been remitted to the correct Head of account by means of separate chalans. While vouching the payment, the auditor should satisfy himself that the chalan produced bear the place, number and seal of the Treasury, amount remitted, head of account, purpose and date of remittance etc. and authenticated by the Treasury Officer or other competent authority.

36. *Expenses out of-* (i) *General Funds.*- Without the previous sanction of the registrar, societies shall not incur any expenditure which is not directly connected with the business or management of the society. So the auditor should see that any expenditure not being directly connected with the routine business or management of the society should have the sanction of the general body and or of the Registrar. If it lacks sanction of the competent authority it should be kept under objection in audit.

There may be other miscellaneous expenses like payment of advances, execution fees, remuneration to clerical staff etc. In all these cases, the auditor, apart from verifying the vouchers should decide each case according to the circumstances and satisfy himself of the genuineness of the expenditure.

(ii) *Reserve Fund.*- A Reserve Fund may be defined as a sum set aside out of divisible profits and retained in order to provide for unexpected or unknown future losses or to strengthen the financial position of the concerns.

37. *Auditor's duty in regard to the audit of Reserve Funds* - (i) He should check that the amount set apart from the net profit is in accordance with the rate prescribed in the Kerala Co-operative Societies Act/Rules/Byelaws and the appropriation is authentic.

(ii) He should check that the amount set apart to the Reserve Fund and Agricultural Credit Stabilisation Fund together forms not less than 40 percent of the net profit, in respect of societies that are to maintain the later fund.

(iii) He should check that appropriation of net profit to the Fund has been properly transacted in the books of accounts.

(iv) He should check that the Reserve Fund has been properly invested and that any amount utilized in business or invested otherwise, has necessary sanction of the competent authority.

(v) In the case of societies which have not distributed its profit in respect of a particular year, by the close of the subsequent year, or till the date of finalizing the audit of the subsequent year, the auditor may set apart the required minimum amount to the Reserve Fund from the net profit after making necessary entries in the Books of Accounts of the societies concerned and in such cases the amount of undistributed profit in the balance sheet should be shown in the balance sheet with the following details.

Undistributed profit:

Profit for the year:

Less amount set apart to Reserve

Fund and Education Fund, Agricultural
Credit Stabilization Fund

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Balance :

(vi) He should also check the regularity of any set off Reserve Fund of towards payment of any debt or outstanding demand with reference to section 38 of the Kerala Co-operative Societies Act and rule 61 of the Rules thereunder.

(vii) In respect of Reserve Fund allowed to be utilised by the society on the basis of sanction of Registrar, the auditor should verify as to whether that portion of Reserve Fund withdrawn or allowed to be utilised has been utilised for the purpose for which it is allowed.

CHAPTER-VI

A. VOUCHING OF TRADING TRANSACTIONS

I. *Purchases.*—The system of internal control on purchases should be examined very carefully. Proper ordering procedure is necessary to ensure that purchases are made only on terms and conditions acceptable to the society. The auditor should see that payment is made only for goods which have been ordered and received.

The auditor has to examine carefully the system of internal check in existence.

(i) Effective control should be exercised over all the orders placed by the management and proper records maintained.

(ii) All orders for purchases should be made from the printed order book which should contain all the terms and conditions governing supplies.

(iii) The “goods inward book” showing particulars of goods received should be maintained upto date.

(iv) The invoices should be checked with goods inward book maintained by the store keeper. The prices should be checked with quotations, estimates etc. and initialled by the clerks who check them.

(v) The invoices should then be passed on to the purchase Department to place orders. The person in charge of the Department will check the invoices and order for the payment.

The store keepers should prepare a requisition note or indent for the articles the stocks of which are to be replenished. The requisition note should be endorsed by a responsible official. Based on such notes, orders should be placed in the printed order books. Where goods are received, quantities, weight etc. should be checked with the delivery notes and entered in the “Goods Inward Register” kept in the godown. The prices should be compared with the quotations. The invoices should be then passed for payment. Particulars of invoices should be entered in the purchases book. Persons who are responsible to submit requisition orders should not themselves be authorized to issue purchase orders.

The practice of inflating profits by means of suppressing invoices must not be resorted to. The auditor should therefore, examine the goods inward register and trace into the purchases during the last few weeks. If any of the purchases made at the end of the period are not entered in the purchase book, he should see that such items are not included in the closing stock, to avoid inflation of profit.

Fraud might also be committed by means of entering an invoice twice in the purchase day book in order to defalcate the amount of that item. Therefore, the auditor should take much care in examining vouchers with the entries in the purchase book.

2. *Purchase returns.*- When the goods are returned to the seller being not according to the sample or of inferior quality, or damaged, a credit note should be obtained, if prices are paid already. If the prices have not been paid, proportionately less amount may be paid to the seller. The suppliers should be requested to send their credit notes. 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.

The auditor should compare the credit note with the purchase return journal or return outward book or the stores records. Particular attention should be paid to the entries in the book for the period immediately following the previous year, to ensure that they are not for neutralising certain fictitious entries for the previous years purchase given and or with a view to manipulating the accounts.

3. *Credit purchases.*-When credit purchases are effected, the auditor should ensure that the credit bills are entered in the books of accounts properly and correctly. It is quite possible that credit bills are converted into cash bills and the amount involved in such bills misappropriated. In order to be sure of the nature of the transaction, the auditor should get statements of accounts direct from the suppliers. He may also obtain confirmation as to whether all the credit bills have been cleared by the end of the audit year.

4. *Checking of invoices.*-Invoices are to be checked both by the Buying Department and Accounts Department. The Buying Department will check the prices, quantities, discount allowed terms of payment etc. and the Accounts Department, their

arithmetical accuracy. The invoices received should conform to the orders of the Buying Department. When more than one copy of the invoices are received, all other copies should be stamped to indicate that they are only duplicate copies. Invoices and credit notes are to be consecutively numbered on receipt and entered in the "Invoice Register."

The invoices after having been checked by the Accounts Department should be passed on to the concerned officials of the society who are responsible for effecting payments. The paying officials should be independent of the Buying Department.

The invoices should be initialled by the persons who check them. During the course of audit, the auditor should see that the society has followed the procedure prescribed for making purchases and payments to creditors. They should also check the arithmetical accuracy of the calculations etc. in the invoices. The entries in the purchase register should be checked with invoices and the 'Goods Received Notes' or materials received certificates stamped on the invoices. They should also check postings in to the stock ledgers. Casts and Cross-casts of the invoices and the purchase journal should be checked and got agreed with the amounts posted in the General Ledger. In the case of missing invoices the auditor should insist on the production of duplicate copies or other relevant records.

5. *Allocation of charges.*-Allocation of charges and credits to nominal accounts and cost accounts should be done by proper authority. The basis of allocation should have been indicated in the invoice of the credit notes themselves. With regard to the acquisition of or addition to fixed assets, it should have been authorised by the committee/Board by means of proper resolutions.

The statement of accounts received from suppliers should be checked with the respective ledger accounts. Wherever necessary, the auditor should also resort to direct verification with the suppliers.

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

6. *Method of checking invoices.*- While checking the invoices, the auditor should pay attention to the following aspects:-

(i) The invoices should be addressed to the Society and not to any individual director or officer of the society (i. e. it should not be in the personal name of anybody). All invoices should be compared with the original requisition issued by the Buying Department.

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

(iii) Quantities and rates should conform to the purchase orders. Where these are not specified in the purchase order, it should be verified with reference to the agreement, tenders of suppliers and other connected documents. .

(iv) The store keeper should have recorded a certificate in the invoice regarding the receipt of the goods.

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

(vi) The vouched invoices should be cancelled and it should be seen that the entries are made after deducting the trade discounts, if any. Where credit is allowed, the auditor should see that payment is made before the expiry of the credit period.

7. *Organisation of a purchase Department.*- In the case of big processing and manufacturing units, the auditors should have a fair knowledge of the modern inventory control and management methods. They have to know how the purchase departments are to be organized on sound lines and made to function efficiently.

It may be seen whether:-

(i) A qualified and competent purchase officer is appointed.

(ii) Minimum, re-ordering and maximum level are fixed.

(iii) Proper material planning is done.

(iv) Economic order quantities are fixed and

(v) Procurement time is contracted properly.

The purchase Department should have a follow up register, in order to watch the pending orders, to find out the total cost of

purchases, total procurement time and to evaluate the vendors before any order is placed. Usually the vendors are evaluated by considering the quotations received and placing orders with lowest cost suppliers. While placing orders with the lowest cost supplier, care should be taken to see that products are of good quality.

8. *Sales.*- Retail sales are mostly confined to consumers' societies and other societies which deal directly with customers. The auditor should be careful in vouching sales, in view of the fact that the documentary evidence available is not as conclusive as in the case of purchases. Therefore, the auditor has to depend on the internal check system.

(i) Proper attention should be paid to the system of ordering goods by the customers with the society. All orders received should be entered in the 'Order Received Book' according to the date of receipt.

(ii) When an order is executed, an invoice should be prepared and despatched.

(iii) The invoices should be duplicated by means of carbon leaves, and from copies of actual invoices. The sales day book should be written up up-to-date.

(iv) A copy of the invoice should be sent to the gate-keeper who will record in the 'goods outward' and check the goods leaving the premises.

Where credit sales are made, the auditor has to examine whether the byelaws of the society contain necessary provision for selling goods on credit. He has also to ensure that credit sales are made only in accordance with the subsidiary Rules, if any, framed on credit sales.

9. *Credit Sales.*- Employees and other consumer Store/Societies allow credit sales to their members upto a certain limit depending on their monthly income/salary/wages. In such cases the auditor should examine the following points also:-

(i) Whether there is provision in the byelaws permitting credit sales and if so any limit fixed for the society and/or for each member.

(ii) Whether the society has obtained undertaking from the members authorizing their pay disbursing officers to recover the dues from their salary, in the case of monthly salary earners.

(iii) Whether the amount outstanding against any member under credit sales has exceeded the limit fixed in the byelaws.

(iv) Whether the society used to obtain indent or acknowledgement duly signed by a member for issuing articles to him on credit basis or his signature obtained in the invoice in lieu of acknowledgement.

(v) Whether bond has been obtained by the society from the member agreeing to pay the amount and interest at prescribed rates after a fixed period.

The auditor should obtain confirmation from the members for the balance outstanding against them as on the last day of each year. He should also verify whether the repayments are regular and in case of default whether proper action has been taken by the society against defaulters;

10. *Control over cash sales.* - For every sale a cash memo is issued. The auditor should compare the entries in the Daily Sales Register with the cash memos issued. He should ascertain the system adopted by the society in fixing the prices. The societies should be instructed to maintain a price Register. The rates mentioned in the cash memos should be checked with the price Register.

11. *Checking of cash memos and Daily sales Register.* - Where the number of cash memos issued are enormous it would be difficult to check all the memos. In such cases, the auditor has to resort to a percentage check of the cash memos, to verify the correctness of the calculations and additions. Wherever sales tax is to be collected from the customers, the auditor should see that the rates of sales tax charged are correct.

The total sales of the day, as is recorded in the Daily Sales Register is carried over to the main cash book/Day book. The total sales according to the sales Register should be checked with the cash received by the cashier. The accounts of Sales tax collected should be maintained separately. The societies should be advised to remit the sales tax collected to the Treasury monthly, before the due date and returns of sales tax in respect of the month should also be filed before the sales tax authorities in time.

12. *Sales in manufacturing and Processing Societies.* - In manufacturing and processing Societies, where goods are manufactured against orders, a register of orders received from

customers should be maintained. Orders for manufacturing of each item should be accepted only on terms and conditions acceptable to the society. Where credit sales are allowed to customers, credit limits should have been properly fixed and checked before orders are accepted.

The society should review the incomplete orders periodically. Orders for manufacture should be executed as agreed to at the time of accepting the orders. It should be seen that for all sales effected, invoices are prepared and sent along with the despatch of goods. The auditor has to check the sale invoices with the entries in the Sales Register or the Sales Day Book. The acknowledgements of receipt of goods by the customers should be attached with the office copies of the invoices. In respect of all goods returned by the customers, or claims made in respect of short deliveries, incorrect prices, mistakes in calculation etc. necessary credit notes should be prepared and issued. Quantities sold as per sale invoices should be traced in the stock register and also compared with the issue of finished goods. In the case of societies, where the system of issuing proforma invoice is followed it should be compared with the sale orders and the goods despatched notes and also with the final sale invoices and receipt advice notes. As regards prices and terms of payment and delivery, the auditor should check the sale invoices with the sale orders. Calculations and additions are also to be checked. Credit notes issued for goods returned should be compared with the "Goods inward Register".

13. *Consignment Accounts.*- Occasionally goods are sent to outstation for sale on consignment basis. In such cases the auditor has to ascertain the terms and conditions of the consignment. Separate accounts have to be maintained in respect of each consignment. The auditor has to examine carefully each consignment account. Goods sent on consignment should be included in stock on hand and not treated as sold until regular account sales are received from the consignee. The auditor should also get confirmation certificates from the consignee for all goods lying with him unsold.

When consignments are charged at proforma invoice plus a percentage above cost, the auditor should see that accounts are suitably adjusted at the time of balancing so as to have the same effect as if they were valued at cost price.

14. *Sales returns.*- When goods are returned due to defective supplies or any other reason they should be entered in the Inwards Return Book. It should also be recorded in the sales Return book and a credit note issued to the customer by a responsible official of the society. The auditor should scrutinize credits and if necessary examine the documents, such as copy of credit notes, goods inward register etc. He should specially examine whether such returns just before the date of balancing the books are recorded in the stock as well as in the Sales Return Book.

15. *Goods on Sale or return.*- Goods sent out on sale or return, cannot be treated as actual sales until the customers have approved the goods. Therefore, they cannot be passed through the Sales Day Book, but be accounted in Sales Return or Purchase Return Stock Register.

Where such transactions are not very numerous, a Sale or Return Book is used. The auditor should examine the details of this book and check the postings from sales column into the sold ledger. He should also ascertain that the goods in the hands of the customers unsold on the date of balance sheet are valued at cost price.

Where the number of such transactions are numerous, separate set of books viz., a Sale or Return Day Book, sale or Return Journal and a sale or Return Ledger should be maintained. The auditor should vouch the sale or return day book and journal with the original records and check the castings and postings of these books.

16. *Packages and empties.*- Where packages and empties are returnable by customers, they should be entered in the 'Issue column' of the Packages and Empties Register. When they are actually returned, they should be entered in the recovery column in the register. Reference should be made in the register as regards the outward and inward slips for issue and recovery of packages respectively. At the time of balancing a reserve must be created for the value of packages and empties in the hands of customers, at the same time creating adequate reserve for depreciation on the same.

17. *Bills receivable Book.*- The particulars of all bills and drafts upon which the business is entitled to receive money are entered in this books. This book will contain particulars such as the date of receipt, from whom received, to whom payable, date of bill,

the term, due date of the bill, amount and how they are disposed of etc. The auditor should see that the proceeds of the bills are accounted for or if the bill is dishonored the amount thereof plus any expenses are debited to the particular debtor's account. He should inspect the bills on hand on the date of the balance sheet and see that the total of the amounts of such bills agree with the balance of the Bill Receivable Account in the ledger.

18. *Bills payable Book*.- All bills accepted by the business in favor of its creditors are passed through this book. When the bills are met they should be marked off in the appropriate column of the Bills payable Book. The bills that have been paid will appear in the Cash Book and the returned bills should be produced as vouchers. The total of the amount of bills yet to be met, as shown in the Bills payable Book should agree with the bills payable account, in the ledger.

When a bill is dishonored the concerned parties, account should be credited with the amount of the bill plus expenses, if any, incurred by him. The accounts of noting charges should be vouched and receipted accounts forwarded to the concerned creditors.

19. *Bought Day Book*.- The whole system of ordering and receiving goods, checking invoices, and authorizing payment should be investigated. If strict control is not exercised in this direction, there is every scope for abuse and fraud.

A simple fraud may be perpetuated in connection with purchases by entering the invoices twice in the bought day book, in each case the creditor's account being credited. In due course and at different dates two cheques are drawn, one being sent to the creditor, and the other misappropriated. These cheques are debited to the creditor's account. In order to provide a receipt in support of the second and fraudulent payment, the bonafide receipt may be produced twice or a duplicate receipt may be obtained and produced before the auditor. Such frauds are difficult to discover and unless there is a perfect system of internal check, and the auditor carefully check all the invoices, these kinds of frauds can not be detected.

20. *Bought ledgers*.- Bought ledger contains the accounts of creditors. The auditor has to check the opening of different accounts

posted in the ledger with reference to the schedule of the creditors of the previous year duly checked by the then auditor. The postings in the bought ledger can be vouched from the cash book, bought day book, returns and allowances book, bills payable book and the journal. The most valuable check on the bought ledger balances is the production of creditor's statements and agreeing them with the books of creditors. In case some of the statements do not agree, it has to be presumed that some of the goods debited by the creditor on or before the date of balance sheet, may not have been received and credited in the books of creditors. In such cases, the auditor has to carefully trace such goods through the goods inward book and see that those goods are not included in the stock.

If the disagreement of the statement and the ledger account is due to some dispute, the auditor should go through the correspondences in such cases and adequate provision made for all outstanding and contingent liabilities.

If the auditor finds that the debit balance in the bought ledger is a bonafide balance he should include the item in the asset side of the balance sheet along with other debtors.

21. *Sales ledger* :-The auditor has first to check the opening balances of the debtors account with the help of the schedule of debtors of the previous year. He can check the postings from the sales journal, Sales Return Book, Cash Book, Allowance book, Bills Receivable Book etc.

While checking the Sales ledger balances, the auditor should check each account thoroughly with a view to ascertaining whether or not the provision for bad and doubtful debts is sufficient. If required the auditor can get a list of good, bad and doubtful debts, from the management.

After vouching the entries in the various subsidiary journals has been completed and their postings checked into the ledger, the Auditor should examine whether any item has been left out unticked. If so, he has to examine why it has been left out unticked and then satisfy himself as to its genuineness.

22. *Stock Register*:- The Auditor has to check the stock register with reference to the cash bills or invoices in respect of the purchases. The date of receipt of goods and other details entered in the stock Register should correspond to the details in the cash bills

or invoices, for issue of goods from the godown, the auditor should examine the indents and satisfy whether the quantity issued as per the stock register agrees with the indent. He should also check the correctness of balance of stock arrived at after each issue.

In the course of checking if the auditor comes across deficits in stocks, it should be carefully scrutinized to find out the actual causes for shortage. If it has occurred due to natural dryage or shrinkage, it should be examined whether the percentage of dry age or shrinkage allowed is reasonable and supported by necessary resolution of the Board.

At the end of checking of stock register the Auditor has to workout the total receipts and issues for the whole year and verify whether the opening stock added to the purchases, tallies with the closing stock plus issues. If there is excess or deficit, he should carefully examine the reason for the same to make necessary adjustments in the ledgers and day book,

23. *Production Register*:- This register shall contain essentially the following details also.

- (a) Cost Sheet
- (b) Process Accounts.

(a) *Cost Sheet*:- Cost sheets are statements setting out the cost of a product giving details for all the elements of cost.

The first element is “materials” used. This is arrived at by adding opening stock of materials and purchases and deducting closing stock of materials. Carriage inward may be added to purchases or may be treated as part of factory expenses. Cost sheet should clearly indicate the prime cost, works cost, cost of production, cost of sales, profit etc., After adding factory or works expenses, money realised by sale or scrap or wastage should be deducted. The work in progress in the beginning of the period should be added at this stage and work in progress at the end of the period should be deducted.

The cost sheet will have the following columns also:

- (i) Total expenditure;
- (ii) Percentage of each element to the total cost of production eg., percentage of materials to cost of production.

(iii) Cost per unit.

(iv) Cost per unit in the previous period.

24. *Inventory Control*.- Inventory control is planned method/scientific system of determining what to indent, when to indent and how much to indent. Without proper control, inventories have a tendency to grow beyond economic limits. Unless stock is carefully planned and maintained, there is every likelihood of overstocking or a impending positive danger of running short of certain indispensable items at inconvenient times. . Scientific and systematic methods of control are, therefore, necessary to maintain stock in right quality, quantity and value.

While checking the stock registers the Auditor shall ascertain whether proper inventory control has been exercised by the management. For a realistic assessment of the system of inventory control in the institution, information on the following matters are also essential.

(1) The minimum quantity of every item of stock that should be stocked at any given time.

(2) Fast and slow moving articles and incidentally items which are not selling.

(3) Data for comparing the growing and falling demands of different items.

(4) Information for assessing the future requirements of the customers.

(5) Details of stock which have become old and unsaleable.

Every inventory control mechanism seeks to answer the following two basic questions, viz.,

(a) How much to order?

(b) When to order?

There are two well known inter-dependant methods for answering the above questions. They are (i) fixed ordering system; and (ii) Fixed frequency ordering system.

(i) *Fixed ordering system*:- Under this system, quantity to be ordered is fixed by the management on the basis of market

situation, demand pattern, economy of scales, etc. The placing of orders will be fixed as to the quantity and intervals are concerned.

(ii) *Fixed Frequency ordering system*: -Under this system, the frequency of ordering is fixed, whereas the quantity to be ordered varies. Maximum stock level to be maintained is worked out with a view to finding out the quantity to be ordered on a fixed date.

Usually, order levels are set for various articles stocked in the godown, so that action is taken continuously for re-ordering when the stocks reach order level. Maximum stock level is also determined after taking into account, factors such as persistability, storage facilities, price trends, discounts, amount of capital necessary and available, seasonal trend of prices, availability of supplies etc.

The Auditor should ascertain and satisfy that the institution has not maintained unnecessary stock of raw materials or finished products required for production/sale. He should also ensure that no indispensable item has gone out of stock and that a proper inventory control is exercised effectively by the Management.

B. PAYMENT OF WAGES

1. *Internal control over wages*:- (a) Wages constitute a major item of manufacturing cost, in societies which undertake manufacturing and processing activities. The system of compilation of the pay rolls and payment of wages vary considerably with the size of the society and the nature of activities. The procedure of evolving a satisfactory system of internal control over payment of wages can be grouped as follows:-

Recruitment, promotions, transfers and dismissal of employees. Orders in writing should have been given for:-

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

The societies should have framed necessary Sub Rules regulating the service conditions of employees. Approval of the Registrar should have also been obtained for the Sub-Rules. Every employee

should have personal cards to record details such as appointment, promotions, rates of pay, retirement etc. These personal cards should be maintained by the Personnel Department. All general increase in pay, deduction from wages, payment of advances against wages etc., should have been properly authorised.

(b) *Attendance and job recording.*- If wages are paid for on time basis, the auditor has to ascertain the normal working hours and regulations regarding absentees.

(c) Compilation of wages sheets and analysis of wages.

(d) Disbursement of wages.

Muster rolls should be maintained to record the attendance of all employees. Where punching clocks are in use, the time keeper should be made responsible for maintaining of the muster rolls and also the attendance card of employees. Where wages are paid on piece rate basis, the system of maintenance of job cards and clock-cards should be studied by the auditor. The quantities produced by individual workers and entered on piece work, job cards, etc. should be checked with the Daily production report and entries in the Production Register. Where there is a large number of employees, a regular procedure should be prescribed for the periodical checking of records of the wages Departments. The method of preparing wage sheets or pay rolls should be examined by the auditor.

Salary slips containing necessary information are to be issued to the employees. These slips should indicate the gross wages payable and the deductions to be made therefrom.

2. *Method of checking pay-rolls.*- The auditor should first call for the office records viz. attendance cards, piece work cards, inspection reports, etc. and check them with the entries in the pay roll or wage sheets. The calculations and additions of pay rolls or wages sheets and acquaintance rolls should be checked.

The totals of the pay sheets should be carried over to an abstract or summary sheet and the total wages paid should be checked with the cash book.

Deductions made in respect of Provident Fund, Employee's State insurance, Income Tax etc., should be paid over to the respective authorities within the time limit (due date) and returns filed.

Where wages are paid on piece rate basis or additional wages are claimed under a scheme of enhanced bonus, the job cards, piece work or bonus cards should be examined. The quantities as mentioned in the job cards should be carried over to the Daily Production Register.

The auditor at regular intervals should attend at the time of payment of wages and satisfy himself that the prescribed procedures are being regularly followed.

3. *Payment of overtime.*- The society should evolve proper procedure for authorising overtime. Overtime should ordinarily be allowed only with the written requisition of the officer in charge of the section. The pay rolls in respect of overtime should be prepared separately. The auditor should ascertain the necessity and basis for payment of overtime, method of calculation etc. The authority sanctioning overtime should be independent of the wages Department. The auditor should in addition to this, examine the compliance of provisions of the Factory Act, the Shops and Establishment Act etc., in allowing overtime.

C. LOANS TO MEMBERS

1. *General.*- Rule 27 of the Kerala Co-operative Societies Rules prohibits membership in two credit Societies. Where a person is a member of more than one credit society; prior sanction of the Registrar has to be obtained to continue as a member in two such credit societies.

Under Rule 56, the Registrar has been empowered to prescribe conditions for grant of loans to members including maximum amount to be advanced and period of repayment both in regard to total advances and also advances against different types of securities. In exercise of these powers, Registrar has issued a number of orders then and there 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.

Section 21 of the Banking Regulation Act (Applicable to Co-operative Societies) gives wide powers to the Reserve Bank of India, to regulate and control advances by Co-operative Banks.

Under Section 59 of the Kerala 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. However, loans may be made to nonmember depositors against security of their deposits, to the extent of 90% of 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, Registrar may permit such inter lendings in special circumstances.

Loans may be either secured or unsecured. Secured loans may be on hypothecation or pledges involving deposits of investments, life insurance policies etc.

In the case of secured loans, the verification involves not only an examination of the loan ledger, but also the security ledger. The auditor has also to satisfy himself that the loan is properly secured and that there is reasonable margin between the loan amount and the value of security offered.

In the case of loans issued on personal security, the financial position of the parties should be enquired into by the auditor. Wherever possible the auditor should obtain a written statement from the borrowers confirming the balances of loans on the date of the balance sheet.

2. *Restrictions on lending.*- Different types of Co-operative Institutions are set up with a view to providing financial assistance for different purposes. Accordingly agricultural credit and multipurpose societies are organised to meet the credit requirements of agriculturists. In towns and cities, Urban Banks are set up to cater to the needs of petty traders, artisans, small scale industries etc. Employers, Credit societies are organised to meet the credit requirements of employees of Government departments, large and small business concerns and of industrial establishments. Long term credit facilities are extended through Land Mortgage Banks for development of land, provision for irrigation facilities, purchase of tractors etc. Even though the main object of these institutions is to dispense credit, their constitution and operations are different.

(I) Every borrowing member of an agricultural credit society is required to execute a declaration crediting a charge in favor of the society on the lands held by him or his interest in the lands cultivated by him as tenant for the dues of the society. (Subject to amendment is Registration Act).

(2) Every salary earner member of a society, while applying for a loan, shall execute an agreement authorising his employer to recover from his wages/salaries the dues of the society as requested by the society.

(3) Transactions of a society with non-members shall be subject to such restrictions as may be prescribed.

(4) Credit sales to non-members when permitted by the byelaws can be made to only such traders and other persons who will furnish an undertaking to the society to refer any dispute to Registrar of Co-operative Societies for arbitration.

There are restrictions on the loaning or credit operations of societies which are not permitted to undertake lending business. No society the objects of which do not include grant of loan or financial accommodation to its members, can grant loans or 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 provide credit against sufficient security on condition that the cost of goods supplied or services rendered shall be recoverable from the proceeds of the goods produced by the members. A consumer society may sell goods on credit to its members and other customers up to the extent of deposits received by them.

The above are certain important provisions and the auditor has got responsibility to see that the transactions of credit as well as non-credit societies are conducted or regulated according to the above provisions.

Besides this, there are provisions and certain restrictions in the byelaws of societies regulating advances to members. The auditor should also see such provisions and restrictions.

3. *Checking of loan operations.*-The byelaws of most of the Co-operative Banks and credit societies specifically provided that the loans to the members should be sanctioned by the committee or Board of Directors. In certain cases, where the loan operations are large, the byelaws provide for the constitution of sub committee to consider the loan applications. In the case of societies/Banks where the Secretary, President, Chairman, or the Managing Committee member are competent to sanction temporary/ emergency/loans to

specified limit, the auditor has to ascertain from the Society/Bank, the extent of and restrictions over the exercise of such authority by the official concerned.

The Managing Director, Secretary or Principal Officer of the society/ bank should verify the loan application with the records of the society/bank and satisfy the correctness of the information furnished. He has also to record his recommendation or otherwise on the application. During the course of examination of the loan transactions, the auditor has to satisfy himself that in sanctioning the loan, the society/bank has observed the normal procedure prescribed.

The auditor has also to verify the proceedings of the managing committee in order to ascertain whether all the loans have been duly considered and sanctioned by the committee. He should also satisfy whether the society/ bank has obtained application for loans, loan bonds or agreements, surety bonds or mortgage deed etc. executed by the borrowers., The auditor has to see- that wherever necessary the documents executed by the members of Co-operative Societies are stamped. So far as credit societies are concerned, all documents executed by the members are exempted from stamp duty and registration fees.

The auditor must satisfy himself:-

(1) that the loan sanctioned is a genuine one and not a renewal of an existing loan; or

(2) conversion of a debit balance; or

(3) a mere book adjustment; or

(4) entered as a fresh advance against repayment of an overdue loan with a view merely to extend payment;

(5) 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;

(6) there must be sufficient time lag between the repayment of loan and disbursement of the fresh loan;

(7) all repayments of loans made by members are promptly credited into bank and not kept on hand and utilised for giving fresh loans;

(8) even if the society has not borrowed from the bank, all recoveries should first be credited to current account and cheques drawn for fresh loans.

4. *Checking of loan bond.*- The entries in the Loan Register should be compared with the details in the loan application and loan bonds to verify whether the following details correspond to:

- (i) Name and clear address of borrower.
- (ii) Names and clear addresses of sureties and nature of security offered.
- (iii) Date of advance.
- (iv) Amount of advance.
- (v) Nature, term and conditions of repayment of the loan.
- (vi) Rate of interest charged.
- (vii) Purpose for which loan was sanctioned and
- (viii) Authority sanctioning the loans.

While checking the documents in connection with the loan, the auditor should see that loans are sanctioned only for purposes which are provided in the byelaws or for which special sanction has been obtained from Registrar of Co-operative Societies.

The following points should be noted while checking the loan bonds

(i) The loan bonds and application should be examined with the loan ledger, Day Book and Minute Book.

(ii) The signatures of the borrower and sureties should be examined. Thumb impression wherever obtained should be properly attested.

(iii) Whether the loan has been paid in cash or by cheque should be ascertained.

(iv) Where the loans are disbursed in cash, it should be disbursed in the presence of the President, Chairman or Committee member.

(v) In the case of loans disbursed partly in kind and partly in cash, the auditor should examine the arrangement made by the society for the supply of the kind component.

(vi) In the case of disbursement of loan in instalment, the auditor has to ascertain whether the instalments have been disbursed only according to the purposes for which the loan has been sanctioned.

5. *Scrutiny and verification of loans and advances by Urban Banks and other societies.*-Urban Banks and other societies, make advances in the form of Loans and Cash credits and overdrafts, the difference being in the nature of operation of the accounts. Although, the advances made by the agricultural credit societies and Small Urban Banks take the form of loans repayable in suitable instalments, Central Co-operative Banks sanction cash credit overdrafts to the affiliated societies, based on the loan requirements of the members. The main difference between an overdraft account and a cash credit is that, the overdraft presupposes existence of a current account, whereas the cash credit account begins with a debit entry. Both cash credits and overdrafts are arrangements under which cheques drawn by the constituents upto a certain limit are honoured by the bank, for a certain period. Sometimes the operations on these accounts are also subject to certain restrictions such as crediting the entire sale proceeds of goods sold into the account, maintenance of minimum balance etc. Interest on this account is debited quarterly.

6. *Loan against different kinds of securities.*-(i) Fixed deposits. Loans against fixed deposit is a facility made available to the depositor, without being required to furnish other security. Usually loans against fixed deposit are to be restricted to 85% of the deposit amount and the period for which the loan is granted should not exceed the date of maturity of the deposit. If the depositor fails to repay the loans within the period for which it was granted, the Bank/Society will be at liberty to adjust the amount and interest against the fixed deposit and, only the balance, if any, shall be paid to the depositor on the date of maturity.

As deposit receipts are not negotiable, they have to be got discharged. and assigned in favour of the Bank/Society before a loan is granted against the deposit. For loans against the security of fixed deposit, the lending rate will be one or two per cent over the rate paid on the deposit. If advances are to be made against the deposits with another bank, the assignment of the deposit receipt in favor of the lending Bank/ Society will have to be got registered with the Bank issuing the receipt.

(ii) *Insurance policies.*- Insurance policies are accepted only as collateral security. Where insurance policies are offered as security, the following points have to be looked into.

(i) It should be seen whether the policy is in the name of the borrower himself.

(ii) Receipt for the payment of the latest premium should be attached to the policy. An undertaking should have also been obtained from the borrower agreeing to keep the policy alive.

(iii) The policy should have been got assigned in favour of the Bank/ Society. The notice of assignment should be sent to the concerned office of the Insurance Corporation.

(iv) Loans should have been limited to the Surrender value of the policy. If required a certificate should be obtained from the L I C, for the surrender value of the policy. It should be ascertained whether the policy is subject to any charge, encumbrance etc.

(iii) *Government and other securities.*-Particulars of the securities pledged, their market value etc. should be verified by the auditor. The securities should have been endorsed in the name of the lending Society/Bank. In the case of debenture issued by the Central Co-operative Land Mortgage Bank, the auditor should note the restrictions on the transfer of such debentures. He should also inspect the securities in possession of the Bank/ Society during the course of audit and find out the margin between the loan amount and the present purchase value. In case the margin is small he should report.

If the securities have not been purchased by the borrower himself, the auditor should see that the last endorsement is in his name. He should also see that all interest warrants not due for payment are intact. If the securities are not endorsed in the name of the lending Bank, a letter of assignment should be got executed along with the bank transfer forms duly signed by the owner of the securities. 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. The auditor should also note that Co-operative Societies Act forbids societies to advance loans on the security of the shares issued by itself. In the case of certain bonds and debentures second

charges are not recognised and hence it should be seen that prior encumbrances have not been created on such securities. Securities carrying Government guarantee should be preferred.

(iv) *Gold and Silver Ornaments.*- Every Bank/Society which make advances against gold and silver ornaments should have appointed a qualified appraiser to test and value the ornaments offered as security. Adequate security should have also been obtained from him. Every advance should be supported by a certificate of the appraiser containing a brief description of the articles pledged, their weight, rate at which valued, prevailing market rate, total value of the articles, and the amount of advance recommended by him. When the loan is repaid and the articles returned to the borrower, his acknowledgement should be obtained for having received back the articles. The Auditor will ensure whether the society has strictly complied with the directions of Registration issued in Circular No. 1/78 dated 6-2-1978 (CRP3-50058/77), regarding custody, insurance etc. of the ornaments pledged.

(v) *Advances against Mortgage of immovable property.*- The auditor should examine the sale deeds or certificates issued by the Revenue Department or by the Civil Courts showing the title of the immovable property, restrictions on its alienation or transfer and creating charges or encumbrances thereon, the legal opinion etc. and ascertain the right of the borrower to mortgage the property. The tax receipts should also be verified to ascertain that the property belongs to the borrower and continues to be in his possession. In order to satisfy the adequacy of the security, the valuation certificate of competent authorities should be verified. The mortgaged property should have been insured for its full value and the policy assigned to the lending Bank.

(vi) *Advances against Hypothecation of goods.*- In the case of hypothecation of goods, the possession of the goods will be with the borrower and he will be free to dispose of the goods, provided the remaining goods are sufficient to cover the outstanding balance of advances. The lending Bank, will have only a charge on the goods hypothecated.

The auditor should ascertain whether the Bank obtains, daily, weekly, fortnightly or monthly statements of stocks of the goods hypothecated. The Bank should verify and satisfy that the required margin is always maintained. It should be seen that the value of

the remaining articles would be sufficient enough to cover the balance of loan outstanding.

(vii) *Advance against pledge of goods.*- When goods are taken into custody, 'intake notes' signed by the borrower should be obtained and certificate of receipt of goods by the Manager of the Bank/Society should be seen. Similarly when goods are released, "delivery orders" signed by the Manager mentioning the amount credited and the quantity released should be only against repayment of the advance.

A register of advances should be maintained indicating the particulars of the goods pledged, their quality, quantity, prevailing market rate, total value, amount advanced and the margin required to be maintained and margin actually maintained. All the goods should have been insured and the insurance policies obtained in the name of the lending Bank/Society. There must always be a sign board bearing the name of the lending Bank/ Society, hung over the main entrance. The locks should bear the seal of the Bank. The stocks should also be got verified by the Bank's staff frequently without advance intimation.

7. *Discounting of bills and hundies:* - Discounting of bills and hundies is a popular form of temporary accommodation granted mostly by Co-operative Banks and certain societies. Cheques and hundies received from the customers are immediately credited to their accounts and they are allowed to draw the amount of the unrealised cheques/bills upto the sanctioned limit. Bills or hundies may either be clear or documentary bills. In the latter case, they are accompanied by Railway receipt of other documents showing title to the goods which are to be delivered to the drawer or consignee only against payment of the bills. As regards clean bills, as in most cases, they are mere accommodation bills, careful enquiries are to be made about the material assets possessed by the borrower and his reputation before accommodation facilities are sanctioned. Limits should have been fixed separately for clean bills and other bills. Cases of misuse of hundies limits, discounting of hundies beyond the credit limit fixed, meeting of previous hundies already discounted, frequent dishonour of bills or delay in honouring them, etc. should receive particular attention of the auditor with a view to ascertain whether these transactions are conducted on sound lines.

The payment of cheques received for collection before they are realised is a very important service rendered by the banks. 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 only in exceptional cases proceeds of the cheques should be credited to the account of the party before realisation. However there should be no objection for discounting the cheques or bills provided they have been received from approved parties to whom hundi limits have been sanctioned.

D. INVESTMENT OF FUNDS

1. *Statutory Provisions*:-Section 55 of the Kerala Co-operative Societies Act states:

“A Society may invest or deposit its funds:-

- (a) in Government Savings Bank, or
- (b) in any of the securities specified in section 20 of the Indian Trusts Act, 1882 (Central Act 2 of 1882); or
- (c) in the shares or securities of any other society approved for the purpose by the Registrar by General or special order; or
- (d) in any Bank approved for the purpose by the Registrar; or
- (e) in any other specified manner”.

So the auditor while vouching any investment made during his period should see that they are in accordance with the above provisions. Wherever the society has opened account with commercial banks, specific sanction issued by the Registrar for opening the account should be verified by the auditor. Whatever may be the mode of investment the auditor should vouch them with reference to the pass book, counterfoils of cheques, the correspondences as the case may be. All societies both Agricultural and non-agricultural are required to purchase shares of the District Co-operative Bank or other financing agencies from which they borrow. Marketing and processing societies facilitate the operation 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 themselves to their respective District Marketing Federation/ Society and also to the State Co-operative Marketing federation. Dairy societies are required to be affiliated to their Milk Unions. Primary consumer stores to the wholesale stores and the latter to the consumer Federation. Similarly, primary housing societies, if they want to borrow funds from the Kerala State co-operative Housing Apex Society, have to become its member. Thus all primary societies are required to invest certain portion of their funds in the shares of their federal 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 amount so invested should in no case exceed a reasonable percentage of the paid up share capital of the society.

2. *Method of checking of investments in shares:-* Receipts or other documents acknowledging receipt of the share money should be seen. Since payments are generally made by cheques or debited to current account, entry in pass book will also provide supporting evidence. The share certificate issued by the Bank or other society should also be verified.

3. *Investment in fixed or Call Deposits:-* 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 auditor should verify the original fixed/call deposit receipt issued by the Bank. In the case of withdrawals, the advices or credit notes and entries in the Bank pass book should be seen. Call deposit and fixed deposit receipts, which have not matured, should be inspected by the auditor during the course of audit.

4. *Purchase of debentures, trustee Securities, National Savings Certificates etc.-* It should be seen that the securities are in the name of the society or bank transfer forms or endorsement from the last vendor have been obtained. If the purchases are made through the Banks, the Bank's memoranda of purchase or advice and entries in the bank pass book could be available for checking. If purchases are made through the brokers, "brought notes", bank transfer forms or endorsement will have to be seen. The securities themselves should be inspected during the course of audit. In case, the securities are pledged with any bank for Custody, certificates

will have to be obtained from the bank and scrutinised by the auditor.

5. *Purchase and Sale of securities on behalf of Customers.*- Co-operative Banks and other financing institutions, which purchase and sell securities in respect of the purchase and sale on behalf of the clients should maintain separate accounts in respect of purchase. and sale on behalf of the clients. The auditor should see that the income, rights and other benefits relating to them are properly charged and credited to the accounts of the customer concerned.

6. *Investment in Treasury Bills*:- Some of the societies, particularly Urban banks and Central banks, invest their surplus funds in Treasury bills or other short term investments which are generally sold at discount. The difference between the face value and the purchase price represents the return of the amount invested.

7. *Investment in land and buildings*:- In the case of purchase of land and buildings, the agreement for sale and the sale deed should be verified. The sale deed should have been registered. In order to verify the possession of the land and building, the tax receipt of the revenue department or municipality should be verified. The title deeds should have been carefully examined by legal advisers and should refer to the property purchased. The valuation of the building should have been made by a competent engineer. Stamp duty, registration charge and legal charges and architect's fees may be allowed to be capitalised. In the case of buildings purchased in auction, the auctioneer's report or certificate granted by the court would be available for verification.

The resolution of the Board/Committee and general body as may be necessary under the provision of the Bye-law should be seen. Sanction of the Registrar as required under the Rules for the purchase of the land and building should be seen. When the purchases or construction are made out of the Reserve Fund, Building Fund or other surpluses, permission of the Registrar for utilisation of the amounts will also have to be obtained. In the case of Banking Institutions provisions of section 9 of the Banking Regulation Act, 1949 will have to be observed regarding the disposal of the non-banking assets.

8. *Investment of General Fund in immovable properties.*- As regards the investment of General Fund in immovable property,

Rule 54 of Kerala Co-operative Societies Rules empowers societies to utilise or invest their General Fund in any immovable property specified by the Registrar by general or special order.

9. *Construction of buildings and godowns by Co-operative Societies.*- Before commencement of the construction, the plan and estimate of the building/ godown as prepared by competent Engineer, should be got approved by the Registrar. All changes in the plans and estimates should be got approved by competent authorities. During the course of audit, the auditor will have to see that the terms and conditions, subject to which the loans and subsidies have been sanctioned, are complied with.

Where construction is entrusted to contractors, it should be seen that the normally accepted canons of financial propriety such as calling for tenders or obtaining quotations, acceptance of lowest tender enquiries into financial position and past performance of the contractor etc. are duly observed. If contract is entered into by private negotiations, or the lowest tender is not accepted, reasons for not calling for tenders, or for not accepting the lowest tender should be ascertained by the Auditor.

The Following points should also be looked into:

(i) Whether tender deposit has been collected from the contractor, and regular agreement executed.

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

(iii) The building supervisor, or other employee of the society who supervises the work should maintain measurement book.

(iv) All running bills should be duly checked by the Engineer. Quantities shown in the bills should be checked from the measurement books and rates with the rates furnished in the tender form filled in by the contractor.

The auditor should also see that the amount of subsidy received and credited to the funds of the society and the full cost of the construction including cost of the land are shown on the asset side. If the actual cost of the godown exceeds the amount of

,loan and subsidy received from Government, permission of the Registrar of Co-operative Societies for investing additional funds for the construction of the godown should be obtained. The final evaluation of the godown should also be certified by the P. W. D: authorities (not below the rank of an Executive Engineer).

E. AUDIT OF CHITTY/KURI ACCOUNTS

1. *Preliminary.*- Before the Kerala Chitties Act, 1975 (Act 23 of 1975) came into force, the conduct of Chitty/ Kuri transactions in Travancore- Cochin area was governed by the Travancore Chitties Act, 1120 (Act 16 of 1120), the Cochin Kuries Act VII of 1107 and the Cochin Starting of Kuries (Restriction) Act XII of 1120. Till 1975, there was no such statute in Malabar area for regulating conduct of Chitties. The Kerala Chitties Act, 1975 codified all the existing Chitty/Kuri Acts and was made applicable to the whole State of Kerala. This Act contemplates the terms and conditions for starting the conducting Chitty/Kuri.

2. *Kerala Chitties Act.*- Important provisions (Included in appendix) [Appendix II (i)]

3. *Provisions in the bye-laws-Observance of other terms and conditions.*- Before proceeding with the audit of Chitty/Kuri transactions/accounts) the auditor should ensure as to whether there is specific provision in the byelaws of the society/Bank to conduct Chitty/Kuri. He will also verify provision if any, which specifies the maximum Sala (amount of Chitty / Kuri) of a Chitty/ Kuri, which it can conduct. The society should have got approval for its sub-rules to start the chitty/kuri, if so provided in the byelaws. The auditor should also go through the terms and conditions with regard to the conduct of Chitties and more especially about the minimum number of persons required to start a chitty, the period of chitty, the minimum and maximum lots that can be taken by a member, periodicity, drawal of prize amount, furnishing of security, execution of bond etc. It is the duty of the Auditor to verify whether the society is running the chitties in accordance with the provisions of the Kerala Chitties Act, 1975 and the Rules thereunder the provisions in the byelaws of the society.

4. *Variola.*-Means the document containing the articles of agreement and the terms and conditions agreed upon between the Foreman and subscribers of the chitty and includes vaimpu and kuri pattika or other similar instrument.

- (1) It should contain the following particulars also:-
- (i) Office where chitty is registered.
 - (ii) Year and Register No.
 - (iii) Full name and address of Foreman.
 - (iv) Occupation and age.
 - (2) Chitty amount and number of tickets.
 - (3) Duration of chitty.
 - (4) The time at which and the place where chitty is to be conducted (bid/auction).
 - (5) Particulars of security furnished or deposited by foreman.
 - (6) Mode of conducting chitty.
 - (7) Mode of payment of each instalment.
 - (8) Procedure for receiving prize amount by a prized subscriber.
 - (9) Disbursement of veethapalisa.
 - (10) Foreman's commission and instalment as which the foreman is to get the prize.
 - (11) Transfer how to be effected.
 - (12) Balance sheet and subscriber's right to examine chitty records.
 - (13) Banks where chitty money will be deposited.
 - (14) Other miscellaneous details, if any.

Before commencement of audit, the auditor has to carefully study the important clauses of the Variola (Chitty sub rules).

(a) *Starting*.-The auditor has to ensure that the society has started the chitty subject to the provisions in its byelaws and Kerala Chitties Act and Rules.

(b) *Registration of Variola by Registration Department*.- As per Section 3 of the Kerala Chitties Act, 1975, every chitty is to be registered by the Registration Department.

5. *Deposit of Security amount*.- Every foreman shall, before first drawal / auction of the chitty, furnish security of immovable

property equal to double the prize amount of chitty or deposit in an approved bank an amount equal to the chitty amount or invest in Government, securities of the face value of not less than one and a half times the chitty amount and transfer the amount so deposited to the Government securities in favour of the Registrar to be held in trust by him as security for the due conduct of the chitty. The Auditor should ensure remittance of security deposit by verifying the original chalan receipt/Pass Book/deposit receipt. If the deposit or Government bonds are in the safe custody of Registrar, the auditor will verify the acknowledgements for the same.

6. *Chitty transactions.*- A know how.-Majority of Co-operative Societies dealing in credit, conduct chitty or 'Kuri'. Ordinarily the period of chitty runs to twenty-five, forty, sixty months or even more than that.

Before starting audit of chitty accounts, the auditor should acquaint himself carefully with the important provisions in the Kerala Chitties Act and Rules, bye-Laws and registered chitty Rules ie., the chitty variola/sub-rules etc. The foreman's commission, the maximum amount upto which a subscriber (Chittal) is permitted to bid in a chitty the rebate permitted for prompt payment etc., are to be thoroughly understood from the registered chitty sub-rules. The conduct of chitty is mostly guided by these rules, and the foreman is not permitted to deviate from them without prior sanction from competent authority. It is the duty of the auditor to check as to whether the society has scrupulously adhered to these rules:

7. *Procedure in audit.*-(i) *General* - After examining the previous year's audit note and ascertaining the figures relating to the chitty transactions, the auditor should carefully go through the chitty subrules (variola) and chitty minutes to know the important provision and procedures to be followed in bidding the chitties. He should also examine whether separate receipt books are used for each chitty or not. If the society conducts more than one number of chitty simultaneously, it is desirable that separate receipts are used for each series of chitties. The same procedure may be adopted in keeping the vouchers also.

The chitty Day Book is maintained with classified columns with separate columns for receipts and payments. (Form No. XVII of chitty Rules).

(ii) *Checking of receipts with Day Book.*- The amounts in the cash receipts shall be checked with the corresponding entries of the receipt side of the chitty day book. The amount to be remitted in 'cash' and 'veethapalisa' allowed for each class of chitty and for each instalment can be verified from the chitty instalment schedule or table of the society prepared after each monthly bid. The auditor shall ensure that amounts realised and veethapalisa allowed are correct, and that they are entered in the day book as appearing in the receipt.

When the society is also a member of the chitty (ie. a chittal) the auditor shall be more careful in checking such receipts. He will see that the instalments as credited in the General Day Book, are actually debited in the Chitty Day Book, on the same date itself.

(iii) *Vouching.*- The Auditor shall see that all expenses are supported by proper vouchers, which are serially numbered and filed. Chitty expenses or payments will include bid amount paid, securities deposited, Bank remittances, expenses for records, stationery and other contingencies etc.

For deposits made outside or bank remittances, the auditor shall verify the chalan or Bank pay-in-slips along with pass books. As far as the security deposit is concerned, the auditor has to see how the amount is raised, say by collection from Chittals or by 'Advance from the Society'. In the case of prize amount not claimed by the bidder before next auction, the auditor shall verify the chitty minutes also and ensure that necessary entries are made therein about the undisbursed amount. While checking expenses like T. A., postage, stationery, records etc., incurred for chitties, the auditor should ensure that these vouchers/expenses are not again debited in the general accounts of the society.

(iv) *Checking of day book with chitty ledgers, general ledger etc.*- After vouching receipts and vouchers, the auditor shall cross check the chitty day book with the chitty ledger (Personal ledger) and ensure that all classified receipts and payment as entered in the chitty day book are posted correctly in the ledger. If advances are paid/received to/from the Chitty Day book to the General Day Book, the auditor shall see that the entries in both the books are entered on same date and for identical amounts and purposes. Delay in recording any transaction in any one of the books may

show unaccounted cash balance. Reasons for such delay, if any, should be enquired into in detail.

The postings in the chitty Day Books are to be then checked with the chitty General Ledger. The consolidated receipts of all chitty general ledgers will be the “chitty day book advance”, found on the receipt side in the consolidated Receipts and Disbursement statement of the society. Similarly, the consolidated payments will be shown on the payment side of the Receipt and Disbursement statement as chitty day book advance. A statement consolidating receipts and payments under the classified heads in Chitty General ledger will help to arrive at the Correctness of chitty day book advance on the two sides of the general statement of Receipts and Disbursement. The daily consolidated total of receipts and payments are taken to the General Day Book of the society, on each day when there is transaction of chitty. These figures which are transferred to the general day book and from there to the general ledger constitute the respective ‘chitty day book advance’ receipts and payments for the year, in the General Receipts and Disbursement statement.

(v) *Bank account.*-It is always desirable that the society maintain separate Bank accounts for each chitty. This will avoid diversion of funds. The Auditor should examine the pass books and obtain confirmation from the Banks and reconcile the balances as in the case of other bank accounts.

8. *Chitty Auction.*- In terms of provision of the Variola, the foreman has to conduct the auction (bidding) of the chitty, at the time and place and day specified for the purpose. The subscriber who is to get the prize (chitty amount) at any instalment shall be determined by lot or auction. In case the prize amount is determined by auction, every prized subscriber or a person authorised by him in writing shall sign the minutes of the proceedings relating to the drawing at which he obtains his prize.

9. *Distinction-Prized and non-prized subscribers.*- Distinction between ‘prized’ and ‘non-prized’ is of great importance for preparing the Balance sheet of chitty.

The chittals who had bid/auctioned the chitties are termed as prized and others as non-prized. The entire prize amounts are treated as loans and the recoveries made by way of instalments from the prized chittals are adjusted towards the prize amounts. The instalments collected from the non-prized chittals are treated

as deposits. On the termination of the chitty, wherein complete payments and recoveries have been made, there will not be any loan amount under asset due from prized chittals and deposits under liability collected from non prized chittals.

10. *Substitution of chittals in the place of defaulters.*-There may be instances wherein some of the chittals cease to be subscribers or are removed consequent on making default in paying the instalments in time. In their places, the forman might have admitted substitutes as per Rules. In such cases the discontinued chittals are eligible to get back the amount subscribed (after completion of the terms of the chitty, or as is prescribed in chitty sub rules), less commission due to the society and loss, if any, sustained by it by such discontinuance. In such cases, the auditor should ensure that the rules and sub rules are followed and that no amount is paid in excess by the society.

11. *Filing of Chitty minutes.*-The auditor should verify the connected records relating to the filing of minutes of every drawing, with the Registration Department, and satisfy that they are filed properly and in time.

12. *Payment of Chitty amount.*- The auction proceedings and chitty minutes may be verified to ascertain the bidder, the bid amount as well as the bonafides of auction conducted. The prized amount is to be paid to the bidder within the time prescribed in the variola on furnishing reasonable security and on his executing the necessary agreement. If the prize amount is paid, the auditor shall verify the voucher and the bond executed therefore. He should also verify the resolution of Managing Committee authorising the payment of the bid amount. In case the prized subscriber, or his nominee fails to receive the prize amount within a month the foreman shall deposit the amount in an approved Bank specified in the chitty sub-rules. The auditor should therefore verify the connected records to satisfy whether the remittances are done promptly. The auditor should also verify as to whether payment of bid amount has been made out of chitty collection or by diverting from the owned funds or borrowings of the society from the higher financing agency.

13. *Verification of Pass Books.*- The auditor may call for some of the pass books of the subscribers and verify the entries therein with the chitty ledgers (Personal ledgers) maintained in the society.

14. *Verification of outstanding and valuation of overdues.*-The schedules of outstandings prepared by the society have to be checked by the auditor with the chitty personal ledgers and the outstanding figures in the balance sheet reconciled. A statement of prize amount to be paid to the chittals at the close of the year and a statement of arrears under prized and non-prized chittals should be prepared and reconciled with the figures in the Balance sheet.

15. *Action against defaulters.*-After preparing the statement of arrears of prized and non-prized chittals, the auditor should ascertain whether the Foreman society has taken effective action against the defaulting chittals. The overdues of chitties are to be specially scrutinized and amounts under good, doubtful and bad are to be properly classified and adequate reserve created.

16. *Books and accounts to be maintained by foreman.*- As per Section 18 of the Kerala Chitties Act, 1975 of the Foreman shall keep:-

(1) a register containing.-

(a) the names and full address of the subscribers together with the number of shares held by each subscriber.

(b) the dates on which the subscribers signed the variola; and

(c) in case of assignment by a subscriber the name and full address of the assignee with the date of the assignment and the date on which the assignment has been recognised by the foreman;

(2) a book containing the minutes of the proceedings of the drawing of chitty;

(3) a ledger containing-

(a) the amount paid by the subscribers and the dates of such payment.

(b) the amount paid to the prized subscribers with the dates of such payments; and

(c) in case of deposit in bank, the date and amount of such deposit;

(d) chitty day book and

(e) any other book as may be prescribed by Government from time to time

17. (i) *Filing of balance sheet.*- The auditor should examine whether the foreman has filled the balance sheet within the prescribed time with the Registration Department, as required under section 20 of the Chitties Act.

(ii) *Chitty audit by approved chitty auditors.*- There is provision in the chitty Act for auditing the accounts of the chitty either by Chartered Accountants or by Departmental Chitty Auditors. It is a statutory obligation on the part of the Foreman, to file the Balance Sheet of the chitty, duly audited by approved auditors.

18. *Preparation of Receipts and Disbursements statement, Profit and Loss Account and Balance sheet.*- As the terms of the chitty usually extend to more than one year, the Auditor shall prepare the Receipts and Disbursements statement of each chitty every year, irrespective of whether the chitty is terminated or not. The detailed Receipts and Disbursements statements of each chitty should be recorded separately in or appended along with the Audit report. The total receipts and the total disbursements should also be included in the general receipts and disbursements statement, of the society.

It deserves special mention, that chitty-war receipts and payments under various heads, Profit and Loss account and balance sheet should be exhibited in the audit note, as otherwise, the final closure of chitties will become difficult at a later date.

19. *Chitty accounts how incorporated in audit notes.*- After preparing the Profit and Loss account and balance sheet of each chitty, the auditor may carry over the profit or loss of the chitty to the General Balance sheet of the society under liabilities and assets respectively. The outstanding liabilities and assets of each chitty should also be included in the general balance sheet of the society under "adjusting heads".

20. *Distribution of Profit.*- The net profit of the chitty has to be divided, as per Rules. [See Registrar's Circular No. 23/76 dated 1-4-1976, issued in No. IC (2)-38646/75 dated 11-4-1976]. Usually the chitty sub rules/ Variola of chitties specify the mode of distribution of profit. The undistributed chitty profit has to be shown separately in the general balance sheet. The net profits of terminated chitties can be distributed only after audit of accounts by the Departmental and chitty auditors.

PART II

CHAPTER I

AUDIT OF DIFFERENT TYPES OF SOCIETIES

(a) *General-* In this part, an attempt is made to explain the special features of certain types of Co-operative Societies and the important points to be borne in mind by the Auditor, while auditing the accounts of such societies. To audit the accounts of any type of society efficiently, the auditor should be well equipped with sufficient knowledge of Co-operative Law and other Laws.

The byelaws of Co-operative Societies restrict the scope of their activities to a few main objectives, say credit/non credit/distribution of consumer goods, farming operations etc., and a few other allied activities incidental to the attainment of the main objectives for which the society has been formed. It is the duty of the Auditor to ensure that the transactions carried on by the society are those permitted under the Co-operative Societies Act, Rules and Byelaws of the society. The Auditor should, interalia, see that the society consists of only persons who are qualified to become members and also ensure that its funds have been applied only to such purposes as are permissible under the Act, Rules and Bye-laws of the society. The Auditor should acquaint himself with the nature of the activities of different types of societies whose accounts he has to audit and also the manner adopted by the societies for conducting their transactions.

Before commencing audit, the Auditor should carefully study the Co-operative Societies Act, Rules, Bye-laws of the society, other relevant laws and the circular instructions issued by the Registrar from time to time about audit of different types of societies. Wherever, the nature or the number of irregularities warrants detailed checking, and if more time is required for completion of the audit, the higher authorities should be appraised of the position. The norms or standards laid down by Registrar in awarding the audit classification should be followed by the Auditor in awarding the correct classifications.

(b) *Accounts and other books to be maintained by societies.-* Statutory provision. Rule 29 of the Kerala Co-operative Societies Rules, prescribe The nature of accounts and other books to be maintained by the societies in connection with the business. The Auditor has to ensure that the societies have properly maintained the required registers.

AUDIT OF STATE/APEX LEVEL CO-OPERATIVE INSTITUTIONS

Special features to be looked into by the Auditor while auditing the accounts of the following State/Apex level Co-operative institutions have been briefly discussed in this chapter.

- (1) Kerala State Co-operative. Bank Ltd.,
- (2) Kerala State Co-operative Apex Housing Co-operative Society Ltd.,
- (3) Kerala Co-operative Central Land Mortgage Bank Ltd.,
- (4) Kerala State Co.-operative Consumers Federation Ltd.,
- (5) Kerala State 'Handloom Weavers' Co-operative Society Ltd.,
- (6) Kerala State Co-operative Rubber Marketing Federation Ltd.,
- (7) Kerala State Co-operative Marketing Federation. Ltd.
- (8) State Co-operative Union, Kerala.

1. KERALA STATE CO-OPERATIVE BANK-SPECIAL FEATURES
TO BE LOOKED INTO BY THE AUDITOR

(1) *Maintenance of liquid assets.*- Maintenance of minimum liquid assets and cash reserves is regulated by the provisions of Banking Regulation Act/Reserve Bank of India Act. The Auditor has to ensure that the relevant statutory provisions are adhered to on a day to day basis.

(2) *Maintenance of average daily cash balance.*- Section 42 of the Reserve Bank of India Act, 1934, prescribes the average daily cash balance to be maintained by the Apex Bank. It should be ascertained in audit whether the bank has complied with the provisions of the Act with regard to the maintenance of average daily cash balance. Since the minimum of the average daily cash balance has to be invested in the Reserve Bank of India, its proper investment may also be watched by the auditor.

(3) *Reserve Bank of India Scheduled Bank's Regulation 1951.*- It may be ensured in audit whether the Bank has strictly adhered to the requirements of the Scheduled Bank's Regulations, 1951.

(4) *Maintenance of State Partnership Fund.*- The proper maintenance and operation of Principal State Partnership Fund should be watched in audit. Since Governments are eligible to get dividend on such investment, the Auditor has to ensure proper arrangements for the timely collection of dividend from societies in which shares have been taken, and for the prompt remittance of dividend to Government.

(5) *Maintenance and operation of Agricultural Credit Stabilisation Fund.*- Strict observance of the Rules for the maintenance and operation of Agricultural Credit Stabilisation Fund, by the Bank, should be ensured.

(6) *Watching of Utilisation of funds.*-It may be verified whether the Apex Bank had utilized properly the funds received from the Reserve Bank of India. Government and Government institutions like National Co-operative Development Corporation, Agricultural Refinance and Development Corporation, Industrial Development Bank of India etc.

(7) *MASK, ASCOF.*- It may be ensured whether the transaction made by the Bank under MASK, ASCOF etc. are according to the Rules formulated under those schemes. The Auditor may also ensure periodical reconciliation of accounts with the other member Banks which joined the scheme.

(8) *Inspection of member Societies/Banks and branches.*- Periodical inspection of the indebted societies/District Banks and branches of the Bank timely rectification of defects pointed out and implementation of suggestions should be ensured.

(9) *Reconciliation of branch accounts.*- Periodical reconciliation of branch accounts with head office account, should be ascertained.

(10) *Developmental activities.*- Being the apex institution for the credit societies in the State it has to evolve new and attractive developmental schemes intended for the advancement of the movement at large. The Auditor may ascertain how far the bank has succeeded in implementing the schemes of Co-operative development in the agricultural and rural sectors and the developmental role played by it in achieving its objectives. The steps taken by the bank for credit planning, training of the staff etc., have to be critically viewed by the Auditor.

(11) *Credit Authorization Scheme for Co-operative Banks.*- The Auditor has to ensure that the bank has strictly followed the directions of the Reserve Bank of India in cases of advances, if any made and which come under the purview of this scheme.

2. APEX CO-OPERATIVE HOUSING SOCIETY

(1) The funds raised by the Apex Society from LIC and other sources are utilised for issuing loans to their members on whose behalf loans are sanctioned by the Apex Society. Since the rate of interest on borrowings varies from time to time, the Auditor has to verify the original sanction order and agreement executed between the Apex Society and LIC and see that the Apex society does not levy interest in excess of the allowed rate.

(2) Debentures are floated only with permission of Reserve Bank of India and Government. The Auditor should examine the condition of sanction and see whether they have been complied with. A sinking fund has also to be created by the society for redemption of the debenture. This fund is to be invested as per directions of Government/Registrar of Go-operative Societies.

(3) The Apex Society is maintaining separate loan account for each loan. The Auditor should go through the individual accounts and see whether penal interest and interest as levied are within the maximum rates prescribed.

(4) As per directions of L.I.C. a compulsory Group Insurance Scheme had been implemented for the benefit of the borrowers. The Auditor has to examine whether the society maintains groups insurance scheme, currently. The Auditor should see that the Apex Society collects promptly the G.I. premium from the primaries.

(5) The Apex Society is a member of the National Co-operative Union of India. Hence, when statutory reserves are made out of the net profit, 1 % of the profit should be provided for giving annual subscription of NCUI.

(6) The Auditor has to check whether any of the Directors of the Apex Society representing Primary Society has committed default at any time in his own loan in the Primary Society or whether the Primary Society concerned has at any time defaulted to the Apex Society.

3. AUDIT OF KERALA CO-OPERATIVE CENTRAL LAND MORTGAGE BANK

Special aspects to be looked into by the Auditor.

The funds required for the issue of long term loans are raised by floatation of Debentures in the open market. Loaning programme and Debenture programme for each year are prepared in advance and got approved by the Government and the Reserve Bank of India. Before floatation of debentures, the Central Land Mortgage Bank has to acquire through the Primary Banks unencumbered mortgages for the amount covered by the proposed debentures. For acquiring such mortgages, loans are advanced by drawing on the cash credit accommodation provided by the Kerala State Co-operative Bank, the State Bank of Travancore or by any other commercial bank, as the case may be. The funds raised through debentures are to be remitted to the cash credit accounts.

As the floatation of debentures is for long periods the Bank has to create a Debenture Redemption Sinking Fund. With the above objects in mind the auditor has to scrutinise the following aspects.

(i) Whether the Bank has obtained sanction of competent authorities for the Floatation of debentures and whether the conditions of sanction have been complied with in floating the debentures. It should also be ensured whether the Bank has acquired adequate unencumbered mortgages before each series of debentures are floated.

(ii) (ii) Whether the Debenture Redemption Sinking Fund is constituted according to the norms prescribed and whether such funds are invested properly. It has also to be verified, whether amounts under Sinking Fund are withdrawn without the specific sanctions.

(iii) It has to be verified whether to Bank has taken timely and effective action for the realisation of overdue loans both at the Central Bank and Primary Bank levels.

(iv) The Auditor has to assess to Bad and Doubtful debts at the end of every year and to see that adequate reserves are created to cover them.

(v) The auditor has to verify the securities held by the bank for the investment of sinking fund etc., and ensure that they are under safe custody.

(vi) The timely receipt of D. V. files from the Primary Land Mortgage Banks and their entrustment with the Trustee, have to be watched by the auditor.

(vii) The Auditor has also to verify whether the bank has achieved the target in the loaning programme and, if not, the reasons for the same are to be investigated.

(viii) It has to be verified whether the bank has conducted periodical inspection of Primary Land Mortgage Banks and follow up action taken for the timely rectification of defects revealed in such inspections.

(ix) Inspection and reconciliation of branch/Regional accounts

It has to be ensured whether the Head office has undertaken periodical inspection of its Regional Offices and whether the accounts of the Regional/ Branch Offices are reconciled at regular intervals.

(x) In addition to the usual reconciliation, the following accounts have also to be reconciled.

(a) Loans due from Primary Land Mortgage Banks.

(b) Branch accounts.

(c) The balance under various heads like shares, sundry deposits, suspense etc., with the Primary Banks.

4. KERALA CO-OPERATIVE CONSUMER'S FEDERATION LTD.

Special features to be looked into by Auditor

I. Purchases

(a) *Textiles*-. The Federation purchases textiles direct from the mills/wholesale distributors etc. through orders placed to the Representatives of the Mills or on samples received. The details of orders placed are to be verified in the Order Book with receipt of goods from the Mills. The Auditor should check the purchase bill, demand draft and relative documents with the day book and the day book with the purchase register, and the purchase bills with the stock register.

b) *Pulses*.- Procurement of pulses, is largely effected from the National Co-operative Consumers Federation. As the purchases

of pulses and its sales are on commission basis, the auditor will check the relative documents to ensure that the Federation has received the Commission on all its sales. The receipt of stock from the National Co-operative Consumer Federation, is entered in the stock register with indication "National Co-operative Consumer Federation, stock". Invoices sent by N. C. C. F. will be checked with the stock register and the purchase register only on the date of sales the goods so sold will be treated as purchase and entered in the purchase register.

In the case of items not available in the National Co-operative Consumer Federation and the purchase of which has been effected from production centers, the auditor will examine the connected files, the market rates etc., to ascertain whether the required safeguards have been taken in effecting such purchases.

(c) *Retiring of bills.*-The auditor should satisfy that all purchase documents, such as R.R. bills/bank intimation etc. are retired only on proper scrutiny with the 'Order Book' to ensure that the goods supplied correspond to the orders placed by the federation and after ensuring that they were actually received in the godown. Confirmation may also be obtained from the Mills, to satisfy the accuracy of payment made by the federation and to have a correct reconciliation of the transactions.

It should be verified whether all the purchases were made on proper authority only.

(d) *Price fixation*

(a) *Textiles.*-The auditor has to ensure that the percentage of profit charged on textiles are those as fixed by the Managing Committee of the Federation.

(b) *Pulses.*- It should be ensured that the federation collects daily market intelligence and an active price policy followed strictly. Deviations from the policy may be examined and causes investigated.

Sales.-Usually the Consumer Federation affects sales to the Wholesale Stores on credit basis. The auditor will check the credit sale bills with the day book and with the stock register. Monthly reconciliation of accounts with each Wholesale Store should be ensured.

In the case of sale of confiscated goods, timely submission of statutory returns, if any, clearance from central Excise Department etc., should also be watched.

Manufacturing of Note books/Umbrellas.- It should be ascertained whether entrusting the production of Notebooks/ Umbrellas to other agencies was made after observing the usual formalities of inviting quotations etc.

Branches- Reconciliation and Incorporation of accounts.- The Auditor should ensure that the branch accounts are reconciled periodically and promptly incorporated with the main accounts of the Federation, in order to exhibit a fair and correct picture of the transactions.

Internal checking.- It has to be satisfied that a system of internal checking is in vogue and works efficiently.

Submission of Sales tax and other statutory returns and remittance of taxes

Timely submission of statutory returns and remittance of sales tax to the concerned authorities are to be ensured during audit. Instances of short collection of sales tax or other taxes if any, should be examined carefully and the loss if any, caused to the federation on this account without satisfactory reasons should be realised from those responsible.

*Licenses for trading.-*The auditor should verify whether licenses have been taken by the federation for carrying on different types of trading activities. By doing so the auditor can appraise the institution about the time expired licenses, if any, and enable them to renew the licenses.

(e) *Warrantees for goods.-* It has to be ascertained in audit that the facility of warrantees is enjoyed in all cases of bulk purchases of goods to which warrantees are offered. If there was any occasion inflicting any penalty on the institution, on account of the non-observance of conditions with regard to warrantees, the auditor has to assess/comment on the responsibility to the Officers responsible.

Reconciliation of accounts with National Federation/Other institutions.- It may be ensured that the Federation periodically reconciles its accounts with the National Consumers Federation/ other institutions to which it has business transactions. Necessary

confirmation of outstanding balances should be obtained from them before finalisation of audit.

Purchases in the retail outlets and departmental Stores.-As far as possible all purchases in respect of retail outlets/departmental stores should be centralised. In effecting individual and local purchases to suit the Local taste the retail outlets/departmental stores should have followed the general norms of purchases.

Further, the quantum of purchases should have relation to the stock in possession, sales and rotation ratio. There should also be proper inventory control to attain maximum profitability.

Retirement of Bills.- Retirement of bills received from banks, - on account of goods ordered and despatched should be done with due care so that the funds of the institution are not locked up unnecessarily. As far as possible bills should be retired after ascertaining the arrival of goods at station enabling delivery. As delay in retiring of bills within the time limit specified will cause payment of demurrage etc. care should also be taken to retire bills within the time. At the same time cash discount, if any, permitted by dealers should not be forfeited simply because of delay in retiring bills.

Provisions for dryage, wastage etc.- Provision if any. made for wastage and dryage should be reasonable and within the limit allowed by competent authorities. If abnormal increase in wastage and dryage is noticed, the auditor should investigate the causes for such abnormal increase and make his observation in the report.

Consignment business-receipt of goods and sales on consignment basis.-In respect of goods received on consignment basis, the relative invoices should be checked with the consignment account. It should be ascertained whether the value of goods received on consignment basis is shown under sundry creditors. The consignment stock outstanding as at the end of the year should have been included in the closing stock of the institution. Prompt realisation of Commission on sales effected should be ascertained in audit. With regard to the accuracy of outstandings under Consignment account, necessary confirmation of balance from the consigner should be obtained.

5. KERALA STATE HANDLOOM WEAVER'S CO-OPERATIVE SOCIETY
SPECIAL FEATURES TO BE LOOKED INTO BY THE AUDITOR

1. *Purchases: (a) Affiliated Societies.*-The requirements of cloth for sale in the depots as assessed by the Regional Officer, are procured from the affiliated Weavers' Societies. The purchase invoices, should be accompanied by necessary certificates of Quality Control Inspectors of the Industries Department/Technical Supervisors of the Apex society, as to the correctness of price fixation, marketability, quality etc. of the goods while checking purchase invoices, the auditor should peruse these certificates also.

(b) *Purchase of Yarn.*- Purchase of yarn by the Society will be effected either direct by placing orders with the production centers/Mills, or by negotiation with agents/wholesalers. In order to watch the market rates of each counts of yarn, the society will be maintaining market intelligence on the rates prevailing at Coimbatore and Madurai. It should be ensured that no purchases are effected above the market rates. As far as possible counts which are produced internally should not be purchased from outside agencies. In respect of negotiated purchases the concerned files should also be examined by the Auditor.

The auditor has also to check the stock register of yarns especially with reference to purchase and Sale/issue.

2. *Production Centers.*- The cost of establishment and other production expenses of the production centre are met by the Head office. These advances should be adjusted periodically when the concerned production centre submit periodical production statements. It should be ascertained whether all productions made at the centre are transferred to the various depots and accounted in the consolidated stock register. This can be ensured by checking the Goods Receipt statements of the production centre sent to the Head Office with the consolidated stock register,

3. *Valuation of closing stock.*- In arriving at the value of closing stock, the auditor has to closely follow the directions issued by the Reserve Bank of India, from time to time.

4. *Agency depots.*- The agreements executed by the Agencies should be verified to ascertain the terms and conditions of granting

agency. It is to be ascertained whether Agencies are given without obtaining proper security as prescribed by the society from time to time. By checking the liability register of Agencies, the transfer of goods beyond the maximum permissible limit to the agencies can be located, and the society can be suitably directed to strictly adhere to the Rules.

5. *Exhibition.*- Participation of the society in the various exhibitions should be based on proper sanction from competent authorities. Wherever the Government provides financial accommodation by way of grant to such exhibitions, the auditor has to watch timely receipt of such assistance as well as its utilisation for the purpose for which it is granted. The stocks in the exhibition depots are also to be adequately-insured specifying the venue of the depot in the exhibition.

6. *Weavers Training Scheme.*- The entire expenses in connection with the Weavers Training Scheme, met by the society in advance is reimbursed by Government subsequently. The auditor has to watch timely reimbursement of such expenses.

7. *Reconciliation of branch accounts.*- Periodical reconciliation of branches depots accounts with that of Regional Offices, and those of Regional Offices/ Head Office should be ensured.

8. *Depots Outside State.*- The accounts of depots outside state have to be reconciled with that of Head Office. The annual stock verification of the depots is conducted through reciprocal arrangement with the Registrar of Co-operative Societies of the concerned State.

9. *Hantex Weaver's Service Centre.*- It has to be examined whether the service centre formulates new attractive designs and propagate them among the various affiliated primary societies.

10. *Business Results.*- The business results of the society may be critically examined, deficiencies/shortfalls if any, pointed out and suggestions for improvement indicated by the Auditor. The Auditor should also make his observations on the depots which are continuously working in loss for years together.

11. *Inspection of Depots.*- The auditor has to ascertain whether the head office exercises proper control over the depots either directly or through the regional offices. Inspection and periodical

stock verification of the depots are also to be ensured. He has also to see whether the defects noticed during inspection or shortage if any, in stock, found during verification, are promptly followed up.

12. *Insurance.*- The Auditor has to ascertain whether all the stocks in depots, godowns etc are adequately insured and policies kept alive by the society.

13. *Rebate Scheme.*- The auditor has to verify whether the society has submitted its claims for rebate from Government in time and has taken follow up action until the claims are settled.

6. KERALA STATE CO-OPERATIVE RUBBER
MARKETING FEDERATION LTD.

Special aspects to be examined by the Auditor

The activities of the Federation are broadly classified into the following heads.

1. Rubber Marketing
2. Fertiliser Mixing
3. Soil and leaf testing
4. Distribution of Chemicals and Fungicides and Aerial spraying
5. Rubber Processing

1. *Rubber Marketing.*- (a) *Purchase.*- The Federation purchases rubber from member societies, estates and dealers and sells the same to the manufacturers or to the State Trading Corporation for export. It has opened sales depots at Bombay, Calcutta etc. It has got a purchase Depot at Trivandrum. Purchases will be effected by the Federation on the basis of contracts entered into by both parties, at the prevailing market rates. The Auditor will verify the diary of market rates maintained by the Federation and see that the purchases effected are not exceeding the rates prevailed in the market. In case, the Federation has effected any purchase at higher rates in order to fulfil any contract entered into with other agencies, the Auditor has to examine those cases, with particular care to satisfy that those purchases were effected in the best interest of the Federation.

The purchases made are weighed at the godown and lot graded and taken to stock. The Auditor has to check the purchase bills with the grading reports prepared by the grader and with the purchase register. It should also be ensured that all the purchases made have been accounted for in the stock register. The stock registers maintained at the godowns are to be recounciled periodically with the stock register maintained at the Head Office. It should also be satisfied that all the purchases have been graded and total of the graded quantity tallies with the purchase bills.

(b) *Sales*.- Sales are mainly effected through the sales Agents/Branches etc. As goods are transferred from the godowns to sales depots, the auditor will verify such transfer slips and the files pertaining to the transporting of goods to ensure whether the goods have been transported on the day of transfer as noted in the stock register. It may also be ascertained that all transfers to the Branches/Sales depots are incorporated in the Branch/Sales depot accounts. This can be checked by verifying the transfer slips with the extract of stock register of branches.

The Auditor should verify the sales agreements executed by the Federation to ascertain whether sales are effected to the utmost advantage of the Federation. It may also be ensured whether all sales are effected through its Agents/Branches. To ensure this, the sales Invoice may also be checked with the representative order form.

2. *Fertiliser mixing*.-All purchases of raw materials for this unit are usually made by the Head Office. It may be ensured whether the Federation has observed the usual formalities in effecting such purchases. The auditor should examine the connected records of the mixing unit to see that the wastage of materials incurred in mixing is reasonable and supported by proper authorisation from competent authority.

3. *Soil testing laboratory*.-It has to be ascertained whether the laboratory is functioning efficiently and serves the purpose for which it was established. Since each bed mixed at the mixing unit has to be checked at the Laboratory before they are released for sale, the auditor should satisfy that proper checking has been done at the laboratory as required. The deficiency if any, noticed in the components may help the auditor in investigating the matter further in the mixing unit.

4. *Distribution of chemicals.*-Fungicides and Aerial spraying: The Federation acts as agent in the matter of distributing chemicals etc., Suppliers will send goods direct to the party who order goods through the Federation and copy of sales bill sent to Federation. It has to be seen in audit that the Federation realises the correct commission due to it as agent.

5. *Rubber processing.*-Accounting procedure and details of registers to be maintained will be dealt with in the next volume of the Manual.

6. *Branch accounts* -The system adopted by the Federation in reconciling the branch. Accounts has to be examined carefully and loop holes, if any pointed out. Periodical incorporation of branch accounts with the main accounts and reconciliation of the accounts has to be ensured. The accounts with the primaries are also to be reconciled periodically.

The auditor has to ensure that dryage/wastage if any, in the stock of Rubber is reasonable and provision made with the approval of the board of Directors subjects to the general guidelines issued by Registrar.

7. KERALA STATE CO-OPERATIVE MARKETING
FEDERATION LTD.

Special points to be looked into by the Auditor

I. General Marketing

Marketing of Agricultural Produce.-It may be ensured that the Federation has valid license for dealing in agricultural produce. On receipt of goods from the primary marketing Co-operative Societies at the godowns, the Federation issues stock receipts to the Primary society on behalf of its members.

The Primary Co-operative Society would be executing an agreement specifying the terms and conditions for sale of produce pledged. The Auditor has to verify this agreement and ensure that the Federation has fulfilled the conditions in effecting the sales. In case, the Federation has advanced loans on the pledge of produce, the Auditor has to ensure that the advance is limited to the percentage of margin specified in the business sub rules if

any adopted. By checking the stock receipt, agreement loan ledger daily and market rates, the Auditor can make sure that advance is issued only on properly pledged produce. He should also verify that the Federation adjusts these advances, on sale of the produce. Realisation of the prescribed commission by the Federation, for effecting the sales, should also be watched.

II. Fertiliser Business

The Marketing Federation assess the requirements of Fertilisers of the primaries and places orders with the Fertiliser Agency/ Company. The requirements will be supplied to the Warehouses from where the Federation lifts the stock. On supplying the Fertilisers to the warehouses, the Fertiliser Companies, issues receipts. The issues from the warehouses will be regulated by delivery notes/orders of the Federation. The stock register may be checked with the warehouse receipts and delivery orders/notes.

Since the purchases of Fertilisers, in majority cases, are arranged by the Apex Bank on issuing letters of credit, through Bankers, the Federation has to reconcile the fertiliser accounts with the Bank periodically. Where the Federation effect, purchases on cash down basis, the auditor may ascertain that the allowable commission has been realised in time.

III. Distribution margin payable to Government

It should be ascertained whether the stock of pool fertiliser has been kept separately. It may also be verified whether the Federation sells the pool fertiliser at the rates fixed by Government from time to time, and margin payable to Government is remitted within the time limit, if any specified.

IV. Branches/Depots

The sale of agricultural produce by Branches/Depots were undertaken through approved agents. The Auditor has to ensure approval of Agencies by the Board of Director for sales through them. The Bank guarantee executed by the Agents may also be verified.

The periodical incorporation and reconciliation of branch/ Depot accounts with Head office account is also to be ensured.

V. Export Sales: Pepper

Export sales are usually done through the agents at Bombay. The auditor may peruse the connected files and ascertain that export sales are done at favourable conditions only.

VI. Special schemes Cashew procurement scheme etc.

The State Government may entrust the Federation with the monopoly procurement of certain crops. The Auditor has to study the scheme in detail and ensure that the schemes are implemented as agreed upon. It should also be ensured that the Federation maintains separate accounts in respect of each scheme. The working results of each scheme should be critically examined by the auditor and suggestions if any, for improvement given.

Since the Federation deals with mainly agricultural produce, dryage, shrinkage etc., in stock, may be an unavoidable feature. The auditor has to verify the relevant Board resolutions fixing the percentage of dryage / wastage etc., that may be allowed and may comment upon the reasonability of dryage/wastage etc.

VII. Fertiliser mixing unit

The Auditor may study the working of the Fertiliser mixing unit and see that the capacity of the unit is fully utilised to the maximum advantage of the Federation.

VIII. Insurance

The goods in possession of the Federation, both procured and pledged, should be adequately insured. In respect of insurance of goods pledged with the Federation by primary marketing societies for sale at favourable circumstances, the auditor may verify the connected records and see that the premium on insurance has been realised from the member societies.

IX. Inspection of indebted primaries and branches of the Federation

The Auditor has to ensure that there is an efficient system in the federation for the periodical inspection of branches and indebted primary societies, and to closely follow up the defects pointed out and suggestions indicated during inspection.

8. STATE CO-OPERATIVE UNION, KERALA

Special features to be examined by the Auditor

1. The State Co-operative Union is established as per section 89 of the Kerala Co-operative Societies Act. The functions of the Union have been specified in Section 91 of the Act.

2. Rule 175 of the Kerala Co operative Societies Rules, empowers the Registrar to audit or cause to audit the accounts of the Circle Co-operative Unions and State Co-operative Union, free of cost. The audit of Circle and State Co-operative Unions, shall include the verification of cash balance and securities and a valuation of the assets and liabilities and on assessment as to whether the activities of the Unions have been conducted fairly and honestly.

3. *Membership* .-As per section 90 of the Act, every Co-operative Society shall get itself affiliated to the Union within six months of its registration. The auditor may ascertain whether the Union collects sufficient data in respect of newly registered Co-operative Societies and pursue action for their affiliation. He may also ensure that affiliation/ renewal fees are collected promptly and accounted properly. In respect of contribution of affiliation/renewal fees to the Circle Co-operative Unions, proper receipts should be obtained and filed. Such receipts should also be verified by the Auditor.

4. *Member Education Programme*.-The member education programmes are mostly financed by Government. The auditor has to verify the connected programmes and relative Government orders sanctioning financial assistance for the same and ensure that they are properly disbursed to the beneficiaries and utilisation certificates forwarded to the competent authorities. It is also to be ascertained whether the unutilised portion of the assistance, has been refunded in time.

5. *Education Fund-Utilisation of*.-As per Rule 53 (2) (c) of the Kerala Co- operative Societies Rules, Education fund has to be utilised for the furtherance of Co-operative Education including propaganda. In view of the fact that the utilisation of the fund is governed by the provisions of Act and Rules and Regulations framed by the Union and approved by Government the auditor has to ensure that they are complied with strictly.

6. *Training Centres and Colleges Incorporation of accounts.*- The Training Centres and Co-operative Colleges conducted by the Union are maintaining separate accounts. It may be ensured that the Union periodically reconciles the accounts with that of the training Centres/Colleges. Periodical incorporation of those accounts with Head office account may also be ascertained in audit. Wherever there are special schemes to give stipend to the participants of the courses, the auditor has to ensure that the disbursements of those assistance are made to the actual beneficiaries.

7. The auditor may also ascertain whether the Head office conducts periodical inspection of the training centres/colleges and defects, if any, noticed were communicated and close follow up action pursued. He may also peruse a few inspection files and point out deficiencies if any with suggestions for improvement.

8. *Publicity and Propaganda.*-With a view to propagate the Co-operative principles and ideals to give the required publicity for the Co-operative activities and for the furtherance of the cause of co-operation etc. the Union may undertake publication of journals and other periodicals. The auditor may scrutinise the accounts of such publication and ensure that proper accounts and records are maintained for the same and expenses incurred are reasonable. In the case of Film Unit, maintained by the Union, the auditor may examine that the procedure followed in effecting purchase of films etc. Deficiencies, if any, are to be pointed out in audit.

9. *Seminars and Conferences.*-The union may be conducting Seminars and Conferences to discuss and formulate policies for the development of the movement. For this, the Union may be giving advances to the sponsors of the function. In such cases, the auditor may scrutinise the individual accounts of the Seminar/Conferences and ensure that the advances are promptly adjusted with proper vouchers etc. He may also ensure that such Seminars and Conferences are conducted on proper sanction.

CHAPTER III

A. AUDIT OF PRIMARY AGRICULTURAL/CREDIT/MULTI-PURPOSE CO-OPERATIVE SOCIETIES

1. *Membership and Share Capital.*- The area of operation of the society should be ascertained from the byelaws, and it should be

ascertained whether all the members are residents in the village or villages or is in occupation of land, in the area of operation of the society.

Share capital and entrance fees are paid along with the application by a person intending to become a member of the society or to increase his share capital. The society, on receipt of the amount, should keep it under suspense account. When he/she is admitted as a member, the suspense amount is transferred to share capital and entrance fees. The Auditor while vouching this item of receipt should verify whether the admission has been made in accordance with section 16 of the Act and Rules 16 & 17 of the Rules under the Act and the byelaws. He must also verify the application for membership and the resolution of the committee admitting, him/her as a member. He should also ensure that the society has observed the restrictions, if any, stipulated in the Act, Rules and the Byelaws with regard to the holding of shares etc. by a member.

A person should not be admitted as a member without his remitting the entrance fees along with the share capital as provided in the byelaws. The Auditor should also ensure whether the signature of the member has been obtained in the admission register. He should also see that the full address of the member together with the name and address of his nominee etc. are entered in the register.

Section 19 of the Kerala Co-operative Societies Act reads:

“No member of a society shall exercise the rights of a member unless he has made such payments to the society in respect of membership or has acquired such interest in the society, as may be prescribed by the Rules or byelaws”. Thus, admission of a member without actually receiving the share capital is not allowable.

2. *Funds:-* The primary object of these societies is to provide loans to its members for agricultural operation/production. Every borrowing member can take additional shares, until the total shares held by him reach the prescribed limit. In addition to this, with a view to augmenting funds of the society and to inculcate the habit of thrift in the minds of borrower, thrift deposit is also to be insisted on as per by-elaws. Reasonable rate of interest will be allowed on thrift deposits. The Auditor has to examine this aspect in detail during audit.

3. *Crop Loans*.-Primary Agricultural Credit Societies mainly advance short term loans for seasonal agricultural operations, and medium term loans for land improvement, sinking of well, and for other approved productive purposes. The Auditor has to examine whether the society has observed the rules and procedures and adhered to the directions of the financing bank. He may also go through the Scale of finance fixed for each crop, arrangement for verification of utilisation of the loans issued as well as taking of effective action in the collection of overdues. He has to check the register and records maintained for the above.

4. *Credit limit Statement*.- The Credit limit application is prepared yearly by the Agricultural Credit Society well in advance within the time limit fixed by the Central Bank according to the seasonality for lending. Distinctions are made in the case of small, marginal and big farmers while preparing the statement. As a matter of fact, the Credit limit statement will be a consolidation of all the applications of the members of the society indicating the credit requirements for the agricultural operations. It is to be prepared after making a realistic assessment of the reasonable credit needs of the members with reference to the scale of finance etc. The committee of the society, before recommending/passing the credit limit, should identify the extent of cultivation, crop cultivated, credit requirement etc. of each member. The Auditor has to bear in mind these points while auditing the issue of agricultural S. T. Loans.

5. *Loans to members*.-Loans will be sanctioned to the individual members based on their requirements and limits fixed in the normal credit limit statement. Individual maximum borrowing power for different types of loans, proportion of share linking etc., are fixed in the bye-laws.

The Auditor has to satisfy whether in sanctioning loans to the members, the provisions in the bye-laws and directions of Registrar of Co-operative Societies and Central Bank have been observed strictly.

6. *Disbursement of loans*.-After sanction of credit limit the society can draw loans from Central Bank by presenting withdrawal applications. The Auditor should ensure that necessary resolution regarding grant of fresh loans to borrowing members who have repaid their dues, have been passed by the committee. The

resolution should specify particulars such as names of members, loans sanctioned, names of sureties etc. The Auditor has also to ensure that all those who have been included in the withdrawal application have been sanctioned sufficient limits in the normal credit limit statement. Where the system of crop loan has been adopted, the loans are to be disbursed in cash and in kind. The kind portion, which is required for purchasing fertilizers, insecticides, etc., is disbursed through local marketing/service society or other agency which stocks them. The cost of the same is paid direct to the Marketing Society or other agency. Though the cash portion and kind portions are disbursed separately, a loan bond for the full amount is to be obtained at the time of disbursement of first instalment and subsequent disbursement are made against separate acknowledgement. The Auditor should see that loans for different crops are disbursed at the appropriate time for carrying out the agricultural operations according to the seasonality in lending and scale of finance and fixing period of repayment/due date of recovery etc. according to the harvesting season.

7. *Supervision of Utilisation of Loans.*-The Auditor has to see whether loans have been disbursed properly, distribution statement obtained and undisbursed amounts refunded in time and whether proper documents and acknowledgements obtained and filed. The Auditor has also to ensure whether the necessary records and registers have been properly maintained by the society for the loans issued. He can also check whether there was any misutilisation of loans disbursed.

8. *Security for Loans.*-Under crop loan, the crop proposed to be grown on the lands is accepted as security. In order to ensure that the borrower does not create any charge on the land owned or held by him, section 36 of the Kerala Go-operative Societies Act provides that a member who makes an application for loan, should make a declaration in respect of the land held by him as owner or tenant (subject to amendment in Registration Act). The Auditor has to ensure whether declaration has been obtained in the form prescribed in Rule 51 (Form 7) and whether the charges created have been registered in the village records. The society has also to keep a register of such declarations in Form No.8 as per Rule 51 (2).

9. *Dual membership.*-While checking the transactions relating to the admission of members the Auditor should ascertain whether

the society has taken necessary precautions to guard against dual membership (Rule 27) and whether the Rules and Bye-laws have been strictly adhered to in the admission, allotment of shares and other allied matters.

10. *Personal sureties.*-Generally, loans upto a limited amount are issued on personal sureties. But, land can also be accepted as security in such cases. But, for loans exceeding this limit, security of anticipated crop, land etc. is insisted. In the bye-laws of certain societies, there is specific provision relating to the amount of loan one can avail on personal surety and the amount of loan for which he can stand surety. Every society should maintain liability register showing particulars of amounts borrowed and liability incurred as surety by each incumbent. The Auditor should verify these points while checking this register and will ensure that the liability incurred has not exceeded the limit.

11. *Repayment of loans to Central Bank.*-For remittances in cash, only persons competent for the same as per bye-laws or by resolution of the Board, should be entrusted. The society should obtain voucher from the person to whom the money is entrusted for remittance. The cash -receipt of the Central/District Bank for the remittance should be checked by the Auditor, and he should ensure that the full remittance has been made on the same day. If there are convincing reasons, remittance on the very next working day can also be accepted. In the cases of amount sent by money order, the money order acknowledgement would be available for checking. These should be vouched by the Auditor both for amount remitted and the commission charged. Pucca receipt from the Central Bank should also be verified. In the case of remittance by draft or transfer credit there will be the chalans of the bank for the commission paid etc. In addition to these documents, the Central Bank's pucca printed receipt giving credit of the amount to the proper head of accounts will be available for checking.

12. *Recovery of loans from members.*-When a remittance is made by a member towards his loan account, appropriation should be made to the proper heads in accordance with the bye-laws of the society. The Auditor should ensure that the allocations are correctly made. In vouching, the Auditor should ensure that admission number, name of member, loan number, amount of principal, amount of interest etc., are correctly and clearly written.

It is desirable to obtain signature of the remitter in the counterfoil of the receipt/chalan.

13. *Assessments of bad and doubtful debts.*-Assessment of bad and doubtful debts is to be made by the Auditor after taking into consideration all the circumstances and examining each case in detail. The Auditor has to follow the guidelines, issued by Registrar /R. B. I. for assessing bad and doubtful debts. The classification of loans into bad and doubtful has to be made with great care as all debts classified as bad will be required to be written off and adequate provision will have to be made for all doubtful debts. Provision for bad and doubtful debts should be adequate to cover all debts classified as bad, and at least fifty per cent of the debts classified as doubtful.

14. *Writing off of bad debts* -Rule 62 (i) and (2) of the Kerala Co-operative Societies Rules prescribes the procedure for writing off of bad debts.

In Registrar's Circular No. 93/75 [G (3) 11491/75] dated 11.11-1975, it has been classified that the Auditors appointed under section 63 of the Kerala Co-operative Societies Act, to audit the accounts, alone are competent to issue the certificate contemplated in Rule 62 (i).

15. *Verification of member's accounts and checking of pass books issued to members.*-It should be ascertained whether pass books are issued especially to all the borrowing/depositing members and their transactions entered and certified in the pass books from time to time. In the course of audit, the members should be requested to contact the Auditor with their pass books in order to get their accounts verified. In bigger societies, where quarterly or half yearly statements of accounts are issued the members can check up such statements to ascertain the accuracy. Personal verification of member's accounts and examination of their pass books should be conducted by the Auditor. The Auditor can attach along with the audit note, a list of members whose accounts have been verified by him during the course of audit.

16. *Medium term Loans.*-Medium term loans are issued for meeting outlay relating to the replacement and maintenance of wasting assets and for capital investment designed to increase the output from land. These loans are generally repayable within a

period of three to five years. They are sanctioned for purposes such as dispensing of old wells, sinking of new wells, installation of pumping plants, purchase of agricultural machinery or a pair of bullocks, improvements to land, bunding, tenacing etc. etc.

Medium term loans are sanctioned after assessing the repaying capacity of the borrower, and considering the incremental income. In all cases, the land concerned and the assets created out of the proceeds of loans are required to be mortgaged to the society.

17. *Conversion of Short term loans into Medium term loans.*- The Agricultural credit stabilization Fund is constituted to facilitate the conversion of short term loan for agricultural purposes into medium term loan and to provide conversion facilities to the instalments of medium term loans in circumstances in which total or partial crop failure resulting from natural calamities; renders the repayment of such loans impossible, without dislocation of the structure and without hardship to the individual agriculturists. The Auditor has to carefully go through the Rules for the establishment and use of Agricultural credit (stabilization) fund and see that, in allowing conversion, the procedure laid down in the Rules, has been followed strictly.

18. *Audit Classification.*-In awarding audit classification the procedure prescribed in Chapter II of Part IV is to be followed.

B. AUDIT OF CO-OPERATIVE BANKS AND SOCIETIES COMING
UNDER BANKING REGULATIONS ACT
(AS APPLICABLE TO CO-OP SOCIETIES)

I. *General:*-Besides being familiar with the provisions of the Kerala Co-operative Societies Act and Rules thereunder, the Auditors in charge of the Banks coming under the Banking Regulations Act, should have a thorough knowledge of the other relevant enactments, such as Banking Regulation Act, Negotiable Instruments Act, Transfer of property Act, and such other Acts which apply to the business of these banks. The Auditor has also to be thorough with the bye-laws of these Banks and the various sub rules and regulations framed for the conduct of business.

They are responsible for completion of statutory audit in time in order to enable the Bank to publish their accounts (Balance Sheet and Profit and Loss account along with Auditor's report) within

the time limit prescribed. With the introduction of continuous and concurrent audit, and internal audit the Departmental Auditor will have enough opportunity to devise scientific internal operating procedures. He will gather from the Bank, the duties and responsibilities of the officers of the Bank, particularly in the internal audit wing. With the assistance and co-operation of the officers of the Bank, the audit work can be arranged so as to ensure the maximum output of work. If possible, all routine and minor irregularities in the working should be got rectified then and there without entering into unnecessary correspondence with the Bank. The Auditor should work in liaison with the officers and office bearers of the Bank.

2. *Maintenance of cash reserve and liquid assets (Fluid resources).*- Section 18 of the Banking Regulation Act stipulates that all Co-operative Banks except State Co-operative Bank should maintain cash reserve in the prescribed manner and submit returns to Reserve Bank of India in the prescribed form mentioned therein.

Again, Section 24 of Banking Regulation Act stipulates that all Co-operative Banks should maintain cash reserve and liquid assets in the prescribed manner and rate indicated therein. The Auditor has to ensure whether the bank has scrupulously satisfied and followed the above statutory requirements on a day to day basis and has submitted all the returns required under the Banking Regulations Act in time. (See relevant sections of the Banking Regulation Act).

3. *Returns to submitted.*-Every Co-operative Bank to which the Banking Regulation Act (as applicable to Co-operative Societies) is applicable shall send to the Reserve Bank of India, the following returns, in the form prescribed within the time fixed.

(i) A monthly return showing particulars of assets maintained in accordance with sections 18 and 24 of the Banking Regulation Act and its time and demand liabilities at the close of business on each Friday during the month.

(ii) A monthly return of unsecured loans and advances granted by the Bank to companies which any of its directors if interested. (Section 20, Rule 5).

(iii) Annual return of accounts which have not been operated upon for ten years (Section 26, Rule 9).

(iv) Monthly return showing assets and liabilities in India at the close of business on the last Friday of every month. (Section 27, Rule 9).

(v) A copy of the annual accounts and balance sheet of the Bank prepared in accordance with Section 29 of the Banking Regulation Act (Section 31).

(vi) Monthly return of the places of business (Section 23, Rule 8).

(vii) Any other return subsequently prescribed by Reserve Bank of India.

4. *Balance sheet and Profit and Loss Account.*- Under Section 29, every Co-operative Bank is required to prepare its balance sheet and profit and loss account in the form set out in the 3rd schedule to the Banking Regulation Act. The balance sheet and Profit and Loss Account together with the Auditor's report should be published as prescribed in the Act. Form of report of the Auditor is as follows:-

Report of the Auditor

I, the undersigned, auditor of the
..... Bank Ltd., report on the Balance Sheet and accounts of the Bank as at 30th June

I have examined the foregoing Balance Sheet of the Bank Ltd., as at 30th June and the Profit and Loss Account for the period ended upon that date with the accounts relating thereto of Head Office and with the returns submitted and certified by the Branch Manager, which returns have been incorporated in the foregoing Balance Sheet and Accounts.

I report that:-

(i) In my opinion, the Balance Sheet is a full and fair one, containing all the necessary particulars and is properly drawn up so as to exhibit a true and correct view of the affairs of the Bank, according to the best of my information and the explanation given to me and as shown by the books of the Bank .

(ii) Where I have called for any explanation or information, such explanation and information has been given to me and have been found satisfactory;

(iii) The transactions of the Bank, which have come to my notice, have been within the competence of the Bank;

(iv) the Returns received from the Branches of the Bank have been found to be adequate for the purpose of my audit;

(v) the profit and loss account shows a true balance of profit for the year covered by such account;

(vi) in my opinion, the Balance sheet and the Profit and Loss account are drawn up in conformity with the Law; and

(vii) in my opinion, Books of account have been kept by the Bank as required by law.

Place:

(Sd.)

Date:

Auditor.

In Registrar's circular No. ADL (3) 16633/68 dated 2-1-1969, necessary instructions on the preparation of profit and Loss Account and Balance Sheet of Cooperative Banks coming under the purview of the Banking Regulation Act, have been issued

5. *Internal Audit*:-As per circular instructions, Registrar has directed that all Apex Institutions, District Co-operative Banks and District Wholesale Co-operative Consumer Stores have to form internal audit wing, by their staff for the internal audit of their accounts. At least two persons are to be allotted to the internal audit wing to work under the control and supervision of Concurrent Auditor.

6. *Books of accounts and records*.-Banking business always require the maintenance of accurate and up-to-date accounts. Every banking transaction has to be entered in the ledger as soon as it takes place. More attention has to be given in maintaining up-to-date personal ledgers, cash book, journals etc. Trial balances are prepared every month and, in bigger banks, weekly. Schedules of personal balances are prepared and reconciled with the general ledger balances at least once in a month or quarter.

Some of the salient features of accounting can be explained as follows:-

(i) Personal ledger postings are to be made direct from the vouchers instead of posting them from the cash books or the journal.

(ii) Postings in the personal ledgers are summarised on summary sheets the totals of which are agreed with the totals of the entries made in the subsidiary cash books and then posted to the general ledger.

(iii) Weekly trial balances are to be prepared from the general ledger.

(iv) Since transactions other than cash transactions are numerous, to ensure correct recording, separate transfer vouchers are to be prepared for credit and debit entries. Similarly individual transactions are entered in subsidiary books and their totals entered in the main cash book or the Day Book, for which purpose consolidated vouchers are to be prepared.

7. Internal Control:- The necessity for a system of internal control is greater in the case of a bank than in the case of any other type of institution. Where there is no arrangement for internal control or where the control is not adequate, the auditor has to conduct detailed checking in order to find out the existence of serious errors or frauds, if any. In the case of smaller banks where the number of employees is not adequate, the honorary directors may also get themselves associated with the staff to effectively carry on a system of internal control. The Managing Director, Chairman, Secretary, Manager and other directors of the Bank may have to participate in the routine checking and control of the transactions, in such cases. The Work of Auditor will be easy where there is a perfect system of internal checking and control.

8. Control over cash:-Some of the salient features of a sound system of internal control over cash are summarised below:-

(i) The safe in which the cash is kept should have an inner chest in which all cash in excess of normal requirement should be kept. The inner chest as well as the outer chamber should be in the joint custody of the Manager/Secretary and the Accountant/Cashier.

(ii) The closing balance of cash should be test checked by any responsible officer and counted fully, occasionally.

(iii) The cashier should not have access to the customer's ledgers and pass book.

(iv) Counterfoils of pay-in-slips lodged by the depositors should be checked and signed by the Accountant in addition to the Cashier.

(v) Payments should be made only against properly authorised vouchers.

(vi) At the end of each day's transaction, the entries in the rough cash book, or counter cash book, should be compared with the entries in the scroll books and carried over into the main cash book or Day Book.

(vii) Ledger Clerks should not have any access to the main cash book, or Day book and the consolidated voucher should be prepared by the Accountant.

The Auditor can check the system followed by the bank, point out defects and give suggestions, if any improvement is required to streamline the procedures.

9. *Postings*:-Before effecting payment of cheques, it should be ensured whether they have been checked in respect of date, amount, signatures, balance available in the account, endorsements etc., and passed by an officer and duly entered in the customer's account, All persons taking part in the checking, viz, the ledger clerk, accountant, comparing the signature, and passing cheque for payment, should have initialled or signed the document, All postings should be checked independently by persons other than the ledger clerks, with the original voucher. Interest debited or credited to the customer's account should be independently checked by at least two officers.

10. *Collection and discounting of bills*:-(i) All documents accompanying the bills such as Railway receipts, despatch notes, delivery orders etc., and received along with the bills should be entered in the Bill Register. When these bills are sent out for collection it should be ensured that all accompanying documents are attached to the bills.

(ii) Where bills are purchased or discounted from approved parties, a responsible officer should ensure that all documents of title issued by transport companies have been properly assigned to the Bank.

(iii) Unless credit limits have been sanctioned, the account of the customer should be credited only after the bills have been collected or advice received from Branch/collecting bank.

(iv) Accounts of all customers to whom credit limit has been sanctioned, should be examined to ascertain the number and frequency of dishonoured bills. In the case of erring constituents, notices should be issued, requesting to regularise the accounts without delay.

11. *Loans and advances.*-Loans and advances should be sanctioned only after proper enquiry about the credit worthiness of the borrower, purpose of loan, his repaying capacity etc., etc. Necessary documents, such as applications, loan bonds or agreements, demand, promissory notes, letter of hypothecation or pledge etc. should be got executed by the parties, before the loan is disbursed or the cash credit account is allowed to be operated.

12. *Prohibition of trading.*-Section 8 of the Banking Regulation Act lays down certain prohibitions on trading etc. by a Co-operative Bank. However these provisions do not preclude a Co-operative Bank from financing hire purchase schemes. But Co-operative Banks are not expected to undertake running of ration shop, acting as wholesale distributor etc. The auditor has to ensure that the bank has not indulged in any of the business prohibited as per Banking Regulation Act.

13. *Opening of branches.*-A Co-operative Bank can open branches anywhere in its area of operation, with the previous sanction of Registrar and Reserve Bank of India. The auditor should satisfy himself that the branches opened by banks are manned by qualified and competent personnel and satisfactory arrangements made for carrying on the work and for supervision. Every branch will maintain its own accounts and at the close of the accounting year, will see that the accounts of branches are incorporated with that of the Head Office and a consolidated balance sheet and Profit and Loss account prepared. The auditor should check and satisfy the accounts in branches and their consolidation and reconciliation with Head Office account. He has also to examine whether, at least after a period, the branches have become economically viable and justify their existence.

C. AUDIT OF CENTRAL CO-OPERATIVE BANKS

I. *General.*-Audit of District/Central Co-operative Banks is much more onerous than audit of credit institutions. In order to audit the accounts of Central/District Co-operative Banks successfully and efficiently the auditor should be well versed with the normal

banking transactions also. Consequent on the recommendation of Government of India and Reserve Bank of India, a system of continually or concurrent audit has been introduced in all the District/Central Co-operative Banks. With the introduction of the system of continuous and concurrent audit, the transactions of a day are normally audited on the subsequent day. Balance sheet and Profit & Loss account of the District/Central Co-operative Bank at the close of each year ending with 30th day of June, together with the auditor's report shall be filed on or before 31st December of the year as required under section 31 of Banking Regulation Act.

With the sanction of Reserve Bank of India this period can be extended upto 31st March. The balance sheet should also be published in a newspaper which is in circulation at the place where the Co-operative Bank has its principal office.

Before commencing actual work of audit, the auditor should study the system of internal check in force. If the system is functioning satisfactorily, the auditor can carry on the mechanical audit quickly. The internal check system regarding the cash transactions of the District/Central Co-operative Bank is as follows:-The cashier receives cash on remittances by customers through chalans. On receipt of cash he enters the same in the cashier's chitta and acknowledges receipt by putting his initials in the chalans and send it to the concerned ledger clerk. The ledger clerk enters the chalan in the concerned ledger and passes it on to the Manager/Officer authorised who passes the chalans and enters the transaction in his scroll. Similarly when payments and withdrawals are made, the vouchers and cheques concerned are sent to the Manager/Officer authorised by the ledger section after proper entries. The Manager/Officer authorised passes them in turn for payment to the cashier, after entering the same in the scroll. As soon as payment is made by the cashier he also enters the payment in his scroll.

At the close of the day's transactions the cashier's chitta and the Manager/Officer authorised scroll are tallied and the cash balance is counted and tallied. Attestation is made after verification.

2. *Checking of Banking operations.*-In view of the position occupied by the District/Central Co-operative Banks, in the provision of banking facilities, in rural areas and holding them responsible for financing different types of Co-operative Institutions

affiliated to them, the auditor has also to look into certain very important points while auditing the accounts of central banks.

3. *Maintenance of fluid resources.*- It should be ensured that the bank does not indulge in overtrading and maintains adequate fluid resources as cash reserves as required under sections 18 and 24 of the Banking Regulations Act (as applicable to Co-operative Societies). It should also be seen that the bank strictly adheres to the instructions issued by the Reserve Bank of India, from time to time, on the maintenance of fluid resources and cash reserves.

4. *Leading operations.*-District/Central Co-operative Banks have been organised with the main object of providing finance to the affiliated societies for conducting their normal operations. Agricultural credit societies form majority of the affiliated societies and therefore providing finance for agricultural operations is the main object of District/Central Co-operative Banks. The District/Central Co-operative Banks provide short and medium term loans. Seasonal agricultural finance or crop finance is normally required to be repaid within a period of one year. Medium term loans are advanced for such purposes as land improvement, construction and repairs of wells, irrigation pumpsets and agricultural machinery and also for purchase of bullocks and milch cattle etc.

Finance to other types of affiliated societies is generally provided in the form of cash credit/overdraft. Cash credit sanctioned to affiliated societies is either "clean", 'hypothecation' or 'pledge'. Where both clean and pledge credit limits have been simultaneously sanctioned, it should be seen that clean credit is used only for the specific purpose for which it is sanctioned and not for providing necessary margin to pledge credit. Hypothecation credit is sanctioned only to good working societies. When the owned funds and deposits are not sufficient to meet the requirements of borrowing societies additional funds are obtained from the State Co-operative Bank by drawing from the credit limits sanctioned.

Special credit limits are also sanctioned to processing and Industrial Societies, including weavers Societies against Government Guarantee under the various schemes sanctioned by the State and Central Governments. Special hypothecation credits are also sanctioned to Consumers Societies under the Guarantee scheme sanctioned by the Government of India.

5. *Short-term Finance to Agricultural Credit Societies.*-Under the production oriented system of credit, a short-term production loan is intended to meet the expenditure in connection with raising of crops. The loans issued for the above purpose should be recovered out of the sale proceeds of crop soon after the harvest.

6. *Normal credit limit statements.*-The normal credit limit statement contains a number of columns for recording details of lands held by each member under irrigation, crops proposed to be grown etc. Although different crops are grown in the same season, only one normal credit limit statement is to be prepared for the whole year and for all crops grown by the member. In other words, separate statements for different crops or different seasons are not required to be prepared. There are, however, certain aspects which warrant revision of the credit limit statements preferably on annual basis. The responsiveness of cultivators to the use of modern inputs and techniques of cultivation is growing fast and consequently the scales of finance fixed for one year may require modification in the subsequent year.

7. *Scale of crop finance.*-Scales of finance are fixed separately for cultivators, who follow the traditional methods of cultivation and those who adopt the improved methods and are fixed in terms of two components viz. component 'a' to be disbursed in cash and- component 'b' to be disbursed in kind. Crop finance includes labour charges, which in the case of small cultivators who have no need for hired labour, would serve to finance their outlays on family consumption during the production period and also additional cash expenditure necessitated by the adoption of improved practices. At the traditional level of cultivation, the outlay on these items of expenditure should not exceed one third of the gross value of produce. For the cash crops like cotton, oilseeds, sugarcane, banana, high yielding variety crops, potato etc. the scales of finance will have to be fixed individually, as there are large variations in the outlay involved for each of such crops.

8. *Disbursement of loans.*-The approval to the credit limit statement by the District/Central Co-operative Banks signifies the upper limit upto which an individual may borrow funds from the society where he is a member, and in turn, the society may borrow from the bank during the ensuing year. The actual drawals by the individuals on the limits should be subject to the satisfaction or

certain conditions with the society and the latter with the District/ Central Co-operative Bank. The individual may be allowed to borrow upto the limit sanctioned to him provided he-

(i) is not in default;

(ii) holds shares in the society not less than the proportion prescribed;

(iii) has furnished adequate security and

(iv) has executed the necessary documents etc.

The society may be allowed to operate on the sanctioned credit limit subject to the following:-

(i) It has repaid to the district/central bank to the extent of at least the minimum proportion of the demand fixed.

(ii) It holds shares of the district bank in the prescribed proportion to its borrowings therefrom.

(iii) The society should have paid to the bank all recoveries made from members and has not made disbursement from out of the cash on hand.

(iv) Every time, when remittances are sent to the bank, the society is required to submit a statement, furnishing full details of the recoveries from members. A time lag of at least 10 days is required to be observed between the date of repayment of the previous loan and disbursement of the new loan.

(v) When a drawal is made by the society from the credit limit sanctioned to it, a promissory note is required to be executed by the society.

9. *Irregularities in sanctioning loans.*- The following are some of the irregularities generally noted in sanctioning of loans to affiliated societies :_

(a) Disbursement of loans before the expiry of the prescribed time lag.

(b) Disbursement of loans to persons other than those who have repaid their dues.

(c) Loans are sanctioned at scales higher than those prescribed.

(d) Failure to deduct share amounts from loans sanctioned.

(e) Shares held by societies not in proportion to amounts lent.

(f) Loans sanctioned in excess of limits prescribed in the normal credit limit statement.

(g) Loans sanctioned in excess of individual limits without proper sanction.

(h) Difference in acreage or crops shown in assets register and normal credit limit statement.

(i) Loans disbursed out of heavy cash balances kept on hand.

j) Loans disbursed out of recoveries instead of paying the same into District Bank.

(k) Loans disbursed without obtaining disbursement statement of the previous loan.

10. *Floating Account.*-Seasonal agricultural finance or crop finance is provided to primary agricultural credit societies, by way of 'maximum credit' sanctioned on the basis of total requirements of borrowing members as mentioned in the normal credit limit statement approved by the Bank. Drawals from the maximum credit are permitted against demand statement or on loan application submitted by the societies. The amounts permitted to be drawn against this statement are credited to a "Floating account" against which societies are asked to draw cheques in favour of the members to whom fresh loans have been sanctioned. This account is to be operated only of purpose of disbursement of loans sanctioned to the members. It is quite different from a Current account. This arrangement ensures that proceeds of loans sanctioned by the bank are not misutilised. The procedure followed by the bank should be carefully studied and it should be seen that the society is not required to pay interest on amounts which it has not been able to utilise. Only such portion of the maximum credit need be transferred to the floating account which is immediately required by societies for granting loans to its members,

11. *Medium term loans.*-On the basis of requirements of members for various purposes, a limit for the drawal of Medium term loan is sanctioned to the society. Drawals from this limit is permitted only when the society presents application for grant of loans to its members. The following are the purposes for which medium term loans are sanctioned.

- (i) Purchase of a pair of bullocks or buffaloes.
- (ii) Sinking new wells and for repairing old ones.
- (iii) Purchase of oil engines, electric motors and pumpsets.
- (iv) Purchase of agricultural machinery.
- (v) Purchase of tractors and trailers.
- (vi) Purchase of milch cattle.

Medium term loans are sanctioned for the above purposes, considering the repaying capacity of the borrowing members and after providing proper security. If the securities furnished is adequate, two sureties as approved by the committee are insisted. In order to watch proper utilisation of the loan sanctioned, utilisation certificates have to be obtained from the societies. Loans for the purchase of oil engines, pumpsets, etc. should not be disbursed in cash, but the societies should be asked to effect payment to the suppliers direct. Where loans are sanctioned for the purchase of bullocks, milch animals etc., the auditor should ascertain the arrangements made for their purchase.

12. *Advances to other types of societies.*-Advances to other types of societies viz. urban banks, marketing and processing societies etc. generally take, the form of cash credit. Cash credits are operated like current accounts by means of cheques. Necessary subsidiary Rules are to be framed governing the conditions of operation of the cash credits. These rules should have approval of the registering authority. The Auditor should carefully examine breaches in the observance of the Rules during the course of checking the transactions. He should also examine the agreements or cash credit bonds executed by the borrowers to see that the agreements or bonds contain provision for the submission of periodical statements of financial position and stocks pledged or hypothecated, insurance of goods in the joint names of the Bank and the borrower, rate of interest etc. The auditor should also ensure that the Bank has ascertained the financial position, general working etc. of the society before cash credit is sanctioned. The auditor should check all the documents connected with the cash credit viz. the cash credit application, reports of the inspecting officers, letters communicating sanction of the bank and the terms and conditions of operation of the account etc. In the case

of hypothecation credit, it should be seen that monthly return of stock on hand and also the trial balance at the close of each month should have been submitted by the borrowing societies.

13. *Confirmation of balances.*- The practice of getting confirmation of all types of ledger balances is being followed by some of the banks. But many of the banks do not follow the procedure of sending confirmation letters in respect of the Savings Bank Accounts. The Auditor should, therefore, get confirmation statements in respect of all types of accounts and the balance confirmed with the closing balances of such accounts in the books of the society.

In the case of Government loans, share capital, subsidies etc. the Auditor should obtain confirmation certificates from the respective heads of departments. Circular instructions issued in this respect is appended separately. Appendix II (2)

14. *Audit of branches.*-In all policy matters, branches are required to follow the instructions issued by the Head Office from time to time. The auditor has to examine the extent of authority delegated to the Branch Managers, particularly in matters relating to sanction of credits, operation of credit limits etc. During the course of audit, if he comes across instances of misuse of powers or exercise of powers not delegated or exercised powers in excess of authority they should be specially pointed out. The Auditor should ensure whether the Branch is prompt in submitting returns to the Head Office. The periodical returns submitted by the Branch should be based on the branch accounts.

Where advisory committees are appointed to review the Progress, the auditor should peruse the proceedings of meetings of such committees, in order to ascertain the action taken on such resolutions.

15. (a) *Inspection of affiliated societies.*-Depending on the size and importance of the societies affiliated to each branch, one or more inspectors should be appointed to inspect the accounts of the Branch. The inspectors so appointed conduct the inspection of branches, periodically in accordance with the model inspection form prescribed for the purpose. The Auditor has to examine a few inspection notes submitted by the inspectors of Branches, in order to ascertain whether arrangements made for the inspection of

Branches are adequate and that the inspectors attend to their duties properly. The annual inspection programme, tour programme, monthly diaries review of work of the inspectors, follow up action etc. should be seen. He should also ensure whether proper action has been taken by the Branches on such inspection reports.

(b) *Subsidy to uneconomic Branches*:-In order to encourage Central Banks to open Branches in rural areas and to ensure satisfactory working of the crop loan system, the banks are given subsidy. As per schemes sanctioned by the State Co-operative Bank, all newly opened branches of Central Banks are entitled to subsidy during the first three years of their opening subject to certain conditions. This subsidy is intended to enable the Central Banks to meet establishment charges during the initial period when the working of the branch may not be economical. (The scheme is discontinued now).

Sometimes, pay, allowances and traveling expenses of the inspecting and other staff incurred before opening of the branches are debited to the account of the branch which should not be allowed. In addition to the above, a portion of the expenditure incurred over the establishment of the Inspecting staff and expenses over vehicles etc. are also allocated to some branches. It should be seen that such expenditure is reasonable, genuine and properly accounted in the accounts of the branches. It should also be seen that such expenditure has no connection with the working of the Head Office.

16. *Assessment of bad and doubtful debts*.-At the 26th meeting of the Standing Advisory Committee on Agricultural credit held in 1964, the R. B. I. (Agricultural Credit Department) has considered the various suggestions of the Registrars of Co-operative societies of different States in regard to the criteria to be adopted in assessing bad and doubtful debts. Based on the recommendations of the committee, the Reserve Bank of India, has evolved guidelines for assessment of bad and doubtful debts of Central Co-operative Banks. The guidelines have been communicated in Registrar's letter No. ADL (1)-61068/75 dated 25-3-1976 (circular No. 19/76) and circular No. 31/78 dated 11-8-1978 issued in ADL (2) 57239/76/R. Dis.

The guidelines should be very carefully studied by the Auditor, before any assessment of bad and doubtful debts is made. Every

year the Central Co-operative Banks have to estimate the bad and doubtful debts, in accordance with the directions issued by the Registrar of Co-operative Societies. The statements and other particulars compiled by the Central Co-operative Bank for assessing the bad and doubtful debts can be made use of by the Auditor.

As regards bad and doubtful debts in respect of loans and advances, the examination by the Auditor has to concentrate on loans overdue for three years and more, all unrenewed cash credit and overdraft accounts and dues from societies under liquidation. If there are special reasons such as defalcations, frauds, benami loans etc. loans overdue for less than three years are also to be considered. The mere reason that the loans due to the bank have not been covered by corresponding dues against individual members should not be the sole consideration in treating the shortfall as bad and doubtful debts. It may be that the funds might have been diverted for trading activities, for which no special funds have been provided by the Bank. The longer the period for which the loan has been overdue, the greater is the chance of its becoming or proving doubtful or bad. An assessment of the realisability of the dues to the bank would have to commence by assessing the realisability of the dues to societies indebted and in default to the Bank.

As regards loans and advances due from Co-operative Societies engaged in trading activities such as marketing societies and consumers' stores and those engaged in production such as processing societies (rice mills, oil mills etc.), 'weavers' and other industrial societies, an assessment of the realisability of overdue advances due from them may be made with reference to the performance in repaying the past and present advances, periodical stock and financial statements submitted by them and their inspection and audit reports.

Another important item which has a bearing on the estimate of realisability of the dues to the bank from non-credit societies will be their fixed assets such as land and buildings, machinery etc. In such a case, it has to be ascertained whether the machinery purchased was new or old, whether there is demand for such machinery and the approximate price it would fetch if sold etc.

In the case of non-agricultural credit societies, such as urban banks and salary earners societies, it will have to be seen whether the dues of the Central/District Bank have been covered by

corresponding dues against members. The overdue position has to be examined carefully with special reference to the security available. The financial position should also be ascertained from the latest available audit certificate.

As regards societies under liquidation, the dues will have to be ascertained, with reference to the liquidator's report and the audit reports.

The investments in land and building, furniture and fixtures, vehicles, etc. should be examined to see whether adequate annual depreciation has been allowed to these items. The extent to which depreciation had not been allowed should be treated as bad.

In respect of land and buildings, acquired from borrowers in satisfaction of the bank's claims, if the title to the property is not clear or the property is not free from encumbrances, or the property is not in actual possession of the bank, the investment may be treated as doubtful of realisation. Otherwise, the value of such properties may be taken at their market value or book value, whichever is lower.

As regards other assets, such as "sundry debtors", Suspended miscellaneous items, adjusting heads etc. the long outstanding amounts under these heads should be scrutinised with all the relevant particulars. If particulars on any item are not available, or if no documents have been obtained for any amount due from an outside party, or if no steps have been taken for recovery, or the bank itself is diffident about the recovery of the dues, then to that extent the amount shown under the head may be treated as bad. 'Branch adjustment' shown on the asset side of the balance sheet of a bank could be taken at the book value as the amount normally relates to assets in transit. However it should be examined from the reconciliation statement that it does not contain items of a doubtful nature or outstanding for a long period.

17. *Rules of Agricultural Credit-(Stabilisation) Fund-* The Rules of Agricultural credit (stabilisation) Fund as approved in G.O. MS./269/67/ AD dated 22-7-1967 and amended subsequently are appended. (Appendix II 37).

18. *Loans and advances to employees for house construction, purchase of vehicles, etc.-*The Auditor should examine whether

there is provision in the bye laws to grant loans to the employees for construction/purchase of houses or motor cycles/scooters etc. If so, he has to see whether the society/Bank has framed necessary subsidiary bylaws regulating payment, recovery and other conditions of such loans and has obtained approval of the Registrar. The Auditor has to examine whether loans sanctioned are in accordance with the terms and conditions laid down in the subsidiary Rules framed and got approved for the purpose. He should examine the following points also among other things.

(i) Eligibility of loan (minimum period of service, linking of loan with the salary etc., maximum amount of loans etc.).

(ii) Fulfilling conditions and sanctioned by competent authority.

(iii) In the case of construction of houses, whether the society has examined the title deeds, encumbrance certificate, legal opinion and plan and estimate etc., approved by the Engineer.

(iv) Proper and timely execution of mortgage deed and other documents as required under the Rules.

(v) Production of completion certificate signed by a competent Engineer.

(vi) Taking of insurance policy for an amount of not less than the loan amount/outstandings, to cover the risk by fire or any other casualty for the hypotheca.

(vii) In the case of loan for purchase of motor cycle/Scooter. production of cash bill/payee's receipt, registration certificate etc.,

19. *Calculation of allocable surplus for payment of bonus.*- Section 2 (4) of the Bonus Act 1965 and Rule 4 (a) of the Rules there under deal with allocable surplus. The method of calculation of allocable surplus is explained in Form A of the Bonus Act. The Auditor may closely adopt the procedure envisaged in the Bonus Act, for the calculation of allocable surplus for payment of bonus.

In the case of institutions for which the provisions of Bonus Act are not applicable and where payment of bonus has been done out of profits only, the Auditor may scrutinise the distribution of profit of the year and satisfy that the distribution is made in accordance with the provisions of the Act and the byelaws [Section 56 (2) (b) of the Kerala Co-operative Societies Act 1969].

D. AUDIT OF CO-OPERATIVE DAIRY SOCIETIES

In addition to the general procedure followed in auditing societies, the Auditor has to check the following aspects, while auditing Dairy Societies.

1. *Checking of production Register.*-The milk brought by the producers, in the forenoon and afternoon, has to be entered in the production register itemwise; (Buffalo milk and Cow milk) in the name of the producer. The Auditor should ensure that the total quantity of milk procured in a day tallies with the quantity shown in the stock register. This will enable the auditor to detect abnormal spillage or spoilage etc., if any. The auditor has also to test-check the pass books given by the society to the producers with the corresponding entries in the production register. While allowing concessions on the spoilage or spillage, the auditor has to satisfy himself by verifying the minutes book, the permissible spiliage or spoilage as allowed by the Board. The auditor has also to study the arrangements made by the society to test the quality of milk procured by it.

2. *Checking of stock register of milk.*-In the case of societies which are engaged in the manufacture of bye-products also, the auditor has to verify the resolutions taken by the Board to ascertain the conversion ratio etc., of each bye-product. The bye-products register should also be checked with the general stock register to satisfy the accuracy.

3. *Sale of milk.*-Where local sale of milk is being made to different agencies/persons, other than the Kerala LiveStock Development and Milk Marketing Board, the Board resolution has to be examined to ascertain the selling price and other conditions fixed for each type of milk, viz., Buffalo or Cow milk. Where sales have been made deviating from the rates fixed by the Board, the reasons for such deviation should be enquired into. In the case of supplies to the Chilling plants or Central dairy, or milk supply Unions, Kerala Live Stock Development and Milk Marketing Board etc., the Auditor should check at random the slips (milk receipt slips) issued by those institutions to find out whether there are heavy discrepancies between quantity shown as issued in the stock register of the society and those accepted by the agency to which milk has been supplied. In case, instance are noticed, on the heavy

cut made by the agencies an account of low quality milk supplied by the society, the auditor has to examine whether the society has taken timely action for remedying such deficiencies.

The Auditor has to obtain confirmation statements from persons/agencies on the outstanding balances under credit sales.

4. *Checking of milk value payment register*:-The milk value payment register has to be checked to ascertain correctness of the payment of the value of milk to the producers and their acknowledgements. This register has to be checked with the personal ledgers also to ensure whether excess payment has been made to the producers.

5. *Coupons*:-The auditor should check the coupon accounts minutely. On no account the coupon liability should exceed the milk supplied against such coupons. In other words, the coupon account is shown as a liability only after adjustment of the milk supplied against such coupons.

The following are some of the important points that are to be borne in mind while checking coupon accounts.

(i) Arrangements made for printing including machine numbering etc., of coupons and their custody.

(ii) Arrangements for the issue/sale of coupons.

(iii) Periodical verification of the stock of coupons by President or other office bearers or by senior officers.

(iv) Accounting system of coupons i.e., whether adjusting entries are passed daily/monthly/quarterly/half-yearly/yearly redeeming the coupons.

(v) Whether redemption of individual coupons are done.

(vi) Test checking of unsold coupons retained in stock.

(vii) Issue as per stock register and those by the sales register.

(viii) Arrangements made for cancellation of coupons to which milk has been issued.

(ix) Finally tally the coupon account with the unredeemed coupon and find out whether there is any discrepancy.

E. AUDIT OF FISHERIES CO-OPERATIVE SOCIETIES

1. *Supply of Boats and Fishing equipments on concessional rates.*-(a) *Sanction order.*-Different types of fishing equipments are supplied to Fishermen Co-operative Societies by Government on concessional or subsidised rates. They include Mechanised boats, country boats, Nylon nets, Nylon yarn, etc. In the case of processing societies, equipments necessary for processing activities are also supplied. In all these cases the auditor has to verify the order sanctioning boats or fishing equipments, as the case may be, and also verify the bond executed by the society to ascertain the terms and condition of sanction. The date of loan and for acquisition of the particular asset should be noted and ensured whether it has been properly accounted. In case the machinery or equipments were purchased from outside parties, with Government sanction, the invoice or bill should also be scrutinised.

In the case of mechanised boats the make of engine, its number, length of boat, capacity etc , and in the case of nets, type of net, accessories issued along with it etc., should be verified. In the case of country boats, the Auditor shall see that the specification in the invoice or bill do correspond with the entries in the books of accounts in all respects.

(b) *Loan repayment Register.*-The Auditor should verify the register of repayment of loan and see that principal and interest are repaid promptly as required in the sanction order. In case they are not repaid in time, adequate provision should be made for the same. While preparing the profit and loss account and Balance sheet the Auditor should provide for the subsidy, if any, received and the subsidy shall be shown on the liability side. Subsidy should not be allowed to be distributed.

2. *Stock Register.*-All purchases should be included in the stock register. The auditor should ensure that the entries in the Boat Account Register correspond with the details in the purchase invoice or bill.

3. *Maintenance and repairs to Fishing crafts, net and equipments.*-The Auditor has to ascertain the arrangements made for repairs to the fishing crafts and other equipments. In the case of fishing crafts supplied on concessional rates, the order of sanction will also indicate the procedure to be followed in repairing them. The

general procedure is that, all major repairs exceeding Rs. 500 are to be got executed through Government boat building yards. In case, major repairs were executed through local work shops, it should be verified whether proper sanction has been obtained from competent authority. The Auditor should ensure that the society maintain a spare parts register and all purchases of spare parts are accounted for properly and their proper utilisation watched by some responsible official of the society. At the same time the method in which the condemned parts are disposed of should also be watched during audit and deficiencies, if any, pointed out.

4. *Running expenses.*-(a) the running expenses may generally be related to the following.

(i) cost of diesel

(ii) cost of engine oil

(iii) cost of cotton waste

(iv) hauling and launching charges

(v) Miscellaneous expenses including cost of coir ropes, wire ropes etc.

In all the above cases, the auditor should ensure that the vouchers are genuine and related to the particular boat. He should also verify that these expenses, particularly costs of diesel and oil are brought to account in the Log book of the boats also. The Log book should also be verified to ensure, that the running expenses reasonably relate to fishing operations. Each purchase bill must bear the countersignature of the crew or Leader of the boats. In societies owning more than one boat it may sometimes be found that the society purchases the Diesel, oil etc., in bulk and supplied to individual boats. In such cases the society should maintain a stock register of diesel etc., and issues made only on indents placed by the crew, duly approved by the Secretary/President. The supplies made should also be supported by the acknowledgements of the crew Leader of the Boat. If oil is purchased on credit the credit balances, if any, should be got confirmed by the party.

(b) *Hauling and Launching charges.*-The main items of expenditure connected with hauling and launching, are charges paid to contractors and cost of timber for supports while hauled ashore. It should be ensured that proper quotations or tenders were

called for such charges including purchase of timber etc., Purchase of timber should be supported by proper and genuine vouchers and the timber etc. so purchased, be brought to stock, as it could be used for a number of years.

(c) *Log Book*.-The auditor should verify whether fuel etc. consumed is commensurate with the number of hours worked. Reasons for abnormal consumption, if any, should be investigated into and commented upon, if any malpractices are suspected. At the close of fishing operations at the end of the season, the balance of stock of diesel in the tank of the boat should be verified by competent persons and accounted for.

(d) *Repairs to country boats*.- Running expenses in the case of country boats may be negligible. All purchases in their cases along should be supported by proper and genuine vouchers duly countersigned by the crew leader/Boat master.

5. Checking of Boat Register.-It should be ensured whether the society maintains the Boat register, in the form, if any, prescribed. It should contain the name /number of boat, the names of members engaged, leader of the crew, engine number, make of engine, date of fishing, place of start, time of arrival, type of net used for fishing etc. oil consumed, quantity and value of fish netted etc. It should be ascertained whether all catches are brought ashore and handed over to the society. He shall also see that the number of persons engaged for each trip is the optimum.

6. *Checking of Register of catches and allocation of catches*.-The quantity of fish netted as per the 'Boat Register' shall agree with the total quantity and value of fish netted as per the Register of catches when boat, net, etc., are supplied on concessional or subsidised rates, the agreement will confirm the apportionment of catches.

Usually the division in respect of mechanised boats is as follows:-

- (i) 55% as wages to members engaged
- (ii) 30% as fund for repayment of loan.
- (iii) 10% as compulsory (thrift) deposit of members; and

(iv) 5% as society's share to meet the contingent expenses. On the other hand the division or apportionment of catches in respect of mechanized boat is as follows:-

- (i) 40% as wages to members engaged in the catch.
- (ii) 30% as fund for repayment of loan.
- (iii) 20% towards expenses for oil
- (iv) 5% thrift for members who engaged in fishing
- (v) 5% as society's share to meet the contingent expenses.

Where there is no definite instructions with regard to the apportionment of catches, it will have to be guided by the provisions of byelaws. Therefore, the auditor should examine apportionment with reference to the resolutions adopted by the committee in this regard.

7. Sale of catches.-Sale of catches should necessarily be made to Fisheries Corporation or to the Regional societies, if any, functioning. In their absence, sale to private parties are permitted in such cases, the auditor should verify the receipts given by the parties indicating the varieties of fish purchased by them. The varieties as indicated in the above receipts should also be compared with the corresponding entries in the Boat register and register of catches. In the case of auction, the auctioners report should also be gone through by the Auditor.

F. AUDIT CO-OPERATIVE STORES

1. *Double compartmental System.* -This system relates to the maintenance of stock by a Co-operative Stores/Society and contemplates that stock in trade of the Stores is divided into "main stock" and "retail stock". The main stock will be under the custody of the Secretary or some other senior persons specially authorised for the purpose. The custodians of main stock will be unconnected with the sale work. Based on the indents made by the salesman, issues will be made from the main stock. The Auditor has to check a percentage of sales bills so as to ensure that goods are sold only at the retail price fixed from time to time by competent authority. He has also to ensure that the sale price is not boosted so as to reduce the value of stock and the salesman's liability. He may also ensure that credit, if any, given, for wastage etc., is reasonable.

The retail sales sections will be in charge of one or more salesmen from whom sufficient security is obtained. The issues made from the main stock to the sales sections will be valued

at the retail selling price and the salesmen made responsible for value of articles supplied as per their indents. The salesmen has to hand over the daily sales turnover, arrived as per the daily sales book, to the Secretary, immediately after the close of business each day. The amount thus received by the Secretary will be entered in the Cash/Day Book under sales and the liability of the salesman reduced to that extent. Where there are more than one salesman, it is better to fix up joint responsibility on all of them. The stock in the retail section is verified at the end of every month, or at least once in 3 months and the reasons for abnormal deficiency, if any, detected and followed up.

Advantages of double compartmental system.-(i) Depreciation due to wastage and dryage is reduced to the minimum since the main stock is kept in tact.

(ii) Clerical work is considerably reduced, as the cumbersome work of daily classification of sales is dispensed with.

(iii) Defalcation of goods, if any, can be easily detected by reconciling the actual stock with the salesman on a particular day.

(iv) It creates a sense of greater responsibility on the part of the salesman, as he is held responsible for the value of stock handed over to him at selling price.

(v) Stock taking at regular intervals is made very easy, for the major portion of the stock is kept in bulk in the main godown.

(vi) Shortages due to careless handling or over measurement can be easily ascertained by calculating the difference between the salesman's liability and the value of unsold stock with him on a particular date.

2. *Vouching of purchases.*-The auditor has to ascertain the system of purchase followed by the Stores. As soon as a particular stock is exhausted, the godown-keeper has to prepare a list of articles to be purchased and send it to the responsible officer of the Society. He should study the list and place the same before the Purchase Committee to decide about the quantity, and the source from where the articles are to be purchased. When the purchase committee gives its approval, arrangements are made to place orders with the suppliers. Approved purchase orders from the printed 'Order Book' should be issued for all purchases made or supplies ordered. If oral

orders are issued or orders are booked over phone, they should be confirmed by issuing a regular order from the printed 'Order Book'.

When the goods are received the Godown-keeper should verify the quantity received with reference to the invoices and the particulars should be noted in the 'Goods Inward's Register'. The ledger section on receipt of the note of the godown-keeper with the invoices, will verify the calculations, etc., and pass it on to the Secretary for orders of payment. After ensuring accuracy of calculations and receipt of goods in the godown, the Secretary will pass the invoice for payment.

The auditor should satisfy himself about the system of internal check in existence. He should also see that payment is made to the suppliers only after proper checking and scrutiny. In the case of credit purchases, the auditor should be careful to see that the credit bills are transacted properly and correctly. The possibilities of presenting credit Bills as cash bills should be avoided.

3. Vouching of Sales. - For every sale, a sales chit or cash memo should be issued by the salesman. At the close of the day the salesman should record all sales in his Daily sale Register and the total of the sales register is taken to the Day Book representing the total sales of the day. The Auditor should check the entries in the Daily Sales Register with the cash memos and then the total sales in the day book. The posting from the Daily sales Register to the Day book has to be checked fully. In the absence of any internal audit, the auditor should check the sales chits completely. While checking the sales chits he should satisfy himself that sales have been effected as per the retail price fixed by the Stores. The retail prices are usually fixed by the purchase committee with reference to the market trend and also the cost of articles, etc. Any change in the retail price has to be effected by the purchase committee, if functioning.

Every Store should exercise strict control over the issue of blank cash memo books. Proper accounts are to be maintained in respect of the cash memos printed. A Register of cash memo books received should also be maintained.

4. Vouching of incidental charges. - Expenditure incurred, viz., Railway freight, cartage, T. A. etc. in connection with the

purchases have to be examined carefully. The auditor has to satisfy himself about the genuineness and reasonableness of the expenditure. Where several kinds of articles, are received in one consignment, the expenditure incidental has to be apportioned approximately between the various items for purposes of fixing the selling price.

5. *Vouching Stock Register, Price Fixation Register.*-(a) *Stock Register*:- The Stock Register has to be checked with the invoices and cash bills for receipt of goods. The auditor has to ensure that the dates of purchase, quantity purchased and the weight or measure of unit as is noted in the invoice are entered in the Stock Register. The salesman's indent has to be verified to ascertain the correctness of issue of articles from the godown. The issues as per the Stock Register and the salesman's indent should agree. In the case of issues in bulk, the auditor should check the wholesale sales or cash bills with the stock register. The balance of each entry should be checked in order to ascertain the correctness of the stock register. At the end of the checking, the auditor should total the item-wise quantity of receipts and issues for the year in the stock register and verify whether the opening stock plus purchases during the year, tallies with the closing stock plus issues and sales.

(b) *Price Fixation Register*:-As explained earlier, the selling price is fixed by the purchase committee. The committee will fix the price of each article taking into account the charges incidental to the purchase of such articles. Instead of maintaining a separate price fixation Register, a combined purchase and price fixation register may be maintained. In certain Stores, the purchase Register itself is being maintained in two parts one part under the heading purchase price and the other sale price. Each invoice is entered in one line. On the left hand side is recorded the cost price and on the right hand side the sale price of the articles. This Register has to be checked with the invoices, and should be seen that selling prices are correctly calculated.

6. *Vouching of Salesman's Liability Register*:-Salesman's Liability Register has to be checked with salesman's indent and also Daily Sales Chitta. The auditor should check the additions and subtractions and ensure the correctness of the balance arrived at. The result of monthly or quarterly Stock verification has to

be recorded in this register and the amount of deficit or excess over the liability disclosed should be recorded in the register. The signature of the salesman for each entry in the Register and also for the closing balance of each month should be obtained. The auditor should ensure that the above procedure is adopted without fail. The auditor should also verify whether the stores has initiated appropriate action for the realisation of the deficit.

7. *System of Trade Deposits.* -Sales are mostly for cash. Credit sales should be allowed only on the basis of specific provisions in the bylaws of the society. To obviate the difficulty of the members paying cash now and then they are allowed to maintain trade deposit with the society to purchase articles from the society against this deposit. The purchase as and when affected is debited against this Trade Deposit Account. The amount drawn out of this is recouped at the beginning of the next month. The auditor should vouch this register with reference to the cash receipts and also the concerned bills and see whether the balances are correctly struck. The pass books supplied to the members may be called for and checked at random

8. *Vouching the Register of bonus on purchases.*-Section 56 (2) (b) of the K.C.S. Act 1969, provides that a society may, out of its net profit, after providing for statutory reserves, set apart a portion of the net profit for the payment of bonus to its members on the amount or volume of business done by them with the society to the extent and in the manner specified in the bylaws of the society. The percentage of bonus payable will be decided by the General Body every year, subject to the limit prescribed in the bylaws. The purchases effected by each member are to be entered in a Register called the 'Register of Bonus on purchases'. The bonus at the rates declared is worked out with reference to the total purchases made by each member. The auditor should see to the correctness of the figures arrived at, and ensure whether they are in accordance with the Rules and whether the distribution is made properly.

9. *Register of empties.*-Goods are received in various kinds of containers, such as gunny bags, boxes, tins etc. The empties should be properly accounted for both by the godown-keeper and the retail section. Whenever goods are received, the concerned empties folio should be posted as to the number of empties received. In cases where empties are to be returned to the suppliers, the empties

account can be posted for returns on receipt of the credit note from the supplier. The empties which are not returnable can be disposed of on proper resolution of the Board of Directors. The auditor should verify the entries in the Register with reference to the inward invoices, credit notes, sales chits, etc. and see whether the sales have been effected on proper sanction.

10. *Vouching of Member's Credit Purchase Register.* -Invariably in all employees Co-operative Stores credit sales are allowed to its members. The bylaws of such societies provide for the maximum amount, in relation to the Salary/Wages. In such cases, the auditor will verify whether the maximum limit fixed in the bylaws is being adhered to strictly in allowing credit sales to its members. He should also examine whether the amount under credit sales is being recovered regularly and that proper action has been taken for the realisation of arrears, if any. As far as possible the auditor should get confirmation, as on the last day about the balance, from the members. A few pass books in the possession of the members may be called for at random, and the entries therein compared with the account of the member as per the ledger.

11. *Return of goods.* -When goods received as per orders are to be returned to the suppliers due to some irregularity in the supply, vizi inferior in quality or damaged, or not according to sample, a debit note should be sent to the supplier and his account debited with the amount involved in the invoice.

12. *Goods issued Register.* -The godown-keeper should maintain separate 'Goods Issued Register' for each branch or section of the society. Goods issued to the branches or sections should be supported by "Goods Issued Notes" or "Delivery Chalan" issued by the Godown-keeper. The goods issued notes or delivery chalans contain the sale price of the articles, which will be entered in the Salesman's liability Register. The auditor should verify whether both the goods, Issued Register and the Salesman's Liability, Register are written-up to-date.

13. *Issue of Stock for retail sales.* -Supply of stocks from the godown to the retail Shores/branches should be made only against approved indents submitted by the Branch Manager or Salesman in charge. The godown-keeper should have also obtained the signature of the Branch Manager or Salesman, on the 'Goods Issued Note' or 'Delivery Chalan'. A copy of the above Note or Chalan

should be set to the accounts department which maintains the Salesman's Liability Register.

14. *Prepacking of goods.*-All commodities received in bulk are packed in convenient packets in different weights, and displayed on the counter or kept on the rack. In order to watch the proper utilisation of articles received in bulk and converted into packets, it is necessary that the Society maintains a 'Conversion Register'. This Register which contain particulars such as number of bags or other bulk containers opened and converted into packages of convenient sizes, the number of different sizes of packets into which the contents have been packed etc. The auditor should check this Register exhaustively and shortages, if any, should be indicated.

15. *Price Variations.*-Sale price fixed at the time of receipt of goods has to be changed according to the market conditions, variations in the rates of tax or duty, etc. In order to note the variation in price a "Price Fluctuation Register" has to be maintained. Credit/debit slips vouchers should be prepared for every article whose selling price has been revised.

16. *Return of goods to godown.*- When goods supplied to the branches/ retail shops are returned by them they should be entered in the Returns Inward Register by the godown-keeper, in accordance with the goods Returned Notes given by the constituent branches/ retail shops. A copy of the goods returned notes should also be sent to the Accounts Department for effecting necessary adjustments. A notice about the adjustment should also be made in the goods issue and stock register and on the original Bill or Issue Note.

17. *Business Management.*- While auditing the accounts of Consumer Stores, the auditors should consider the following points viz.-

(a) *Employment of funds.*-The investment of funds in circulating and non-circulating assets should be studied. If the investment is disproportionately large in non-circulating assets such as lands and buildings, furniture, fixtures, etc., the auditor should make suitable comments on it.

(b) *Management.*-Adoption of scientific methods of control over purchases and sales, inventory control including adequacy of arrangements made for periodical stock taking, etc. should be examined.

(c) *Budgetary control.*-Quarterly, half-yearly and yearly targets should be fixed for purchases and sales. The expenditure should be regulated within the budget.

(d) *Supervision over branches.*-The arrangements of branches and sales depots, maintenance of proper accounts, reconciliation of head office accounts etc. should be seen. If found necessary suggestions for improvement should be given.

(e) *Management accounts.*-Periodical reports should be obtained from the branches/sales depots/department on purchases, sales and stock, and should be considered by the Committee. The working results should also be reviewed periodically in order to arrest unhealthy developments, if any, in time.

(f) *Government assistance.*-Proper utilisation of financial assistance from Government and prompt repayment of such assistance and other borrowings should be commented upon.

(g) *Accounts.*-It should be seen that the price fluctuation register and the salesman's Liability Register are always maintained up to-date

G. AUDIT OF MARKETING SOCIETIES

1. *Activities undertaken:*-Co-operative Marketing Societies confine their business in arranging the marketing of produce of their members, advancing loans on the pledge of produce distribution of fertilizers and agricultural implements etc. In addition to the above, many of the marketing societies undertake a number of other activities also. The auditor should, therefore, carefully study the by laws of the society to examine whether the society is engaged in any other activity as was not contemplated in the bylaws. If any activities, which are not permitted in the bylaws are undertaken, the auditor has to appraise the Board of Directors of their liability for the irregular or unauthorized transactions so undertaken. Separate accounts are to be maintained for the various activities undertaken by the Society.

2. *Marketing of Agricultural produce.*-The Society should have obtained necessary license to function as General Commission Agent. An arrival Register is to be maintained to record the receipt of agricultural produce. Receipts of agricultural produce received

for sale should be checked from the receipts issued and the entries made in the Arrival Register and the weightment slips. Sales should be checked from the Auction Register and also the sale agreements and weightment slips. A daily sale Register is to be maintained from which postings into the personal accounts of the customers and the merchants who have bought the produce can be checked. Cash payments of sale proceeds to the customers should be checked from the "Account Sales" and the payment slips.

Entries in the register of sale agreements should be checked from sale agreements. Entries from the register of sale agreements should be carried over into the Daily Sale Register. Postings from this register should be seen into personal accounts of customers. Cash payments may be checked with payment slips.

3. *Outright purchases.* - There should be provision in the bylaws, enabling the society to make outright purchases. It should be seen that the amount invested in outright purchases does not exceed the limit if any, fixed in bylaws. Every effort should be made to ensure that all purchase and sales made on behalf of the society in its name are genuine. Arrangements made for the proper storage of the goods pending resale should be ascertained. All goods belonging to the society should have proper and sufficient insurance cover.

4. *Pooling and grading.* - All produce received for being pooled should be entered in the 'Pool Register'. Entries in this register have to be checked with the "Goods Received Reports" the weightment slips and the counterfoils of receipts issued to the member. The auditor should ascertain the arrangements made for grading the produce according to trade qualities. When sufficient quantities are collected the date for holding the auction should be fixed and the produce sold in auction after giving due publicity. The auditor should carefully examine the auctioneer's report and connected papers.

The expenses incurred and the commission earned by the society are deducted from the sale proceeds and the average price or pooled price is calculated. Members are paid at pooled rates. The auditor should examine whether advances if any, made are deducted at the time of final settlement of accounts. If produce received for sale is processed before it is sold it will enable the members to realize better prices for the produce. Where processing activities are undertaken by Marketing Societies, it should be seen

that processing activities are treated as separate units and separate accounts are maintained.

5. *Payment of advances pending sales.*- There may be instances when advances are to be paid to the producer members pending sale of their produce. The auditor should verify the bylaws of the Society and see whether advances are paid in excess of the limit prescribed in the bylaws. It should be seen that advances are recovered at the time of finally settling the accounts. Regular vouchers should be obtained for payment of expenses such as transport charges, market cess etc. The auditor should verify the application for advances and agreements executed by the borrowers.

6. *Linking of credit with marketing.*-It is expected that every borrower from an agriculture credit society sells his produce through the Co-operative Marketing Society to which the Credit Society is affiliated and agrees to allow the marketing society to deduct the credit society's dues from the sale proceeds. The marketing society at the time of payment of sale proceeds, deducts the dues to the society.

7. *Hiring of Tractors, ploughs and other Agricultural machinery.*- Some of the marketing societies are hiring out tractors, ploughs and other agricultural machinery to its members. Such societies have to maintain a Machinery Hire Charges Register, showing the name of person hiring, date on which hired, date of return, rate of hire charges, hire charges due, hire charges recovered, balance, if any, etc. It should be seen that the bills for hire charges are prepared promptly and recoveries made without delay.

The auditor during audit should check the receipt of hire charges from the, Machinery Hire Register. Machinery Register should be checked to ensure that hire charges are collected for all the days the particular machinery was hired out.

8. *Verification of stock.*-All stocks in possession and those pledged with the society should be verified physically, at the close of every Co-operative year. Shortages and driages are to be properly enquired into.

9. *Advances against produce or goods.*-Subject to the provision in the bylaws a society may make advances against the produce or goods pledged or hypothecated to the society. In such cases the

Auditor should examine whether, the advances made for different produces are within the margin fixed by the Board of Directors or Central Bank. It should also be ensured that the advances made on the security of produce are closed within the period fixed in the bye-laws. The produces stored with the society should be insured at a reasonable market rate, against fire and burglary at the cost of the members. Auditor should also verify whether the produce or goods so deposited are stored in such a way as to prevent deterioration. He should also see whether periodical checking of stock is done by the management and result recorded and follow up action taken. He should also ensure whether the society is vigilant on the fluctuation, if any, in the market rates of the commodities so as to take quick action in case the market price goes far below the advanced rate,

10. *Unauthorized advances.*- Payment of unauthorized advances is highly irregular and tantamount to temporary mis-application of money. The auditor should note down such cases of mis-application of money and suggest appropriate action.

H. AUDIT OF CO-OPERATIVE FARMING SOCIETIES

1. *Pooling of land.*-In a Joint Farming Society owner occupants of agricultural lands agree to pool their land for purposes of common cultivation. Agreements are executed by the members, agreeing to pool their lands in the form prescribed in the bye-laws. Every farming society should maintain a "Register of Lands Pooled". This is the basic Register and will contain full particulars of the lands pooled, dates of pooling, period of pooling, the dates of execution of agreements, registration of mortgage deeds, the value on the date of pooling, number and date of general body resolution fixing the valuation and the capital expenditure incurred by the society for its improvements and the members signature. At the top of each folio, the name and admission number of the member, the total extent of lands pooled by him, and the name of the revenue village in which they are situated should be entered. The entries in the lands pooled Register should be checked with the agreements executed by the members.

2. *Register of improvements to lands pooled.*- The Register contains particulars such as description of land taken up for improvement, nature of improvement, the estimated cost of work

dates of commencement and date of completion of work, and the actual cost of improvement. Before undertaking any development work, plans and estimates are required to be prepared and approved. The cost of Improvement has to be apportioned on between the different plots which have been benefitted by the improvement. The cost of the improvement apportioned to a particular plot has to be debited against the member and it has to be recovered from him.

3. *Programme of cultivation.*- A cropping programme will have to be prepared and adopted by the general body. The general body has also to decide the method of organisation of teams or groups according to plots, crops or operations, appointment of group leaders, fixation of scales of wages for different operations and for different categories of workers and allied matters. A production committee is also to be appointed to supervise the farm operations, during cultivation.

4. *Payment of wages.*-Wages are usually paid on daily basis, although for certain operations, such as sowing, harvesting etc., piece wages may be paid. The society has to maintain muster rolls according to plots, or crops and pay wages on the basis of attendance or quantum of output of work. Daily cultivation sheets showing plot numbers and crops sown, labour engaged, and other equipments used are filled in daily and entries made in the consolidated cultivation register. It is from this register that the cost of cultivation is to be ascertained. The auditor has to check the payment of wages from Muster, acquaintance rolls, Daily labour sheets, etc. The Job-wise register of engines and tractors should be checked with daily cultivation sheets.

5. *Purchase of fertilizers, seeds chemicals, etc.*-A purchase register showing seeds, manure, chemicals, pesticide and other materials purchased for farm work should be maintained. An issue register showing issues of different kinds of materials and operations and to which their cost is to be debited should be maintained. The purchase register can be checked with invoices and stock register. The closing stock has also to be verified.

6. *Cultivation Account.*-The register is to be maintained with separate folios for each crop, the cultivation of which is undertaken by the society at a time or during one season. The cultivation account has to be closed for each crop as soon as the harvesting is completed. An abstract will be prepared indicating the total value

of the harvested produce, the total cost of cultivation and the gross income from the crop.

7. *Harvesting of crops.*- A. *General.*-When the crops are ripe, the harvesting should be done in the presence of committee members. A note regarding measurement or weighing of crops harvested may be taken in the proceedings of the managing committee. After measurement or weighing, the crops harvested should be taken to stock Notice regarding harvesting, weighing or measuring should be given to the members.

B. *Marketing of produce.*-Such portion of the produce, after meeting the requirements of the members should be sold, preferably, through a Co-operative agency.

C. *Valuation of standing crops.*-The entire expenses incurred over the new crops upto the date of the balance sheet should be shown as the value of the Standing crops.

D. *Valuation of agricultural produce.*-Produce harvested should be valued at selling price (ie at prevailing market price) after making necessary adjustments towards expenses to be incurred for marketing the produce.

E. *Valuation of livestock.*-Every animal should be valued according to its age and usefulness. While valuing the livestock, the prevailing market rate should also be considered.

8. *Register of apportionment of wages paid.*-The total wages paid for a week as disclosed by the muster roll is apportioned among the following items:-

- (i) Capital expenditure (Reclamation, etc.)
- (ii) Cultivation account.
- (iii) Maintenance of bulls.
- (iv) Working of pump-sets and
- (v) Other sundry items of miscellaneous work.

The expenditure as apportioned above is taken to the appropriate account maintained for each item.

9. *Register of land dividend and Bonus paid.*-It contains the admission numbers and names of the members, the extent of lands

pooled by them, their value; rate of land dividend declared, amount payable as land dividend, total wages earned by the members, the rate of bonus on wages declared and the amount payable as bonus, the total of land dividend and bonus according to the members, the date of payment with cash book folio and the signature of the payee. The general body resolutions declaring the payment of land dividend and bonus should be verified.

10. *Daily record sheet.*-The object of this register is to give at a glance, information about the farm in all its aspects viz., participation by members in the farm operations, adequacy of labour force, condition of the standing crops, etc.

I. AUDIT OF WEAVERS' CO-OPERATIVE SOCIETIES

Weavers Co-operative Societies generally undertake all or any of the following activities.

1. *Supply activities.* -Purchase and sale of yarn, dyes and chemicals, shuttles and other spare parts etc.

2. *Production activities.*-Production of cloth and running of handlooms and power looms and providing employment to its members.

3. *Processing activities.*-Dyeing of yarn, bleaching and dyeing of finished cloth.

4. *Marketing activities.*-Purchase and sale of handloom cloth and running of sales depots.

5. *Credit activities.*-Provide loans to its members for the purchase of power looms, tools and equipments such as shuttles, bobbins, etc.

The auditor should study the objects clauses of the bylaws and satisfy himself that the activities undertaken by the society are within the purview of its bylaws.

1. *Supply activities.*-Sources of supplies should be ascertained and it should be seen that as far as possible all purchases of raw materials and other requisites are made from the Kerala State Handloom Weavers Co- operative Society. Only when supplies are not available with the Apex Society, purchases should be made from outside.

For the purchase and supply of raw materials to its members the society should get indents from them and purchases should be effected considering their requirements for a month. Invoices and bills received from the suppliers should be checked in order to check whether the discount and rebate received are accounted or not. Cases when purchases are made on credit, the auditor should check the accounts of creditors. Credit balances outstanding at the close of the year should be got confirmed. All stocks in the possession of the society should be insured and proper control exercised over the receipts and issues of stocks from the godown. Stocks should be verified as at the close of the accounting year.

To watch the proper distribution of raw materials the society should maintain a register showing the selling price. Where sales have been made on credit, the auditor should see the provisions of bylaws permitting credit sales. The bills or credit memos should be checked and total credit sales agreed with the total amount outstanding against debtors. Cash sales should be checked with the cash memos issued. Entries in the stock register should also be checked.

2. *Production activities.*- The committee should prepare an annual production scheme and it should be got approved by the General Body. The production scheme envisages two types of production methods. They are-

(a) Yarn of the required counts as also staple yarn and other requisites are issued to members and they weave the cloth in their houses and bring the finished cloth to the society; and

(b) The society runs the factory and works its own handloom and power looms. In this case, master weavers are appointed to supervise the work.

Detailed manufacturing instructions should be issued irrespective of whether goods are to be manufactured against orders received or for stock. The auditor should also check the "costing Register" maintained.

A register of tools and equipments should be maintained. Societies which have installed power-looms should maintain "Machinery Register" also.

If wages are paid on piece rate basis, arrangements made for measuring cloth and inspecting its quality or grade and method

adopted for the fixation of purchase from the producer members should be examined carefully. Where the producer-members are paid only wages, it should be seen that a system of payment on piece rate basis is adopted. In such cases it should be seen whether the rates of wages are fixed according to counts of yarn design, and width of border weaving pattern design etc.

3. *Processing activities.*-Where yarn or finished goods are dyed before issue or sale, accounts of colours and chemicals used and of other expenses should be checked by the auditor. It should be seen that cost of dyeing is properly added to the selling price of yarn or finished goods. Where the society has no dyeing house, the work of dyeing is to be got undertaken through co-operative institution, if available.

4. *Marketing activities.*- Sale of finished goods should be made through the Kerala Handloom Weaver's Apex Co-operative Society only. Direct sales, can be made to other Primary or wholesale Co-operative institutions and to Government/quasi Government departments. The invoices of such sales should be checked with the stock register.

Separate accounts are to be maintained in respect of the wholesale sales and retail sales. Total quantity of different varieties of cloth produced and purchased from members should be checked with the quantities shown as sold, where goods have been sent on consignment basis, account sales received from them should be checked. Certificates should be obtained from consignees regarding quantity and stock of different varieties held by them. The stocks with consignees should be included in the closing stock at cost price.

With regard to retail sales, cash memos should be checked with the daily sale register and the sale register with the day book. It should be seen that rebates allowed to customers are calculated correctly.

5. *Credit activities.*-Subject to the provisions in the bylaws, some societies advance loans to its members for the purchase of power looms, tools and equipments such as shuttles, bobbins, etc. The auditor should examine the loan application with the issue of loans.

6. *Costing Register*.-The auditor has to verify the costing register and see that the cost of finished products is fixed taking into account the cost of raw materials (yarns, dyes etc.), labour etc. and adding a percentage of profit margin with the actual cost.

J. AUDIT OF CO-OPERATIVE SPINNING MILLS

To audit the accounts of Co-operative Spinning Mills, the auditor has to completely acquaint himself with the various stages of processing.

The following registers are maintained as regards cotton purchases, issue and stock.

1. *Cotton lot book*.-Purchase of cotton in lots is entered in the register. So also the issue of cotton for mixing is also entered in the same register.

2. *Mixing book*- This is intended to denote the variety, the lot number from which the issue is made and quantity received with weight. The percentage of each variety used for one mixture is also arrived and noted in the register.

3. *Cotton stock Register*- The stock register of cotton gives the balance of stock on hand every day, variety-war.

4. *Blow loom lap register*.-This register is maintained to show the number of laps produced per day.

5. *Preparatory Section*.-(a) *Drawing Hanks Production Register*.- This register is maintained to exhibit the total number of hanks produced per day in both the shifts.

(b) *Hanks Production Register*.-This is a register supplementary to the Drawing Hanks Production Register and gives details of the cotton hanks processing.

(c) *Drawing Wrapping Register*.-(d) *Sample Wrapping Register*.- These registers are maintained to enter the strength of slivers whenever tested and show whether the standard is maintained throughout.

6. *Spinning Section*.-(a) *Yarn Production Doff Weighment Register*.- This gives information regarding the production of yarn per shift per frame per day and gives gross weight and net weight.

(b) *Unreeled yarn stock Register*.- This register is posted from yarn production register with the quantity produced per day and the quantity issued for reeling per day and also the balance of unreeled yarn at the close of each day.

(c) *Hanks Production Register*.- The figures as shown in the indicator of the machine is recorded in this register.

(d) *Pneumofil Waste Chitta*. -Gives details of the waste of cotton in the frames worker-war daily. The acknowledgement of the worker is obtained in the Register as having accepted the quantity as correct.

(e) *Pneumofil Wage Percentage Register*.-This register furnishes details of total percentage of waste cotton per shift per frame. A commission is given to each worker if the waste is less than a fixed per cent.

(f) *Spinning Production Commission Register*.-A commission is usually given to the worker every week, as an incentive for the production of yarn over and above the standard weight fixed. The Register is maintained to arrive at the above commission.

7. *Reeling Section*.-

(a) *Doff Receipt Register*.

(b) *Main Doff Register*.- These Registers give the total production per shift per day and also the total monthly production by each worker.

(c) *Monthly Wages Register*.- This Register is posted from the Doff Register and gives details of total doffs produced by each worker and also the wages due to him.

(d) *Reeled Yarn Stock Register*.- This gives details of daily receipt and issue to bundling section and also discloses the closing stock every day.

8. *Bundling Section* (a) *Bundling Production Register*. -The receipt of yarn from the Reeled Yarn Stock Register is posted in this Register and also the number of bundles produced per day.

(b) *Bundle Yarn Stock Register*.- The total receipt of bundles is entered from the Bundle Production Register and after entering the issue of bundles daily to Bale Section, the balance as on the close of the day is arrived at both in number and in weight.

(c) *Bale Stock Register*.- It gives details of the opening balance of each day, receipts and issues for sale per day together with the closing balance of stock on hand in bales.

The auditor should carefully go through the bylaws of the society. He should enquire the practice and system of effecting purchases of raw materials like cotton. In respect of the purchase of stores the requirement should be passed by the factory Manager and then orders placed for purchases. In such cases the auditor should verify whether the purchases are approved by competent authority and are in accordance with the subsidiary regulations framed for that purpose. The auditor should verify whether arrangements are made to tally the balance of stocks, Stores register with the priced stock ledger maintained

K. AUDIT OF OTHER SPECIAL TYPES SOCIETIES

I (1) *Motor Transport Societies*.-In auditing the accounts of Motor Transport Societies, the Auditor has to devote more attention to the following points, viz.

- (a) On the accounting of daily collections of the vehicles,
- (b) On the cost of repairs and renewals; and
- (c) On the proper maintenance of spare parts and tools.

In order to examine the daily collections, the Auditor has to examine the following records also:-

- (i) Trip Card
- (ii) Chalan of remittance.
- (iii) Vehicle (Bus) collection Register.

The trip card contains the vehicle (Bus) number, date etc. and also provides columns for recording the number of tickets sold denomination wise. It is by means of this card that the Conductor works out the total number of tickets sold. The collection of a day is remitted to the Society by means of a chalan.

Vehicle (Bus) Collection Register is opened with the chalan of remittance, and is intended to record the daily collections of all the vehicles (Buses) and batta, etc. paid to the operating staff. It is from this register, that total collection of the day is posted to the Day

Book. The Vehicle (Bus) Collection Register contains columns for Vehicle (Bus) number, Date, Shift number, chalan number, amount name of the Conductor and Driver, batta, etc. paid to them, etc.

In the case of lorry services, the rate is fixed per Kilometer. To hire a lorry, the parties have to book the lorry by paying an advance. After the transporting is completed the lorry driver can receive the balance of hire charges, and issue a temporary receipt for the balance amount. The collections during return trip can be made by the driver, by issuing temporary receipt. The collections by the lorry driver have to be verified with reference to the duplicate of the temporary receipt book, trip sheet, etc. The Society has to issue regular or permanent receipt thereafter. The Auditor has to check the daily collections of buses and lorries very carefully.

In the case of societies which run workshops, indents for the supply of spare parts for the repairs of the vehicles should be signed by the Foreman. The replaced or condemned parts should be accounted for separately. The Auditor has to vouch the issue of spare parts with reference to the concerned ledgers, viz. the Stock Ledger, etc.

The Stock Register has to be checked with the indents and the log books of the concerned vehicles. The stocks have to be verified on the close of the accounting year.

With regard to consumption of petrol or oil, it varies from vehicle to vehicle and depends on the age of the vehicle. The Auditor has to compare the consumption of fuel, with reference to that of the previous year. The society should send the vehicles for mileage test to the competent authority in time. If the study of log book reveals any sudden increase in the consumption of fuel for a particular period the matter should be examined in detail and ascertained as to whether there is any convincing reason for the same.

2. *Labour Contract Societies.*-Labour Contract Societies take contract of work and execute the same directly employing members on piece work basis/ on daily wages or by giving sub contract to groups of members. The Society may be executing a number of works at a time. In order to enable the auditors and other authorities to study the economics of each work the societies have to maintain separate accounts in respect of each work. In the

register maintained for the purpose, separate pages will be allotted to record the transactions in respect of each work. It will contain details such as the nature of work, estimate, nature of execution, amount spent, margin of profit etc. The auditor has to check this register critically and note delays in the execution of work and ascertain as to whether there is any violation of conditions on which the work is undertaken. The auditor should study whether the society employs its members in the execution of work and examine whether the members are really benefitted.

Under the Special Employment Programme, a number of labour contract societies have been organised. Financial assistance by way of share capital contribution and managerial subsidy are provided to these societies by Government and the Kerala Employment Promotion Corporation. As per the existing pattern of assistance, share capital contribution of Rs. 5,000 and managerial subsidy of Rs. 6,270 are available to these societies. The Societies which have availed these assistance should maintain separate register to record these assistances. The auditor should check this register, with reference to the orders sanctioning the assistance, utilisation, etc.

3. *Employees' Co-operative Credit Societies.*-Employees Credit Societies advance loans for non-agricultural purposes. The auditor has to examine the bylaws of the society to ascertain the purposes for which loans can be sanctioned, the individual maximum borrowing power, maximum loan permissible etc. etc.

(1) *Sanction of loans.*-Loan applications received should be entered in the Register kept for the purpose. The auditor has to examine the loan applications with the relevant records maintained by the Society and the details such as the amount of shares held by the member, balance of existing loans, if any, liability of surety, etc. The member's credit worthiness and the Liability Register should also be examined while scrutinising the application for loans. It should be seen whether individual and total limits fixed for different types of loans as per bylaws have been exceeded. Loan applications and loan bonds should be checked carefully and it should be ensured that no unauthorised corrections are made therein.

(2) *Disbursement of loans.*-As far as possible, disbursement of loans should be, made by means of cheques. If, in any case, loans

are disbursed in cash, the auditor has to see whether the borrower has been properly identified and the payment made in the presence of one Committee member/two reliable witnesses.

(3) *Recovery of dues by the Society.*- Section 37 of the K.C.S. Act, empowers the pay disbursing officer to recover any dues, payable to the society, provided the member concerned has executed an agreement in the form prescribed under the Act, authorising the pay disbursing officer to recover the dues of the society. Monthly recovery sheets sent to the employer showing dues of the society under different heads to be recovered from the salary/wages of the member should be checked and the total amount of recoveries posted in the individual accounts should be reconciled with the total recovery remitted to the society by the employer. It should be ensured that a regular receipt from the printed Receipt Book has been issued to the employer for the amounts received from him. Signature of the person paying the amount on behalf of the employer should be obtained preferably on the back of the carbon copy of the receipt issued. Even in cases where remittances are sent direct to Bank for credit to the account of the society, official receipt should be issued by the Society.

(4) *Preparations of overdue debts.*- After preparing a detailed list of overdue debts, the auditor has to check the Arbitration Register in order to ascertain the progress in the recovery of overdues. Classification of overdue debts into good, doubtful and bad should be properly made, and adequate provision made in the audit certificate for bad and doubtful debts. Overdues should also be classified year-wise and according to the security available, nature of realisability, etc. etc.

4. *Co-operative Sugar Factories/Mills.*-Before commencement of audit, the auditor has to familiarise with the various books of accounts and records that are maintained by Co-operative Sugar Factories/Mills, the nature of their transactions, method of accounting etc. The under mentioned books of accounts are some of the most important records that are to be specially checked by the auditor.

I. MAIN SECTION (ACCOUNTS)

1. *Day Book.*-This is to be maintained according to the double entry system of book keeping with columns to record all the daily transactions of cash and total of adjustment (transfer) as per

receipts and vouchers and credit entries of daily totals of subsidiary registers.

2. *Journals*.- Three journals are maintained viz., purchase journal, sales journal and journal proper.

(i) *Purchase Journal*:

All purchases of store materials other than sugarcane, are entered in this journal. The Auditor has to check the paid bills and their adjustments with this journal and ensure that all the bills have been correctly entered therein.

(ii) *Sales Journal*:

The invoices of materials sold viz., sugar, molasses etc., are entered in this journal. The Auditor has to check the invoice with this register.

(iii) *Journal proper*:

All adjustments of accounts other than those entered in the purchase and sales journals are entered in this register. The journal proper is mainly intended for passing transfer entries, closing entries of accounts, rectification entries etc. The Auditor has to check the journal slips (formal vouchers) with the journal entries and has also to cross check the entries with ledgers.

3. *Ledgers*.-Three important ledgers are maintained viz., (i) General Ledger; (ii) Personal Ledger; and (Hi) Expense Ledger.

4. *Cane payment Register*.-This is intended to record details of cane supplied by ryots/members, its value and final payments to them after due deductions of advances, loans etc., if any.

5. *N.R.D. Register*.-This shows details of collection of non-refundable deposits from-ryots and interest due thereon at the close of every year.

6. *Molasses and Press mud Stock Register*.- This shows details of the production, issue and balance of each item.

II. CANE SECTION

The following are the important registers kept in Cane Section :

- 1 . Planting register
2. Agreement register
3. Month-war register of cane supply.

4. Cutting order register.
5. Cane purchase register.

III. STORES AND MANUFACTURING SECTION

(a) *Stores:*

(i) *Cardex*.-This shows the opening stock, purchases, issues and closing balance of each individual item of store stock.

(ii) *Bin Card*.-Particulars of stock with balance as on date.

(b) *Manufacturing*

(i) Daily manufacturing report- Daily arrival of cane, cane crushed, yard balance, production of sugar, sugar in process, molasses and other bye-products and on process, fuel, firewood, and other chemicals used, percentage of recovery etc., are entered in this register.

(ii) Sugar stock register:

IV. DISTILLERY

Co-operative Sugar Mills/Factories which have distillery units, will have to maintain the following registers:-

- I. D3-Molasses stock register.
2. D3 (b)-Production, attenuation efficiency register
3. D5-Stock register of each finished good.
- 4.D4-Production registers of day receivers.
- 5.Raw material stock register.
6. Vending fee register.

The Auditor has also to check the muster roll of the labourers, and their acquittance, Expenses Ledger, Cost of Production Register, Cane Production Register, purchases of ryots who are supplying cane etc. He may also call for confirmation certificates from the members /ryots who are supplying cane to verify the balance, if any, due to them. The Auditor has also to ensure that efficient systems for internal checking and for internal audit of accounts are in vogue in the society. He may also qualify his report with suggestions, if any, for reduction in the cost of production of the end products.

5. *Primary Land Mortgage Banks.*- Besides checking general aspects concerning the working of the Bank, the Auditor has to check the following aspects also.

(1) *Loan Application Register.*-The Auditor should ensure that the Bank keeps a record of all loans application received and that such loan applications are disposed off as expeditiously as possible. Instances of long delay without valid reasons should be enquired into and cases, if any, pointed out to the Managing Committee for action. Thorough scrutiny is also necessary as to the proper accounting of administrative charges, legal fees, fee for encumbrance certificate etc., realised from the loanees.

(2) *Scrutiny of loan applications.*-All papers connected with sanction of loan, are to be thoroughly examined. The following aspects deserve special attention.

(i) Whether legal opinion has been obtained as regards clear title, previous encumbrance of the property etc., and the borrower's right to create a charge on the property, its marketability etc.,

(ii) Whether certificate of the Village Officer has been obtained as to the possession and enjoyment of the property by the borrower.

(iii) Whether a realistic assessment of the income and repaying capacity of the borrower has been made.

(iv) Whether the Bank has obtained valuation and final report of the valuation Inspector and that the Bank has advanced loans only in proportion to the value of the land and within the limit prescribed in the bye-laws of the Bank.

(v) Whether final sanction of the loan has been given by the Managing Committee/Executive Committee for purposes specified in the bye-laws of the Bank.

(vi) Whether the Bank has obtained mortgage deed and other connected documents duly examined by the borrower as per rules.

(3) *Borrowings from Central Land Mortgage Banks.*-The Auditor has to examine the day book, borrowing ledger, loan sanction orders etc., and see that all loans issued by Central Bank have been properly accounted in the books and that amounts drawn has been utilised for disbursement of loans according to the loan sanction order. The timely repayment of instalments to the Central Bank

should also be looked into. Instances of diversion of funds and delay in refunding the undisbursed loan portion to the Central Bank should be pointed out. He should also verify whether the loans closed at the primary bank level have been closed at the Central Bank also.

(4) *Verification of utilisation of loans.*-In cases where loans are required to be disbursed in instalments, it has to be verified whether proper utilisation certificates are obtained before the disbursement of 2nd or subsequent instalments. The Bank should have arranged spot inspection through their officers to ensure utilisation of the loan for the purpose for which it was sanctioned. The auditor should test check a few spot inspection/verification reports of the Bank supervisors in order to verify whether verification/inspection has been made by actually visiting the spot or by physically verifying the pumpset Engine etc., and that the verification report is complete in all respects. It should also be ensured that the Board has taken appropriate action to realise the loan in lump, where cases of utilisation has been reported. In respect of all loans the Bank should have obtained final utilisation certificate and filed it after due verification by competent officer.

(5) *Recovery of instalments and classification of overdues.*-The position of recoveries, both under principal and interest, as compared to demand, should be reviewed by the Auditor. Undue delay on the part of the Bank to recover the instalments from the borrowers through persuasion or otherwise should be pointed out. A classified statement of overdues should be prepared and checked with the balances appearing in the loan ledgers. All overdues should be classified into good, doubtful, and bad by the Auditor.

(6) *Reconciliation of Central Bank's account.*- The Auditor should obtain a statement of accounts from the Central Bank and check the same with the accounts of the primary bank and get the accounts reconciled. Cases of difference should be investigated into.

(7) *D. V. Files.*-The Auditor should also verify whether the primary Banks have forwarded to the Central Bank all D. V. files punctually.

6. *Primary Housing Co-operative Societies* (i) *General.*-Housing societies grant Medium term and long term loans to its members

for construction of new houses or for repairs to existing houses. The construction is directly undertaken on proprietary basis or loans advanced on agency basis for the construction.

(ii) *Source of finance.*- The primary Housing Societies obtain finance from the Apex Housing Society/Government who raises funds by way of loans from L. I. C. by floating debentures on Government guarantee and by raising share capital from member societies and Government. Since the interest rate on the finance given by L. I. C. varies from time to time, such variation has to be reflected in the rates charged by the Primary societies also. The Primary societies are permitted to retain a margin of interest of not more than 1 % on funds received out of L. I. C. funds. The Auditor has to ensure that the margin of interest charged on loans does not exceed the limit permitted as per Rules. Since the society can charge interest as per bye-laws on loan raised from sources other than L.I.C. the Auditor has to see that the society realises interest subject to the maximum prescribed in the bye-laws.

(iii) *Sanction of loans.*-Where loans are sanctioned for acquisition of house or house site together, or for the construction of house on land or plot owned by the borrower, the society should also examine the documents of the property such as title deed, tax receipts, encumbrance certificate, possession and enjoyment certificate etc. The legal opinion should also be verified by the Auditor.

(iv) *Verification of mortgage deed and tax receipts.*- The mortgage deeds executed by the members and the connected records in the loan file should be verified with the loan ledger, minutes book etc., It should be ensured that the borrower remits the tax on the building and land punctually and receipts produced in the society for verification and filing.

(v) *Disbursement of loans.*-It should be ensured that the loans received from the Government/Apex Housing Society are disbursed to the concerned members on whose behalf the loans are sanctioned. Deviation if any should be examined and satisfactory explanation obtained.

(vi) *Release of loans instalments.*- Loans are released by Government Apex society in instalment according to the stages of construction. Therefore, the auditor should examine the relative

records and ensure that the Board of Directors have adopted necessary resolutions in time for release of installments from the Apex Society after satisfying about the progress of construction. It should also be ascertained whether loans are repaid by the members as agreed to in the registered mortgage deed. Instances of inaction or absence of effective action against defaulters should be suitably pointed out.

(vii) *Repayment of instalments to the Apex Society.*-The primary societies have to repay the loans to the Apex society/Government in annual or half yearly instalments, within a period of 5 to 20 years. The Auditor should verify whether the society has remitted the instalments to the Apex Society/Government on or before the due dates. The primary society has to pass on to the Apex Society/Government the entire recoveries in respect of loan assisted from the Apex Society/Government.

(viii) *Loans for repairs etc.*- In some societies loans are issued out of the society's own funds for purposes mentioned in their byelaws, like construction of or extension or repairs to etc. of the houses. In such cases, it has to be ascertained whether the loans are disbursed for purposes mentioned in the bylaws. The auditor should also ensure that loans assisted from the funds of L. I. C. are utilised only for construction of new dwelling houses.

(ix) *Collection of group insurance premium.*-The L. I.C. collects from the Apex Society, 1% of the loan sanctioned to it, by way of premium for the Group Insurance Scheme, for the benefit of the borrowers. Under this scheme, the lives of the borrowers will be covered from the first of the month following the release of the loan. The Apex society collects this premium from the Primary society along with interest on loans. The Auditor should check whether the society collects the premium @ 1% from its members along with the collection of interest.

(x) *Valuation of building.*-In the case of house construction societies as soon as the construction of houses is completed, they should be got valued through a competent Engineer and the Valuation certificate filed in the society. The Auditor should verify whether the society has obtained and filed valuation certificates for the expended amount.

(xi) *Insurance.*-Every house, constructed out of loans availed from the society, should be got insured against fire/earthquake etc.,

and the policy assigned in favour of the society. It should also be ensured whether the insurance policies are renewed periodically and for amounts upto the loans outstanding.

7. *Co-operative Hospital and Dispensaries -Special points to be looked into by the Auditor.*-(1) *Vouching of Receipts.*-Collections of Co-operative Hospitals/ Dispensaries mainly consist of Registration fees, cost of medicines, service charges X-rays and E. C. G. charges, charges for Laboratory investigations, room rent from inpatients etc. These collections are classified and entered in a register. The consolidated totals of the same are taken to the Day Book daily. The collections on account of each item is to be checked with the help of the concerned registers, inpatients and out patients tickets, case sheets, receipts etc. The Auditor should ensure that the society has realised the charges in accordance with the sub rules approved or rates fixed by the board from time to time. The receipts should also be checked with the collection Register and see that all collections are accounted for in the books of the society promptly.

(2) While verifying the Collection Register, the Auditor must be vigilant to ascertain as to whether all the issues of medicines and consumable Laboratory articles are made under proper orders of the Medical Officers and whether cost of the same has been realised from those who are liable to pay.

(3) *Purchase of Medicines, Laboratory Equipments etc.*-Indents for medicines and laboratory equipments are to be duly approved by the Medical Officer (in charge of purchase of medicines) or Board of Directors. In the case of items of heavy cost the indents are to be signed by the Secretary after approval as above. All purchases should be effected from approved sellers or Manufacturers and after observing the store purchase rules to the extent possible. The auditor should also ensure that the Medical Officer has satisfied and certified about the quantity, quality etc., of the Medicines purchased. The purchases should be the minimum required for a reasonable period. Special care should be taken that the medicine used within its actual lifetime and that no medicine is used after expiry date. The auditor should also check utilisation of the equipment grant, subsidy towards cost of staff, share capital contribution and other assistances, if any, received by the society.

(4) *Re-imburement of date expired medicines.*-The auditor has to watch whether the society has taken timely action to get

re-imburement of date expired medicines in the stock. At the same time, care should be taken to see that the value of such stock are not included in the total value of stock, while arriving at the closing stock.

8. *Harijan Co-operative Societies.*-Apart from the common features in the audit of Co- operative Societies, the auditor has to concentrate on the following main items also.

(1) *Collection of shares.*-Majority of members of Harijan Societies are economically weak. To facilitate easy payment of share capital byelaws of such societies provide for, payment of share amount in instalments. The Auditor should examine whether, collection of shares in instalments has been effected in accordance with the provisions of bye-laws, and whether share accounts in which there is heavy default have been transferred to the Reserve Fund/ Building fund, as provided for in the byelaws.

(2) *Admission of members.*-In order to carry out the functions of the society efficiently, the bye-laws of Harijan Societies provide for admission of a certain percentage of non-harijans as members. In such cases, the auditor has to ensure that the society has maintained the proportion prescribed in the byelaws.

(3) *Working capital grant.*-Proper utilisation of working Capital grant, if any, sanctioned to the society has to be verified by the Auditor. For this, he has to peruse sanction order and other relevant records and see that the grant has been utilised only for the purposes specified for in the sanction order. In the case of unutilised portion of grant, the question as to whether the society has refunded the amount to Government without delay has also to be ensured, The auditor is also to check the implementation of the scheme for which grant has been sanctioned.

(4) *Issue of loans to members.*-Since majority of the members of Harijan Societies are illiterate, acknowledgements for having received the loan amounts will be in the form of thumb impression only, These thumb impressions might not have been attested by any competent person. Therefore, the auditor has to get confirmation of loans outstanding from members in order to satisfy as to the genuineness of the disbursement of the loans and receipts, if any.

(5) *Raw materials Register.*-In the case of Societies engaged in production activities, the auditor will check the stock Register

of raw materials and their proper utilisation and the percentage of out-turns. In cases where the Societies have received any raw materials from Government at concessional rates, their proper utilisations also has to be ensured during audit.

(6) *Production Register*.-The production Register should be examined to ascertain whether the cost of finished products had been worked out correctly and their selling price fixed at reasonable rate in relation to the current market price of such items of similar quality.

(7) *Tangia Cultivation*.-In the case of societies which are allotted land from Government for Tangia cultivation, the Auditor should ensure that the lands have been allotted only to the members and that the rates fixed for allocations are reasonable etc.

9. *Autorickshaw Co-operative Societies*.-In addition to the general matters, the auditor has to check/examine the following aspects also while auditing these societies.

(1) *Admission of members*.-These Societies are organised mainly to provide employment to educated unemployed persons who possess valid driving license. The auditor has to verify whether those admitted as members, possessed the required qualifications.

(2) *Allotment of Autorickshaws*.-The societies normally get allotment of autorickshaw chasis, through State quota, on the recommendation of Government/Registrar. The auditor has to verify whether the society maintains proper records with regard to the purchase of autorickshaws, also indicating the chasis number, date of purchase price etc He has also to examine the procedure followed by the society in the body building of rickshaws; whether the work has been done after observing the required formalities,

(3) *Allotment of vehicles*.-The vehicles should have been allotted to members on proper resolution of the Managing Committee and according to priorities. The vehicles should have also been registered with the Transport authorities and necessary taxes remitted to ply the vehicle on the road. Insurance policies covering the risk in respect of each vehicle are also to be verified.

It should be verified whether the total loan debited in the name of an allottee, on account of value of the vehicle, cover all expenses incurred by the society to put the vehicle on road. The Auditor

should also verify acknowledgements in token of receipt of the vehicle and also Hire Purchase/ Hypothecation deed executed in favour of the Society hypothecating the vehicle.

(4) *Remittance of collections.*-It should be ensured whether members were prompt in remitting the daily collections towards the loan account as stipulated in the agreement. Instances of failure should be enquired into in detail with special reference to the action taken for recovery.

(5) *Running of workshop.*-Where the society is running a workshop mainly for the benefit of its members, it should be ascertained whether the members are availing of the services of the workshop. The economics of the workshop should also be examined during audit.

10. *Poultry farming Societies.*-In addition to the general aspects, the Auditor has to check the following points also.

(i) *Loans to members.*-Loans are disbursed to the members for various purposes, such as construction of poultry sheds, purchase of birds, feed etc. The auditor will ensure that those loans are disbursed to the members on the very same terms and conditions imposed by the financing agencies such as State Bank of India, State Government etc. He should also see that repayments of such loans are made promptly. In the case of loans issued by SFDA, subsidy will be disbursed on full utilisation of the loan amount. In such cases it has to be ensured that subsidy is released after due verification of the utilisation of the loan portion.

(ii) *Egg Collection Register.*-The eggs collected by the society from the members are sold to the nearest IPD Units. The daily collection of eggs are first entered in this register and subsequently transferred to the personal accounts of the members. The Auditor has to check the entries in both these registers as well as individual postings in the personal accounts.

The weekly sale of eggs as revealed in the consolidated stock Register should be compared with the totals of the Daily Egg Collection Register. Abnormal difference if any, between procurement and sale of eggs should be enquired into. He should also satisfy the percentage of damages allowed is the minimum and within the reasonable limit and supported by proper and valid authorisation.

(iii) *Confirmation from IPD Units*:-in the case of societies which adopt credit sale of eggs to the IPD Units, the auditor has to obtain necessary confirmation for the outstandings from with those units.

(iv) *Supply of feed by societies*:-In the case of societies, which get the feed on the recommendation of SFDA, the Auditor will ascertain as to whether the societies effect the sales at the rates fixed by the Agency. In such cases, he will ensure that the society has collected and accounted the commission due in the audit year.

11. *Circle Co-operative Unions*:-During the course of audit of Circle Co-operative Unions, the following points in addition to those generally examined are to be looked into by the Auditor.

(1) *Register of Societies*:- The Auditor should ensure whether the Circle Unions maintains a Register of Societies in the Circle with the following particulars.

- (i) Register No. name and date of registration of the society.
- (ii) Paid up Share capital.
- (iii) Date on which affiliated to Circle Union.
- (iv) Details about the collection of affiliation/renewal fees.

The Auditor should check these particulars with reference to the records available in the Union.

(2) *Affiliation fees Remittance to the State Union*:- The Auditor has to examine whether affiliation fees are duly collected from all the Societies affiliated and 50% of such fees remitted to the State Co-operative Union.

(3) *Utilisation of grants*:-The Auditor should examine whether grants if any received by the Circle union from State Government or from any other agency has been duly accounted for in the books of the Union and utilised for the purpose for which it was sanctioned.

(4) *Propaganda and Education*:-The Auditor should ascertain as to how far the Union has succeeded in propagating Co-operative Education by conducting study classes for the employees and/or directors of Co-operative Societies.

(5) *Budget*:-It should be examined whether annual General body meetings are held in time and budget passes and programmes of activities for each are approved in such meetings. It should also

be ensured that a copy of the budget estimate and programme of activities have been sent to the State Co-operative Union and Registrar, as required under Rule 147 of the Rules.

(6) *Meetings*:-Whether meetings of Managing Committees are held monthly and decisions taken on papers received for opinion of the Union such as amendment to byelaws, supersession of committees of affiliated societies winding up of societies etc. Delay in the disposal of papers referred to the Union and meetings which could not be held for want of quorum should be noted and commented upon.

(7) *Maintenance of registers*:-The auditor should ascertain whether the Union has maintained the following registers with up-to-date information.

(i) Register of Directors of affiliated societies.

(ii) Register of employees of affiliated societies.

(iii) Service register of employees.

In the case of Circle Unions which have engaged paid staff;

(iv) Affiliation fee Register

(8) *Byelaws of affiliated Societies*:-Whether copies of the byelaws of each affiliated society in the Circle has been obtained and kept.

12. *Co-operative Canteen/Restaurants, Special features to be examined by the auditor.*

(1) *Production Register/Conversion Register*:-Raw materials required for the production of various items of eatables will be supplied from the main stock to the Chief cook daily/weekly which will be entered in the production register/conversion register. It should be ensured that issue of articles from the main stock, are properly accounted for in the books of accounts maintained by the Chief cook.

The relevant resolutions of the managing Committee/business Committee, fixing, production ratios for production of each unit of eatables, with a specified quantity of raw materials, should be verified, and it should be ensured whether such minimum ratios have been achieved in producing furnished products by the Chief cook. Say for example:-

(a) Number of meals that can be produced by cooking one kilogram of rice.

(b) For preparing 100 cups of tea how much quantities of milk, sugar and Tea/Coffee are required or with one litre of milk, number of cups of Tea/Coffee that could be produced etc. (different ratios are seen fixed by societies in this regard).

The production register has to be checked with the sales register to see whether the entire production has been sold in the canteen and, if not, the arrangements made to destroy perishable items.

(2) *Liability register*:-The liability register maintained at the kitchen, showing the liability of cook in respect of articles supplied from the main stock, should be checked with production register to see that the cost of articles supplied to the kitchen compare with the cost of articles produced. If there is wide variations the causes for such abnormal variation should be investigated.

(3) *Coupon Redemption Register*:-Where sales have been effected on the basis of coupons sold in advance to the members, the auditor should check this register with the coupon issue register to ascertain that the total value of coupons sold in advance, has been correctly recorded in this register in order to assess the actual liability of the society in meeting the demands of the members. Similarly the daily/weekly sales effected on the basis of coupon, should be entered in this register, reducing the total liability of the members. While preparing the final accounts, the outstandings as revealed by this Register, should be treated as a liability of the Society. The arrangements made by the society, in destroying the coupons returned on account of Sales effected should be examined. It should be examined whether the society conducts periodical reconciliation of unused coupons kept with the members.

(4) *Credit Sale of Coupons*:-In Societies, where the system of credit sale of coupons is followed, the auditor should check the personal accounts of the members who avail such facilities. The outstanding balance under this head should be treated as an item of asset while preparing the final accounts.

In certain societies, a different procedure is followed for issuing coupons on credit. At the time of issue of coupons on credit, a loan, equal to the value of coupons issued on credit will be shown

as issued in his name. In such cases, the auditor should check the loan ledger, with the recovery schedules etc.

13. *Literary writers Co-operative Societies.*

Specials aspects to be looked into by the Auditor 1. *Membership.*- Membership in Literary writers Co-operative Societies is usually restricted to persons engaged in literary works. If the byelaws provide for the admission of persons other than those engaged in literary works, to a limited percentage, the Auditor has to be ensured whether the society has strictly complied with the provisions.

2. *Printing Section.*-If the society is running a printing press, all printing works should be got executed through it, to the extent possible. Wherever deviations have been noted by the Auditor in entrusting the work of printing with other printing press, it has to be examined whether, the society has followed the normal procedures, viz., inviting of quotations etc. before entrusting the work with outside parties. The printing order form given from the Publication Department, for printing books etc., should be checked with the Register kept in the press to ascertain whether manuscripts of books given for printing are kept unattended in the press for long.

The Auditor has to ascertain whether the society has observed the necessary formalities for purchase of paper, ink and other materials. He has also to examine the stock register of printing materials. While examining the stock register, the Auditor will make an assessment of the consumption of printing materials required for printing a specified number of books, with those issued for the purpose and decide whether they are reasonable. He will also enquire about the percentage of wastage, if any, allowed by the society and compare it with the actual wastage. The annual working results of the printing unit has to be assessed and short comings, if any, indicated with suggestion for its proper working.

Publication Section.-All publications should have the prior approval of the committee of the society. As the books are to be printed and published according to priority, the Auditor has to examine the deviations, if any, from the approved policy and decide whether such deviations are justifiable.

In case the society takes up printing, publishing and sale of books at its cost on behalf of authors, care should be taken to see

that the society does not take up printing and publishing of books which are difficult for sale, because the investment of the society will be locked up in such cases.

(a) *Copyright investment Register.*-The Auditor has to ascertain whether the committee has laid down specific norms for fixing the value of copyright and whether these norms have been strictly followed.

The copyright investment register has to be examined to ascertain whether all the titles purchased have been published or whether they are ready for publication. In the case of titles purchased and remaining unpublished for long, the reasons for such pendency should be ascertained. The copyright agreement may be checked with copyright investment register, the day book with the voucher for payment of amount and with the copyright investment register.

(b) *Royalty.*-In the case of books published on royalty basis, the royalty agreement has to be examined to ascertain whether the agreement has been executed as soon as the selection of the title is made. It should also be ascertained whether the society has printed and sold only the number of copies as agreed. Printing of books beyond the valid period of agreement should also be located in Audit. If it is for pre-publication sale, the agreement must have been executed before starting the work of pre-publication.

Since the offer of pre-publication concession extends to a specified period only, it may be ensured that such concession were allowed only to those who remitted money within the time limit specified for the purpose.

Since the royalty payable is calculated on the basis of books sold, the Auditor will verify the stock register and see that no excess payment is allowed on this account. Statements showing the sale of books, amount of royalty payable etc., are to be prepared both for publication and distribution books and got checked. The Auditor will also examine the subsidiary rules, if any, framed by the society for the purchase of royalty and ensure that there had not been any violations. The concerned board resolution should also be verified.

Distribution Section.-Distribution books are published by the society at the expense of the authors concerned. The terms of

agreement of distribution books have to be verified in order to ascertain the mode of payment of sale proceeds, commission etc. It may be ensured whether payment has been made to the party, before the actual sale of the books, which is against rules. It may be verified whether payment on account of sales of distribution books, has been made entirely on the basis of the half yearly verification of stock at the various depots/Agency/Branches. Proper realisation of commission on sales is another important aspect which has to be looked into by the Auditor. It should also be assessed whether the commission realised on sales is sufficient to meet the expenses in connection with the sale of such books. As the distribution books are not treated as purchases, the possession of stock with the society is indicated by showing the value of the books in both sides of the balance sheet.

Agency system.-Accounts relating to the agencies are to be checked. The agreement executed by the Agencies should be verified to assess the security deposit to be furnished by the Agency, the maximum value of books that could be entrusted to the Agency for sale etc., and regarding the fulfillment of those conditions. The liability register, in respect of each agency should be checked to ascertain whether the agencies remit the sale proceeds regularly as per terms of agreement and the periodical reconciliation of balances outstanding with them.

Closing stock.-Method of arriving the cost price.-Calculation of cost price of closing stock is a very important aspect. An unrealistic assessment of cost price of closing stock will affect greatly the profit and loss position of the society.

(a) *Publication books.* - The opening stock of books at Face Value and cost price/value will be taken from the previous years Audit certificate. The face value of publication books published during the Audit year will be added to the opening stock of books at face value and the total arrived at. Similarly, along with the opening stock of books at cost price/value, the cost price/value books (which include material cost, printing expenses etc.,) published during the year will be added and the total cost price/value arrived at. In order to calculate the percentage of cost to face value of books, the total of cost value/price arrived at as above will be divided by the total of face value. The annual verification of stock will reveal the face value of closing stock. Multiplying the face value of closing

stock by the percentage of cost price will reveal the closing stock at cost price for the preparation of final accounts.

(b) *Outright purchases.*-In the case of outright purchase of books, cost price will be the actual Purchase price. The cost can be arrived at by deducting the commission earned in effecting the purchase. The method of calculation of percentage of cost and assessment of the value of closing stock at cost price will be the same as in the case of publication books.

(c) *Charging of depreciation on books.* -Depreciation has to be charged on books according to the age of books. The rate at which such depreciation has to be charged will be fixed by the Registrar from time to time. The rate now fixed is as follows:-

(i) No depreciation has to be charged on books which are upto 5 years old.

(ii) Depreciation @ 5% to be charged on books which are 5 to 10 years old.

(iii) Depreciation @ 10% to be charged on all books which are more than 10 years old.

Book shelf, Book instalments, Novel Club etc.-These are schemes designed to boost up sale. It may be verified that such schemes have been started on proper resolution of the Managing Committee of the society. The sub rules formulated for each scheme should be examined. The Auditor has to ascertain whether they are complied with fully.

Branches.--Usually the control of sales units/branches will be exercised by the sales wing of the Head office of the society. The books/publications for sale will be distributed among the branches from the main godown. In order to ensure proper accounting of books transferred from the main godown to branches, the transfer bills of books issued by the godown keeper have to be checked with the liability register/stock register maintained at branches.

With regard to the checking of sale proceeds of branches, the Auditor will check the daily extracts of sales with the ledger, and the ledger with the Day book.

Reconciliation of Branch accounts.-It should be ensured that the society conducts periodical reconciliation of branch accounts.

The working results of each unit will be assessed realistically and deficiencies if any pointed out indicating suggestion for improvement.

Monthly reconciliation of Head Office account with the accounts of Publication, Distribution and the sales wings of the society should be ensured. Similarly reconciliation of agent's accounts with Head office accounts is also necessary.

The auditor has to check whether all the stock in sale depots, godowns, press, Head office etc., are adequately insured and policies kept alive.

14. *Toddy Tappers /Producers' Co-operative Societies-Special Features.* I. Accounting of business transactions in a toddy tappers /producers' Co-operative society can be broadly classified into three major heads.

- I. Tapping of Toddy.
2. Pooling and distribution.
3. Sale through shops.

1. Tapping of toddy.-(a) Coconut trees are taken on hire basis by the society and allotted to tappers. The rate of hire charges (Chethupattam) will be decided by the managing committee of the society from time to time. For tapping the trees, the owners are paid "Chethupattam" direct by tappers which will be ultimately met by the society. The auditor has therefore to see whether "Chethupattam" is paid only on properly prepared bill and passed by competent authority.

(b) Chethu Cooly includes wages payable to tappers, charges incurred for transporting toddy from the field to the storing place and the dearness allowance. It has to be ascertained whether 'Chethucooly' is paid at the rates prescribed by the managing committee and are supported by bills duly passed by competent authority. Since 'Chethucooly bills' serve the purpose of acquittance also, the auditor will verify these bills to ensure that proper acknowledgements have been obtained for payments made.

The auditor has also to verify the wage rolls on account of payments made towards "Orukkufees" Upakarana fees, Ayudha Allowance and dearness allowance.

(2) *Pooling and distribution.*-(a) *Pooling*-Toddy tapped are carried to the various stores/shops by the tappers. Toddy will be measured and taken to stock by the store Managers/shop Managers and necessary entries made in the “Kallu Alavupass Book” of the tappers. Wage bills are prepared by the Managers from the books maintained at the stores. While checking the wage bills “Kallu Alavu” pass books of the tappers may be called for at random and correctness of the toddy measured and accounted in the stores/shops got verified.

The shop/store managers would be sending ‘a store memo’ to the Head Office indicating the stock of toddy in the store/shop every day. Based on the ‘store memos’ received from different stores/shops, a consolidated stock Register will be maintained at the Head Office. It has to be cross checked during audit whether the actual quantity measured and stored as per store memo tally with the actual quantity measured as shown in the weekly ‘Chethucooly bills’ prepared and sent to the Head Office by the Managers. The store memos should also be checked with the stock register.

(b) *Distribution.*-The toddy pooled in the stores are distributed to the toddy shops for sale. It has to be checked whether proper invoices and delivery notes are prepared and signed by the store Managers and acknowledged by the shop managers. Issues from the stores have to be verified by checking the “Issue Register” / Daily stock statement, maintained at the store, with the Invoice prepared by its Manager. The reports of messengers who distribute the toddy to the shops may also be checked with the ‘Daily stock statement’ sent by the store Manager, to see whether the supply as indicated by both reports tally.

(3) *Sale through shops.*-(a) Toddy received from the store and toddy, if any, measured at the Toddy shops by the tappers, where there are no stores, are sold at rates fixed by the Managing Committee. The shop Managers will be sending ‘a daily shop statement’ to the Head Office indicating the stock of toddy, sales, and other petty expenses incurred in connection with the sale and the net sale proceeds handed over to the messengers. The messengers account has to be checked with the ‘Daily shop statement’ at random to see whether the toddy supplied at shop has been accounted for properly. While checking the vouchers of petty expenses at shops, the auditor should ensure that incurring

of such expenses is within their competence and supported by proper vouchers. In checking these vouchers, the auditor may use his discretion to check them entirely or at random or depend on the effective internal checking, if any, in force.

In order to ensure that all the sale proceeds entrusted to the messengers are remitted in the Head Office, the Messengers account may be checked with the daily shop statement regularly. The liability if any, of each shop manager is to be worked out and reconciled daily.

(b) *Destruction of Toddy.*-Unsaleable toddy has to be destroyed or transported to various distilleries as per permit. In case of destruction, it has to be ascertained that destruction has been made under the supervision of competent authorities, as authorised by the Managing Committee. Reports on the destruction of toddy may also be verified.

(c) *Accounting of sale proceeds.* -Toddy sales receipts remitted in office by the messengers as per chalan are first accounted in the cashiers' 'cash book'. A daily abstract will be prepared and the shop sales receipts and expenses are entered in the main day book from the subsidiary cash book. It has to be ensured whether daily receipts and expenses as exhibited in the subsidiary cash book are properly carried over to the main day book and whether all the daily receipts and payments are entered in the subsidiary cash book.

II (a) *Contribution under Kerala Toddy Workers Welfare Fund.*- It has to be ascertained whether welfare fund contributions at rates prescribed under the Act have been remitted monthly to the concerned authority on or before the due dates.

(b) *Remittance of Kist, tree tax etc.*-The terms on which the toddy shops have been entrusted to the society, may be ascertained by verifying the relevant orders in this regard. Timely remittance of Kist, tree tax etc. has to be verified in Audit.

(c) *Abkari Act and Rules.*-It may be ascertained whether the society has complied with the statutory requirements, if any prescribed in the Abkari Act and Rules, in conducting the Toddy shops and other transactions related to it.

Daily receipt and sales of stock are to be reconciled in respect of each shop and store, and each store and Head Office.

The auditor will review the working result of each shop during the audit period and appraise the Managing Committee of its performance with suggestions if any, for improvement.

15. *Primary Coir Co-operative Societies special features.*-(i) *Purchase register (Husk)*:-Procurement/purchase rates of husk is fixed by Government from time to time. Purchase is therefore to be effected from approved dealers at controlled rate. In order to ensure that purchases are effected only at controlled rate, the purchase bills are to be checked with purchase register. This will also enable the auditor to satisfy about the quantity procured, charges incurred for unloading etc. The day book is also to be checked with purchase register.

(2) *Stock register of retted husks.*-The quantity issued as per purchase register, for retting is to be checked with "stock register for retted husk". It should also to be ensured that when husks are entrusted to the Moopers/ group leader, for retting, his acknowledgement is obtained. The auditor may also examine the connected records to see that charges incurred for retting is reasonable and within the limits fixed by the Managing Committee.

As the retting of husk is done by Mooppan/Group leader etc., on furnishing sufficient security, the auditor has to verify the concerned registered documents, to satisfy about the adequacy of security furnished. He should also verify the inspection reports of the sub committee as to the existence of husk in the retting yard and see that such reports are placed before the managing committee for consideration.

(3) *Distribution Register of retted husk.* -The husks after retting will be distributed among the members/group leaders. For this the/society issues permits. Such permits may be checked with the distribution register to satisfy about the quantity issued. It may also be ensured that the number of husks retted in a Mooda and those taken out at a time tally each other. While distributing the retted husks to the members/leaders, their acknowledgements should be obtained.

The quantity issued as per distribution register is to be checked with 'finished goods receipt register' to ascertain whether, the required quantity of finished goods have been returned, as against the quantity of retted husk supplied. As the finished goods have

to be returned within a specified period after issue of retted husk, the auditor may ascertain whether, a second consignment has been issued, before returning the finished goods of earlier supply.

(4) *Finished Goods Register*.—The quantity of fibre contents vary during certain season. Therefore, some societies, divide the year into different terms, and fix the quantity of finished goods to be returned in each season. The Auditor may check whether, the members have returned the prescribed quantity of finished goods as fixed by the committee. In case, any concession/reduction has been allowed, on account of reduction in the fibre contents, the auditor has to ascertain that the society has made a realistic study of the fibre contents in the husk, before such reduction/concession has been allowed.

The auditor may also ensure that the total quantity of finished goods returned maintain the prescribed proportion to the quantity of retted husk distributed.

(5) *Acquittance/wages register*.—By checking this register, the auditor can assess whether coolie/wages have been paid only at the rates prescribed by the managing committee. It may also be ascertained that the total quantity of finished goods received in a day are properly accounted for in the stock register of yarn on the same day. This can be ensured by checking the finished goods receipt register with Coir/yarn stock register.

(6) *Labour Welfare Fund*.—It should be ascertained whether the society has accounted properly the welfare fund contributions of the workers.

(7) *Sales*.—As the sales are effected to Central Coir Marketing Society, on consignment basis, the concerned consignment account has to be checked by the auditor.

(8) *Sales tax Returns*.—The timely submission of sales tax and other statutory returns should be ensured by the auditor.

(9) *Insurance*.—It should also be ensured by verifying the insurance policies etc. that the stocks in possession of the society are adequately insured and policies kept alive.

16. *Central Coir Marketing Co-operative Society*.—Special aspects to be looked into by the Auditor:-

(1) *Purchase of coir.*- The main function of the Central Coir Marketing society is to procure coir produced by the Primary Coir Co-operatives and to market them at favorable conditions. Ordinarily, procurement is to be done from the primary Co-operatives only. Whenever, purchases are seen effected from outside parties, it may be ascertained whether such purchases are supported by sanction of competent authorities. Since the procurement rates of coir is fixed by Government, the auditor has to check whether the purchase price has not exceeded the limit. There may be instances where the society sells coir at a lower price than the procurement price. In such cases, the auditor may investigate into the reasons and assess the loss so incurred. If any loss has been caused on account of sales of inferior quality, the auditor may verify the report of the quality testing officer and fix responsibility for the loss.

(2) *Utilisation of building materials.*-The stock register of building materials may be checked in order to ensure proper utilisation of building materials.

(3) *Export sales.*- The order forms for export sales are entered in a register for execution. It should be ensured whether the society takes close follow up action with the bankers, for the realisation of value of coir sold. Since a majority of sales are being arranged on negotiation, the auditor may peruse the connected files and the market bulletins to satisfy that the society has entered into the contract at the best advantage of the member societies.

(4) *Export license.*-The licenses for export sales are being issued by Coir Board. The Auditor may make enquiries about the periodical renewal of the licenses, for export sales.

(5) *Branch accounts reconciliation.*-Separate day books will be maintained in respect of the branches. The auditor may verify whether the society incorporates the branch accounts periodically in the main day book and reconciliation done at frequent intervals. The auditor may also assess the working result of each branch, and suggest remedial measures to improve the working of branches running in loss.

(6) *Insurance.*-The Auditor has to ensure that the stocks both at Head office and Branches are adequately insured and policies kept alive.

17. Coir Mats and Mattings Co-operative Societies:-

Special features.-(1) *Purchases.*-The Requirements of mats and matting society, are met by the central coir marketing society. There may be instances where the mats and matting society effects direct purchases from primary coir co-operatives and also from individuals. If such instances are noticed, the auditor may enquire whether the purchase price of those articles have exceeded the rates prevailing in the central society and whether the articles so purchased were available at the central society during that period. In case, such varieties were available with the central society, the necessity for making such outside purchases should be enquired into.

When goods are purchased and brought to the society, a gate in-pass will be prepared as to the number of bundles. The goods so bought will be weighed and the weight noted in the weighment register. With that weight noted in the weighment register, the society prepares the purchase bill. The Auditor may check this bill with the “gate in pass” and weighment register to ensure that the weight and number of bundles purchased tally. Checking of these transactions entirely or at random, will be decided by the auditor considering the volume of transactions and the internal check in force. The stock so purchased will be then entered in the stock register noting “In pass” number and bill number.

(2) *Production and payment of wages.*-In order to produce different varieties of coir mats and mattings, the coir and dyeing materials will be supplied from the main godown. The Auditor may check the issues from the main godown with the production register and see that the quantity relate each other.

Wages are being paid periodically on piece rate basis. The totals of the wages register so paid are entered in the day book/journal. The production of mats and mattings as revealed by the wages register will be entered in the production register and from there to the stock register. The Auditor may check the production register and ensure that the prices of finished products, are fixed taking into consideration the material cost, manufacturing cost etc.

(3) *Sales Procedure.*-The minimum sale price of export quality goods are fixed by Coir Board. It may be checked whether the selling price of each quality is fixed realistically taking into account of the actual cost of production.

The goods sold will be sent out of the factory/society premises after noting the weight and other details in the despatch register. Goods will be sent out only by means of an out pass. The Auditor may check the stock register, despatch register and out pass to verify that, the quantity sold as per sale invoice and as revealed by the out pass tally. Generally the sale invoice will be prepared only after getting R.R./Shipping receipt. Till that is obtained, the stock sent out of godown, will be treated as stock with agents. In such cases, the auditor has to get confirmation from the agents.

(4) *Consignment sales*.-Where the society adopts consignment sales, the consignment account should be checked and tallied.

(5) *Branches*.-It should be ensured that the society reconciles the Branch accounts periodically. The Auditor may assess the working results of each depot and give suggestions for improving those depots which are working at loss.

(6) *Submission of statutory returns*.-Prompt submission of statutory and other returns and remittance of sales tax, including those for interstate sales should be ascertained during audit.

(7) *Insurance*.-Raw materials and finished products in possession of the societies should be insured adequately and policies kept alive.

18. Industrial Co-operative societies-General features.-Industrial Co -operative societies are mostly production and sale societies. In order to carry out these objectives, they have to purchase raw materials and other appliances and sell them at reasonable price. In the case of production units the society has to employ workmen, both members and non-members, at piece rate basis. The finished goods so produced have to be sold at on favourable terms.

The auditor has to concentrate mainly in scrutinising the following aspects:-

- (i) Use of raw materials.
- (ii) Receipt of finished goods. (iii) Payment of wages.
- (iv) Costing.
- (v) Price fixation.

They are briefly explained below:-

(i) *Use of raw materials*:- The society should have a specification chart, indicating distinctly the raw materials required for producing a particular item. The quantity of materials issued to a member, to produce a particular item should be compared with the specification chart to ascertain whether they have a reasonable co-relation. If there is abnormal variation, such instances should be enquired into in detail. The Auditor has also to ensure that the society has an efficient system of inventory control and the stocks have been adequately insured and policies kept alive.

(ii) *Receipt of finished goods*:-The raw material issue register should be checked With the finished goods receipt register to ensure that all the goods produced are properly accounted.

(iii) *Payment of wages*:-In order to keep up the high quality of the finished products, technical advice should be available to assess the workmanship of the finished goods and to decide on the rate of wages payable in respect of different varieties. While checking the wages register/sheets the auditor has to ensure that wages have been paid only in accordance with the rates fixed by technical experts. This can be ensured by checking the wages register/sheets with the approved schedule of wages.

(iv) *Costing*-The elements which constitute total cost of any product are (a) Direct expenditure (b) Indirect expenditure. Direct expenditure includes material cost, labour and direct expenses. Indirect expenditure are those incurred for the undertaking as a whole for production and distribution of the products. This includes factory expenses, office or administrative expenses-Selling and distribution expenses etc.

Every production unit should have an estimate of the probable cost of a unit of a particular commodity proposed to be produced by it. The statement which shows the estimated cost is termed as cost record/cost sheet. The total of factory cost and office overhead will be the cost of production or actual cost. The auditor may compare the actual cost of a particular unit with the estimated cost and see how do they compare with each other. If the actual cost exceeds the estimated cost heavily, the auditor has to investigate into the causes for such increase, and appraise the Board of Directors of the same. He may also examine whether the increase in the cost of production has been noticed in direct expenditure or indirect expenditure or has occurred as a result of non-production of the items to its optimum level.

(v) *Price fixation.*-The selling price of a product/unit is fixed by adding a percentage of profit on the actual cost of the product. The Auditor may examine whether the selling price has been fixed reasonably taking into account all the related factors and subject to the decisions of the managing/sub committee.

PART III

CHAPTER I

DEPRECIATION AND RESERVES

1. What is depreciation?

Depreciation is the shrinkage in the value of an asset due to frequent use for the purpose of earning profits. It may be described as “loss or diminution in the value of an asset consequent on wear and tear, obsolescence, effluxion of time or permanent fall in the value of the asset”

Depreciation is also defined as “the measure of exhaustion of the effective title of an asset from any cause during a given period”.

The above definitions indicate that depreciation is a loss arising out of wear and tear due to constant use in the business for earning profits or the diminution in the value of an asset from year to year.

Depreciation would arise from Internal or External causes. Internal depreciation is the loss arising from the operation of any natural cause, ie. by frequent use. External depreciation is that arising from the operation of forces outside asset itself, such as effluxion of time which means automatic loss, in value resulting from the passage of time. The main objects of providing for depreciation are:-

(i) To show the correct profit earned during any particular period. When the profit earned by an asset is taken into account, the loss inherent should also be taken into account simultaneously, in order to ascertain the net income derived by the use of that asset.

(ii) To show the correct value of assets in the Balance Sheet. Unless the assets are shown at their correct values, the Balance Sheet will not exhibit a true and correct picture of the financial position of the institution.

(iii) To make provision for replacement of a wasting asset. Unless depreciation is provided periodically (say every year) and the amount invested outside the business of the society, it would be difficult to replace an asset which has become obsolete. Investment of such depreciation in the business of the society would lead to the locking up of depreciation in the working capital and may create difficulties, to find out necessary funds to replace the assets.

(iv) *To keep the original capital in tact.*

In order to bring about uniformity in the procedure for charging Depreciation, Circular instructions have been issued. See Registrar's Circular No. 26/72 in file ADL(1) 21274/72 dated 5-6-1972.

2. Measure of depreciation:

(i) *Wear and tear.*-After a machine is put to constant use, it may not fetch the same value as time goes on. Broadly speaking, the decrease in the value of a fixed asset by constant use less the probable scrap value represents depreciation.

(ii) *Obsolescence.*-Obsolescence is a special form of loss in value due to external reasons. This generally arises due to invention of a new and improved type of machinery, which can by applying latest techniques turnout increased production of quality goods in a comparatively cheaper way. But such loss can be ascertained, only when the asset is actually replaced. So it is better to face this contingency separately by means of appropriation from profit to a special Obsolescence Reserve,

(iii) *Effluxion of time.*-Decrease in the value of an asset by the passage or effluxion of time as in the case of lease concession or patent is also termed as depreciation. In this case, when the period of lease or prescribed time terminates, all value ceases. The amount paid for lease is in effect rent paid in advance and should be fully written off to revenue account over the period of lease.

(iv) *Fluctuation in market value.*-Fluctuation in the market value of fixed assets has to be disregarded because any fluctuation in price does not affect its earning capacity. Hence the value of such assets is shown at cost price less depreciation. In the case of fixed assets held in investments if it is anticipated that the market value may fall down permanently, it is wise to provide for the same

against such contingencies. Reserve should be provided for the shortfall in the market value in each case.

3. *Methods of providing for depreciation:*

(i) *Annuity method.*-It is assumed that the asset earns a given rate of interest. So, under this system, the interest expected would be added to the value of asset, and rate of depreciation to be written off would be ascertained from the Annuity Tables and credited to the asset account. This system is considered to be scientific and better. But this method is not generally used for plant and machinery where additions are made from time to time.

(ii) *Sinking fund or depreciation fund method.*-Under this method, no depreciation is written off from the asset, but an equal amount of depreciation is charged to the profit and loss account and credited to depreciation fund account, during the lifetime of the asset. The asset is shown at its original cost in the balance sheet. The instalment is fixed in such a way that if invested outside every year at compound interest it will produce an amount equal to the original cost of the asset at the end of its effective life. This procedure is allowed until the Depreciation Fund Account equals the asset account. In the meantime the investment must also be shown in the Balance Sheet, under a separate head "Depreciation Fund Investment Account".

This method of depreciation is best suited for lease, patents etc.

(iii) *Depletion unit method.* -This system is suitable to wasting assets such as mines, oil wells, quarries etc. The contents of the assets are estimated in terms of quantity. Taking into consideration the quantity of the mine, the value of one unit raised is calculated. Depreciation in any year is calculated on the total output.

(iv) *Fixed instalment or straight line method.*-Every year a fixed amount is written off as depreciation by charging to the profit and loss account. The amount to be written off would be determined by estimating the working life of the asset and distributing the cost of the asset less any scrap- value, over the Working Life. It is suitable for writing off the cost of short leases and patents where the life of the asset is known exactly. But in the case of plant and machinery, the life cannot be estimated so easily as it depends on its use.

(v) *Reducing instalment or diminishing balance method.*-This system is adopted with a view that every year the profit and loss

account would be charged with depreciation. A fixed percentage is written off every year on the diminishing book value of the asset till it is reduced to scrap value. By applying this method the revenue bears an average burden, as the increased repair charges in the later years are off set by the decrease in the provision for depreciation. In this case no separate calculation is necessary for any additions during the year as the percentage is calculated on the total book value of the asset at the end of the year.

This system is adopted for charging depreciation on plant, furniture, machinery etc.

4. *How to charge depreciation:*

(i) *Building (Circular No. 26/72)* .-Societies construct buildings by utilising their building fund created out of profits and or by the general funds which is recouped in subsequent years. When buildings are constructed out of funds from the building reserve created out of profits, the entire building fund appears on the liability side of the balance sheet while investments from the building fund will appear as building fund investment on the asset side.

Societies which do not have sufficient building fund construct buildings from the general funds with the prior sanction of the Registrar. In such cases, the investments thereon appear on the asset side of the balance sheet, without a corresponding coverage on the liability side. In both cases depreciation should be charged on the prescribed rate on all buildings irrespective of the fact whether they were constructed/acquired by investment of Building Fund, General Fund or any other source. The Co-operative Societies which are recouping expenditure incurred on buildings from General Funds may however be permitted to charge depreciation, as a measure of relief, after the expenditure incurred from general funds is fully recouped. (Registrar's Circular No. 101/75 dated 15-11-1975). When a building is constructed with the general funds and building fund of the society, the balance sheet has to be prepared in accordance with the principles explained above in proportion to the amounts spent from different sources.

(ii) *Furniture and equipments.*- The value of furniture and equipments, as on the last day of the Co-operative year, at cost is exhibited on the asset side of the balance sheet. Depreciation every

year (@ 5% of the value for Iron Safe, Almirah, Racks and Tables 10% for Iron chairs, trays and similar articles of rough use, 5% for Teak or Rosewood Almirah, tables and racks and 10% for other wooden articles) at the total value of the furniture as at the end of audit year is taken to "Reserve for Depreciation of Furniture", on the liability side, after debiting the amount to the profit and loss account year after year. This procedure has to be followed till the amount of "Depreciation Reserve for furniture etc", equals of value of furniture on the asset side and thereafter no depreciation is allowed. The very same method is applicable to Libraries also.

(iii) *Motor vehicles*.-The value of vehicles has to be normally written off during the course of five years. The income from a lorry will be higher during the first one or two years, as the cost of repairs and maintenance will be the minimum. During the succeeding years such expenditure will be on the increase, and so depreciation during the first year will have to be the highest and will be decreased during the subsequent years. General scale of depreciation of vehicles is given below:-

1st year	-	30% of capital investment
2nd "	-	25% "
3rd "	-	20% "
4th "	-	15% "
5th "	-	10% "

Thus value of the vehicle has to be written off almost fully within 5 years, and only a nominal value shown in the asset side of the Balance Sheet till the vehicle is condemned or otherwise disposed of.

(iv) *Others*.-If no provision is made for depreciation in respect of any fixed asset, that fact has to be indicated in the audit note. Bylaws of some of the societies contain specific provisions laying down rates on which depreciation should be charged on different assets. These rates if higher are to be applied in accordance with the above circular instructions.

5. Reserves:

I General

In the ordinary course 'Reserve' is meant to indicate something kept apart for future use or for emergency. But from the point of

accounting, it means that part of the capital which is set apart for any known or unknown or unforeseen losses/contingency-Reserves are broadly classified as under :-

1. General Reserve
2. Specific reserve or provision
3. Sinking Fund
4. Reserve Fund
5. Capital Reserve
6. Secret Reserve

1. General Reserve.-This is created out of net profits. The general reserve can be created only where there is profit. The purpose of creating such a Reserve is three fold.

(i) To provide more working capital

(ii) To provide a cushion to meet any unknown or unforeseen contingencies in future

(iii) To increase the financial stability of the concern.

The general reserve is an appropriation from profit and not a charge against profit.

2. *Specific reserve or provisions*.- Specific Reserve is a charge against revenue to provide for losses/contingencies which are known or expected as on the date of making the provisions, to occur at a future date. It is created even if the concern is working on loss.

3. *Sinking Fund*.- “A Sinking Fund is a form of Specific reserve set aside for the redemption of a long term debt or the replacement of a wasting or a depreciating asset”. It is created out of revenue or divisible profits as the case may be to meet a known liability at a future date. A corresponding amount of the fund is invested outside the business also.

Sinking fund for redemption of a liability, like debentures, is chargeable to profit and loss account. Creation of this fund avoids any risk involved in the sudden withdrawal of capital from business which may upset its normal continuance.

The two types of Sinking Fund usually referred to as “Depreciation Fund” and “Redemption Fund” have got distinct characteristics.

(a) *Depreciation Fund.*

- (i) It is a charge against Profit & Loss Account.
- (ii) On realisation of the investment, the amount thus made available is utilised in replacing the assets.
- (iii) It is closed by a transfer to the old asset account.
- (iv) It cannot appear in the books after the purpose for which it was created is accomplished.

(b) *Redemption fund:*

- (i) It is by appropriation of profit.
- (ii) It can exist only if there is an excess of assets over liabilities.
- (iii) On realisation it is utilised for discharging a liability.
- (iv) Redemption Fund takes the form of liability and therefore not closed.
- (v) When the purpose of creation of the Fund is accomplished, it may be transferred to General Reserve Account.

(vi) It can be used for the purpose for which General Reserve is used.

4. *Reserve Fund.*-A reserve fund is nothing but a general Reserve created out of divisible profits, except that the surplus of assets represented by the reserve is invested outside the business. The purpose of creating Reserve Fund is to provide ready and liquid funds for any specific purpose at any date which may be obtained by realising investments.

5. *Capital Reserve.*- Capital Reserve is created out of capital profits which are quite distinct from trade profits. While trade profits mean profits made during the ordinary course of business, capital profits are of extraneous nature earned but not in the usual course of business.

Generally the following extraneous profits are transferred to capital Reserve Account.

- (i) Profit on forfeiture of shares.
- (ii) Profit on sale of an asset
- (iii) Profit on revaluation of an asset,
- (iv) Profit on repayment of debentures
- (v) Profit on issue of shares of debentures.

6. *Secret Reserves*.-Secret Reserve is not disclosed on the face of the balance sheet, though in fact, the actual financial position is much better than what is disclosed by a balance sheet. It is also called as 'Internal Reserve' or 'Hidden Reserve'. This reserve represents surplus or assets over Liabilities and capital. It does not appear in the Ledger. Its purpose like that of any other reserve is to increase the financial stability. Eg:-As per the audit certificate the book value of the land & building owned by the institution may be nominal whereas its market value will be much higher. The difference between the book value and the actual value that it may fetch when, sold out, will represent secret reserve in this case

II. *Statutory Reserves*-(a) *Reserve Fund*.-Reserves in Co-operative Institutions are being created with a view to strengthening the financial position and to provide for possible depreciation in the value of the assets. Reserves under liabilities can come into existence only in one of the following methods.

(i) By allocation from divisible profits

(ii) By retrenching profits

Reserves cannot be created by allocation from divisible profits if such reserve is not contemplated in the byelaws of the society. The allocation of the net profits should be done by the general body in the order in which it is provided under the provision of the Kerala Co-operative Societies Act Rules and the Bye-laws.

The statutory reserves must be provided for as per statute (see Sn. 56) and the bye-laws whichever is higher in the order of allocation and the remaining items allocated as per the bye-laws of the society and standing instructions of Registrar.

Object of Reserve Fund and disposal thereof on the winding up of a society are indicated in Rule 61 of the Rules.

(b) *Co-operative Education Fund*.-Sub clause (b) of clause (C) of section 56 of the Act lays down that "A society shall, out of its net profits in any year credit such portion of the net profits, not exceeding five per cent, as may be prescribed, to the Co-operative Education Fund referred to in clause (xix) of subsection (2) of Section 109".

The constitution, maintenance and administration of Co-operative Education Fund have been specified in Rule 53 of the Rules.

6. *Other Reserves*:-(a) *Common good fund*.-Appropriation of profit to this fund is governed by Section 56 (2) (d) of the Act and bylaws of the society. After appropriation to the statutory reserves, the General body, subject to the restrictions imposed in the bylaws, may set apart an amount not exceeding ten per cent of the net profits to the Common Good Fund. This fund should be utilised only for the objects specified in section 2 of the Charitable Endowments Act, 1890.

Charitable purpose under Section (2) of the Act includes relief of the poor, education, medical relief and advancement of any other objects of general public utility but does not include a purpose which relates exclusively to religious teaching or worship.

(b) *Dividend Equalization Fund*.- Allocation to this fund is not mandatory if not provided for in the bylaws. The general body of its discretion, after completing appropriation towards the items provided in the Act may allot a portion of the net profits to this fund at the rates, if any, prescribed under bylaws. The fund is created to enable the society to pay dividend at a uniform rate during the future years.

(c) *Building Fund*.-The allocation to this fund is not mandatory if not provided in the bylaws. If the general body so desires, it can earmark a portion of the net profits to this fund, in accordance with the bylaws. For utilization of this fund permission of Registrar is necessary. So, wherever the auditor comes across debit to this fund he should verify whether proper administrative sanction has been obtained for the expenditure.

(d) *Bad Debt Reserve*.-Allocation to Bad Debt Reserve (otherwise known as Reserve for Bad and Doubtful debts) is made by the General body. This reserve is contemplated not only in credit societies but also in non-credit societies, which have provision in their bylaws for credit sales.

(e) *Price Fluctuation Reserve or Fund*.-The allocation to this fund is not mandatory if not provided in the bylaws. The fate of contribution to this fund depends upon the rates, if any, fixed in bylaws. The fund is intended to meet any losses in trading due to fluctuation in prices. Where drawals are made from this fund the Auditor has to ensure its proper utilisation.

(f) *Wages Equalisation Fund*.-Allocation to this fund is permissible but not mandatory unless provided in the bylaws.

Drawals are made when in any year expenditure on wages is abnormally high. The auditor has to ensure proper utilisation of the drawals from the fund.

(g) *Reserve for depreciation of investments.*-This kind of reserve is provided mainly in State Level and District Level Institutions who have invested substantially in Government and other securities. If they keep the securities till the date of maturity they can realise full value. But loss is likely to arise from depreciation when the securities are disposed of or sold before maturity. Securities purchased should be shown at its face value in the balance sheet. The commission (the difference between the face value and purchase value) if any earned at the time of purchase has to be taken to the profit and loss account. In any year, if there is any fall in the market value to that extent, reserve should be created by charging Profit and Loss Account so that the total of such reserve should not be less than the fall in market price. In the course of redemption of the securities, if the auditor feels that such reserve outstanding is disproportionate to the value of total securities outstanding at the end of a particular year, he may with due diligence and care, transfer a portion of the reserve (worked out on the basis of the outstandings) to the profit and loss account. Any appreciation in the price should neither be taken to profit nor result in the reduction of the existing reserve.

(h) *Business loss reserve.*- The allocation to this reserve is permissible. It is usually created in Consumer and Marketing Societies. There are no specific rules or regulations governing the utilisation of this reserve. Hence the auditor should ascertain whether administrative sanction has been obtained by the Society for its utilisation.

(i) *Provision for gratuity.*-Circular No. 85/75-ADL (I)-49283/75 of the Registrar of Co-op: Societies explain in detail the guidelines to be followed by Auditors for creating provision for payment of gratuity to the employees. The Auditors may strictly follow those guidelines in this regard.

7. *Non-statutory Reserves:*

(i) *Reserve for stock deficits.*-The value of deficits of stock noticed every year is shown on the asset side of the balance sheet with a corresponding reserve on the liability side to cover up the amount

of stock deficit. When the value of stocks deficit is recovered from the person responsible the reserve created will be released to that extent, automatically. If the society does not pass necessary entries for such release of reserve, the Auditor can pass necessary entries for the same.

(ii) *Depreciation reserve*.- Whenever any of the items of asset, viz. Furniture, Vehicle, Buildings etc., are disposed off, the unrealised book value of such items may be adjusted from the depreciation reserve and the loss so incurred by that sale or disposal recouped. If the disposal of items fetched Book value less depreciation of the sale price is less than the loss incurred it should be taken to profit and loss account. If the auditor suspects any unusual practice in the transaction, the loss incurred should be shown as realisable from persons responsible.

(iii) *Reserve for excess Profit*:- This is usually provided in Weavers Societies, the business of which is subjected to heavy price fluctuations. In such cases, profit earned over and above a reasonable percentage due to abnormal price increase for the end product is set apart and credited to special reserve.

(iv) *Specific Bad Debt Reserve*:- When Bad Debt Reserve is created by retrenching profit to cover certain specific bad debts the Auditor may at his discretion release the reserve in case those debts have actually been recovered in full. But any write off from this reserve should be supported by administrative sanction.

(v) *Special Bad Debt Reserve*:- Contribution to this reserve is made by Government mainly to encourage primary agricultural credit societies and Central/District Co-operative Banks to provide necessary credit to increase agricultural production, and in particular to advance loans for small farmers and weaker section in the community.

Loan issued for agricultural production alone is taken into consideration for the purpose of payment of contribution towards this. This reserve can be drawn upon only with the previous sanction of the Registrar of Co-op: Societies.

(vi) *Provision for Income-tax*:- Income-tax liability for a particular financial year/ accounting year is assessed on the profits earned during the preceding assessment accounting year. So the auditor has to make provision for income-tax, if any based on this. Since

the profit of the year under audit forms the basis of assessing income-tax, it is only just that the assessment of income-tax for a particular year is debited to the profit and loss account of the same year. If, on the last day of the co-operative year, the tax is pending payment it is to be shown as liability in terms of the order of assessment of the Income-Tax Authorities.

When an institution earns substantial income in a particular year due to some unexpected favourable circumstances, but does not expect similar, income in the succeeding years, the auditor has to provide sufficient Reserves in consultation with the Income-tax authorities, for meeting the income-tax liability.

(vii) *Reserves for objected payments*:-The auditor should create reserves for all objected payments except those which can surely be recovered. Otherwise the balance sheet of the society will not exhibit a true and correct financial position. At the time of objecting a payment the auditor will not be in a position to assess the realisability to the amount. Therefore, when a payment is objected without creating a reserve, the assets of the society will be shown enhanced to that extent and is likely to be distributed as profit in due course. In order to avoid such a contingency the auditor has to provide for sufficient reserve, for the amounts objected. He should also explain the circumstances under which the items are objected in audit.

(viii) *Reserves directly chargeable to Profit and loss account*.-Reserves for gratuity, income-tax, salestax, bad debt, depreciation, etc., are specific reserves which are debited directly to profit and loss account. The reserves for the above items must be created even if the result is profit or loss. Creation of such reserves is necessary so that the balance sheet can exhibit a true and fair picture on the affairs of the institution.

No. ADL (2) 12314/75.

Office of the Registrar of
Co-operative Societies,
Trivandrum 15-11-1975.

CIRCULAR No. 101/75

Sub:- Co-operative Department-Assets acquired Utilising
General Funds-Charging of Depreciation--Instructions
issued.

- Ref:- (I) This office endorsement on ADL (3) 18572/69 dated 9-7-1969.
- (2) Letter No. ACD (T) 3430/P (8) 74/5 dated 10-3-1975 of the Assistant Chief Officer, Agricultural Credit Department, Trivandrum.
- (3) Letter No. ACD (T) 1521/P (8) 75/6 dated 28-10-1975 of the Assistant Chief Officer, Agricultural Credit Department, Trivandrum.

In Chapter I of Volume II of the Madras Co-operative Manual, it is laid down that no depreciation need be charged on the value of buildings constructed/acquired investing Building Fund or by utilising General Funds which is recouped in subsequent years. The general principle underlying the above procedure is that the "Building Fund" and the "Building Recoupment Reserve" are created charging the profit and loss account and if depreciation is charged on the assets acquired out of the above Fund/Reserve, it will result in the profits being cut twice for the same purpose. An extract of the above procedure as contained in the Madras Co-operative Manual was communicated to the Deputy Registrars (Audit) for information and guidance vide reference 1st cited. The Reserve Bank of India have since pointed out in the letters referred to as 2nd and 3rd papers above, that the "Building Recoupment Reserve" created to recoup expenditure incurred from General Funds for Construction of buildings will not in any way be a substitute for reserve for depreciation on building, and that depreciating the value of fixed assets like building, besides being a requirement in scientific accounting is also essential in prudent financial management. Moreover, in respect of Co-operative Societies coming under the purview of the Banking Regulations Act, it would also be a requirement of law as depreciated value of the premises is to be shown in the balance sheet prepared under Section 29 of the Act. Under the above circumstances, the following instructions are issued for strict compliance.

- (I) Depreciation should be charged at the prescribed rate on all buildings irrespective of the fact whether they were constructed/ acquired by investment of Building Fund, General Fund or any other source.

- (2) The Co-operative Societies which are recouping expenditure incurred on buildings from General Funds may however be permitted to charge depreciation, as a measure of relief, after the expenditure incurred from General Funds is fully recouped.
- (3) The above instructions will apply also to other assets acquired utilising General Funds to be recouped in subsequent years.

CHAPTER II

PREPARATION OF MANUFACTURING, TRADING AND PROFIT AND LOSS ACCOUNT

1. *Checking of postings in the ledgers.*-By carefully vouching the cash book/day book and subsidiary ledgers, the auditor will be able to acquaint himself with the nature of entries in them. While vouching the Cash Book/Day Book the Auditor has to see whether the entries in them have correctly recorded the transactions. Since all the transactions affecting the business are entered in the ledgers also, they generally form the centre of the accounts and the basis for preparation of the profit and loss account and balance sheet. The Auditor will, therefore, has to tract carefully the entries from the cash book and subsidiary ledgers and satisfy himself about their correctness in postings etc., in the respective ledgers.

The general ledger will contain all accounts which records the consolidated operation of the business in a given period or date. The consolidation of operation are again summarised into trading and profit and loss accounts and also to the statement of assets and liabilities of the concern. The Auditor has therefore added responsibility to ensure thorough checking of all the entries in general ledger in detail.

2. *Checking of General Ledger.*- The entries in the General Ledger are posted from the Day/Cash Book or subsidiary journals. The totals of all subsidiary journals viz., purchase register, sale register etc., in a manufacturing concern, deposit ledgers in a banking institution, other subsidiary ledgers in other institutions etc., are posted in the Day Book first and then the totals are posted into the General Ledger from Day Book. All transfers from one head in

the General ledger to another account are passed through the Day Book. No transfer is made directly in any account in the General Ledger or Personal Ledgers without first being entered in the Day Book. Routine checking of posting, is normally to be made by two clerks or assistants working together. Entries in the Day/Cash book and the General Ledger should be checked simultaneously. The opening balances of all real or property accounts and all accounts in the Personal Ledgers will however have to be carried over from the previous years ledgers.

3. *Drawing up of the trial balance.*-After checking the postings, totalling and balancing into the General Ledger all the closing balances are entered in a sheet separately depending on the nature of balance whether debit or credit. This statement which contains a classified summary or list of all closing balances of the General Ledger is known as the "trial balance." If the totals of two sides of trial balances agree, normally it signifies the arithmetical accuracy of the accounts. If they do not tally, the difference is to be located by checking the postings, totals etc. An important point to be borne in mind in the preparation of the trial balance is to include the cash balance and bank balance as indicated by the cash and bank columns of the Cash/Day Book. In smaller societies, instead of the trial balance, a receipts and disbursements statement is prepared from the Cash/Day Book. However, the auditor should not proceed to prepare the final accounts unless he is presented with an agreed trial balance/ receipts and disbursements statement.

4. *Checking of the transfer entries.* - When transfer entries are passed through the Cash Book/Day Book, both credit and debit entries should be checked simultaneously. These contra entries are to be marked with special ticks in order to distinguish them from other entries; which may involve passing of cash. All contra or transfer entries should be checked very carefully, as they do not affect the cash on hand. Since contra entries create monetary obligations, they are as important as cash transactions, and should therefore receive due attention of the auditor.

While vouching entries in the journal or in the Cash Book, the auditor should see that not only there is sufficient evidence in support of the entry, but 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 are passed through the journal or through the Cash Book and that no posting into the ledger is made directly from the ledgers. The details furnished in the transfer vouchers (both credit and debit) should be verified carefully and ensured that the entry has been correctly passed.

5. *Adjustment and closing of nominal accounts.*-All nominal accounts are to be checked by the Auditor so as to satisfy himself that all transactions of the business have been correctly classified and included in the final accounts. The Auditor should take special care to see that all accrued income and expenditure incurred, but not paid and income received in advance are duly brought into account. In the case of consumer stores, and other trading societies, it is necessary to see that the sales made during the last few days prior to the closing of the accounts have been duly recorded. For this the auditor will trace back the issue of despatch of goods to the relative invoices or sales memos. Similarly in the case of securities and other investments, the auditor should ascertain whether all interest accrued during the period has been received and all dividend declared duly credited.

6. *Items coming under:* (i) Manufacturing Account.-Manufacturing or production account contain items relating to the manufacturing operations of the Society. The main heads under which 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 (ie. opening stock plus purchases minus closing stock)
- (3) Fuel, Oil, Electricity and other power charges.
- (4) Stores and spare parts consumed.
- (5) Direct or indirect labour.
- (6) Maintenance of factory, plant, machinery, tools, stores, etc.
- (7) Insurance of Factory building, tools, machinery etc.
- (8) Depreciation of plant, machinery, tools etc.
- (9) Factory lighting, water charges etc.
- (10) Rent rates and taxes of the factory premises.

(11) Salaries of the technical staff and officers including works manager, factory Superintendent etc.

(12) General administrative expenses pertaining to the Factory.

(ii) *Trading Account*.- The following items will appear on the debit side.

(1) Opening stock (value of finished goods at the beginning of the year) .

(2) Cost of goods purchased, which include expenses connected with purchases.

(3) All trading expenses.

On the credit side the following items are usually included:

(1) Net sale proceeds (ie. total sales minus sales returns)

(2) Value of closing stock.

The difference between the two sides will show gross profit/gross loss.

(iii) *Profit and loss account*.-The items coming under debit (loss) side are the following: --

(1) Interest paid and due.

(2) Establishment and contingent charges paid and due.

(3) Depreciation.

(4) Assets written off as bad debts.

(5) Reserves for overdue interest.

(6) Reserves for doubtful debts.

(7) Miscellaneous items.

(a) Provision for gratuity

(b) Provision for income tax

(c) Provision for other items (to be specified)

(8) Last year's loss.

(9) Net profit.

On the credit (profit) side:-

- (i) Interest earned.
- (ii) Miscellaneous income.
- (iii) Commission etc.
- (iv) Profit in non-credit business
- (v) Reserve for interest of last year.
- (vi) Other items
- (vii) Net loss.

7. *Other items:*

(a) *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. It may be likely that there may be expenses outstanding on account of fuel charges, electricity charges etc.

With regard to the outstanding payments the auditor should examine "Goods Inward Book" or the "Invoice Register" for the last few weeks of the period and satisfy himself that all purchases made and included in the 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 services rendered are not received from the suppliers and other creditors. For eg: the Transport Contractor might not have submitted his bills for goods transported during the last few days of the year. Similarly in most of the Societies, salaries and wages for June may not have been paid before the close of the year. All these items will have to be brought out as the outstanding expenses. For this purpose the Societies should maintain a register of outstanding expenses.

(b) *Interest receivable and payable.*-Interest accrued upto the date of balance sheet should be worked out and brought into account. 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. Interest on bank loans and other borrowings is generally debited to the account of the Society. In

the case of deposits and other temporary borrowings, interest accrued up to the date of the balance sheet should be calculated and provided for. Care should be taken to include interest accrued on fixed deposit between the dates of last payment of interest up to the date of balance sheet.

c. *Expenses prepaid*.-Prepaid expenses include expenses on account of rent, rates and taxes, insurance premiums, subscriptions, membership fee etc. for periods that extend beyond the date of the balance sheet. The auditor should examine the individual accounts and also the demand notices, bills etc. and see that correct calculation has been made of the proportion of amounts relating to the unexpired periods.

(d) *Deferred Revenue Expenditure*.-There may be instances of incurring heavy expenditure the benefits of which extend to periods beyond the date of the balance sheet. In such cases, the expenditure incurred should be equitably spread over the period during which the benefits of such expenditure would be available. The auditor should examine carefully the whole of the circumstances in order to satisfy himself that the carry forward of art of such expenditure is fully justified.

8. *Manufacturing Account*.-The object of the manufacturing account is to ascertain the cost of goods manufactured during the period. The manufacturing account is therefore debited with the actual materials used and all production charges, eg: wages, power, works and factory expenses adjustment being made for work in progress at the beginning and end of the period The balance in this account which is carried to the debit of the trading account represents the factory cost of the goods manufactured during the period.

9. *Trading Account*.-The trading account is relating to the trading activities of a concern. The object of this account is to show the result of trading activities for a period. In the case of a trading concern it will include the items relating to purchase and sale of goods and stock in trade at the beginning and close of the year. All direct charges incurred in collection with the purchase of goods should be included in the trading account.

Where manufacturing account is prepared to show the profit on manufacture, the cost of sales is transferred to the trading

account from the manufacturing account. The trading account is also debited with any finished goods purchased less any return outwards and is credited with sales less returns inwards. The balance on the trading account then represents the gross profit or loss as the case may be.

10. *Profit and Loss Account*.-(*Proper*).-The account is credited with the gross profit brought down from the trading account, along with any miscellaneous income such as discounts, interests, rent, dividend etc. On the debit side all the expenses incidental to the period under audit will appear. It would be the duty of the auditor to examine each item of expenditure to see that it is necessarily incurred in the course of business, that it relates to the period of audit and that it is classified under proper head .

It is essential that this account should be so drawn up as to disclose full information at a glance. It should also enable easy comparison of the various expenses and the sources of incomes with similar items of the previous years. The grouping expenses under different heads facilitate such comparison. The calculation of percentage of each group of expenses to the turnover or to the total expenditure affords valuable information.

In the Royal Mail Steam Packet Co. case, the question of auditor's responsibilities regarding the profit and loss account was raised. It was held that the auditor should see that the account represents a true view of the normal earnings of the business during the period under audit and that abnormal, items if any, should be shown separately in the account.

11. *Revenue account and income and expenditure account*.-In the case of non trading societies such as Co-operative Education Societies, hospital, societies and similar other types of 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 these accounts are more or less the same as that for preparing the profit and loss account, the object being to disclose the excess of income over expenditure, or the deficit incurred during the period.

12 *Principles governing the preparation of profit and loss account*.-

(1) Only such items of income and expenditure as properly belong to the business should be included in the account.

(2) There should be proper grouping and classification of items so as to present a clear picture of the current earnings.

(3) The whole account should be prepared up on a consistent and uniform basis from year to year so as to facilitate useful comparison.

4) Adequate provision should be made for depreciation, bad debt and other losses.

(5) Provisions of the bye-laws relating to creation of capital Redemption Fund, Sinking Fund, Guarantee Fund etc. should be strictly observed.

(6) Interest payable on deposits, loans, debentures and other borrowings should be calculated and included in the account.

(7) Transfers to profit and loss account from funds created out of past profits should be made.

CHAPTER-III

BALANCE SHEET-PREPARATION OF

A. Verification of Assets and Liabilities

1. *Balance Sheet*.-De Paula defines balance sheet as following:-

“A Balance sheet is not a statement of assets and liabilities, as is commonly thought, but merely a ‘sheet’ showing a classified summary of all the balances appearing in a set of books, after all the nominal accounts have been closed by transfer to the Profit and Loss Account-the balance sheet including in one form or another, the balance on the latter account”. It shows, in a classified form, all the balances remaining in the books, after the nominal accounts are transferred to the Trading and Profit and Loss Account and the Corresponding accounts in the ledger are closed.

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. For example, debit balance, of the profit and loss account appears on the assets side, although it is not an “asset”. Similarly statutory reserve fund and other reserves, credit balance

of the profit and loss account, which appear on the liability side cannot be termed as “liabilities”. The balance sheet is expected to exhibit a true and fair view of the financial position of the society. 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 will be clear. Therefore it is the duty of auditor to satisfy himself that the balance sheet is properly prepared according to the correct and consistent accounting principles.

2. *Meaning of valuation of assets for the purpose of Balance Sheet.*-A comparison of the capital at the beginning of the year and at the close of the year would undoubtedly reveal whether the business runs at a profit or loss. Increase in capital will indicate that the business is running at a profit and conversely decrease in capital is an indication of loss. Since the surplus of assets over liabilities represents the capital of a business concern, any such increase or decrease in surplus of capital represents the profit or loss made during a year. The term valuation in connection with the Balance Sheet can be interpreted as follows:-

- (i) The value may be the estimated amount that the assets would fetch, if sold or disposed of, ie. the realisable value.
- (ii) Value may mean the amount that is estimated to replace the asset ie. the replacement value.
- (iii) The amount that an asset costs, when purchased or acquired, less the provisions made for depreciation since its acquisition ie. the written down value or going concern value.
- (iv) The balance of revenue expenditure which is being written off over a period of years, ie. ‘Deferred revenue expenditure’ or ‘prepaid expenses’.

3. *Going concern value.*-Even though all the above basis for valuation may be used in connection with different classes of assets, ordinary only the written down or going concern value is taken into consideration. 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 is arrived at. For this it is necessary to estimate the working life of fixed assets like buildings, plant, machinery etc.

4. *Form of Balance Sheet.*-As the Balance Sheet purports to reveal the financial position of the business it follows that it should be drawn out in some intelligible form or order.

No definite rule can be laid down as to the correct order in which the assets and liabilities shall appear in the Balance Sheet. Two methods of arrangement are employed. In the first, the assets are shown in the order of liquidity ie. cash and bank balances, 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, viz. share capital and reserves appearing first and liabilities and provisions for credit balance of profit and loss account appearing last. The second method is in the reverse order of their reliability. That is, fixed assets are shown first, floating assets next and liquid assets like cash and bank balances in the last. On the liability side, liabilities are shown in the reverse order of repayment. Capital is shown first reserves next and credit balance of profit and loss account as last.

B. Verification of assets

I. (i) *Fixed Assets.*-Verification of fixed assets by the auditor should be made with reference to the documents relating to their acquisition. A schedule of fixed assets at the beginning of the year and acquired during 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. Physical verification of plant and machinery and other fixed assets, should be 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.

(ii) *Floating or current assets.*-Floating assets are those assets which are acquired for resale or produced for the purpose of sale and consists of cash and such assets as are held for purpose of conversion into cash in the course of regular business. Current assets are ordinarily classified under the following main heads:-

- (i) Interest accrued on investment and loans.
- (ii) Stock in trade in case of trading concern.

(a) Stores and spare parts

(b) Loose Tools

(c) Semi-finished goods, work in progress and finished goods in case of manufacturing concerns.

(iii) Loans outstanding and sundry debtors.

(iv) Cash and bank balances etc.

Interest accrued on investments should be shown separately in the balance sheet. While taking interest receivable, adequate provision should be made for overdue interest. Physical verification of stock in 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 the balance at Bank confirmed by obtaining confirmation certificates from the Banks for all balances.

(iii) *Wasting assets*.-Wasting assets are those of a fixed nature and are gradually exhausted and used up in the course of working, such as a mine or quarry. It is difficult to assess how much a mine or a quarry has been exhausted and how much minerals remain. Therefore, the common method following in the valuation of this type of assets is to show it in the Balance Sheet at its original cost and provision made for depreciation.

2. Valuation of different types of assets.

(i) *Goodwill*.-Goodwill is a peculiar asset. "It is a thing very easy to describe but very difficult to define" Goodwill is an intangible asset and will not appear in the balance sheet except in the case of purchase, when it should appear at cost. It represents the sum paid for anticipated future profits and therefore it is argued that it should be written off from profits. Since it is an intangible asset it is wise to write it down out of available profits.

It may not be easy for the auditor to verify the correctness of Goodwill which is assumed to be the capital value of extra profits which an average business would earn on the capital employed. 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 general body or by the Managing Committee. Where the consideration paid exceeds the market

value of the assets acquitted the excess amount paid will have to be treated as goodwill.

(ii) *Patents*:-These types of assets are not ordinarily possessed by Co-operative Societies. However, where they have been acquired, it should be verified by the inspection of the 'patents' themselves. The certificate of grant of the patent obtained from proper authority should be examined. The auditor should see that the cost of each patent is written off during the course of their expected life. The auditor should be careful enough to examine the last renewal certificate and satisfy himself as to the currency of patents.

(iii) *Trade marks*:-Verification of trade marks can be made by inspection of the certificates of registration or of any assignment of the Trade Marks. Where the trade marks have been registered, the auditor must vouch the amounts treated as capital expenditure. Fees paid for renewal should be charged to revenue account. The entire amount shown under trade marks should be written off during the lifetime of the trade mark.

(iv) *Copyrights*:-These will be acquired only by co-operatives which undertake publication of books. The Copyright Act 1957, ensures sole right to authors of books, articles etc. When the right is purchased, the written assignment must be examined and the price paid should be vouched. As far as possible, these assets should not appear in the balance sheet for a period longer than 2 to 3 years. The valuation of copyright should have regard to the prospect of future sales.

(v) *Plant and Machinery*:-Purchase of new plants and machinery will be vouched during the course of audit. In addition the auditor will also see and verify the invoices and receipts, the correspondence regarding the purchases and also contracts with machinery manufacturers and engineers' certificates. Where there are only a few machines, the auditor should personally inspect and identify them. Where the number of machines is large, he should obtain a schedule of plants and machinery. A certificate of their existence and efficient working should also be obtained from those responsible. The mode of valuation should be original cost less depreciation.

When the machines are sold or scrapped, the auditor must see that the machinery account is credited with the account of their book value as on that date.

(vi) (a) *Free hold lands*:-The auditor should examine the title deeds and satisfy himself whether the society has got a clear title to the property. The last title deed should be examined to see that the property has been duly conveyed to the society. Encumbrance certificate should be obtained and verified. It should also be ascertained that extensions and alterations, if any, have been properly apportioned in between capital and Revenue expenditure. The auditor should also ensure that the property/building still continue to be in possession of the society.

The building should appear in the balance sheet at original cost. Depreciation reserve, created should be shown in the liability side.

(b) *Lease hold property*:-The lease should be inspected. Where the client is not the original lessee, the assignment made in his favour should be inspected. The auditor should ascertain whether conditions such as prompt payment of ground rent, maintenance of fire insurance etc., have been fulfilled. Otherwise, the lease might be forfeited. The lease hold property should appear at cost less proportionate depreciation for the period expired.

Where the lease hold property has been sublet, the counterpart of the tenants agreement should be examined. The cost of lease hold property must be written off to Profit and loss account over the period of the lease, for at the end of the period of the lease, the property reverts to the lessor.

(vii) *Motor Vehicles*:-The auditor should verify the vehicles register or vehicles account. The auditor should also examine the registration book of each vehicle and satisfy himself whether the registration number and description recorded therein agree with the particulars shown in the vehicles register. If the Society has got a fleet of vehicles it will be necessary to keep separate account of each vehicle. The expenses under repairs etc. should be charged to revenue and only the cost of major repairs carried out be allowed to be carried over to for one or two years so as to spread over the benefit of the expenditure over the period for which it is availed of.

The auditor should examine the adequacy of depreciation provided for. In special circumstances, such as accident etc., a special depreciation will have to be charged. As regards valuation the method adopted is original cost less the aggregate depreciation. In special circumstances, such as accident, etc. special depreciation will have to be charged. (Also see para III Chapter I)

(viii) *Tools, implements, furniture and fixtures, installation and fitting*:-Tools, implements, furniture, fittings etc. should be dealt with as in the case of plant and machinery and adequate depreciation should be charged every year, based on the working life of different items. In the case of fittings upon lease hold 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 equipments should be obtained and the total agreed with the amount appearing against the item in the balance sheet.

(ix) *Library books*:-Purchase of costly books especially reference book's and technical books, may be capitalized and shown under the heading "Library books". Library register should be maintained for all purchases under the item whether the expenditure is debited under revenue head or capital account. Periodical inspection and physical verification of books should be conducted. 10% depreciation per annum may be charged on Library books.

(x) *Live Stock*:-A register of livestock showing the particulars of acquisition, identification marks (or name), price paid, depreciation charged etc. should be maintained. The basis of valuation should be revaluation at the end of each year. In the case of animals such as working bullocks, milch cattle etc. their working or useful life and their usefulness to the society should be taken into consideration. Calves, heifers and other young animals appreciate in value as they grow up. Necessary adjustments are made on the death or disposal of any animal.

3. *Verification and valuation of current assets:*

(i) *Investments*:-Where investments are numerous, a complete schedule of all investments held, showing the nominal amount and full title of each investment, the book value and the market value thereof as at the date of balance sheet, should be obtained. The auditor should compare this schedule with the books and other records. The auditor should examine all the investments simultaneously and compare them with the schedule. He should see that the amounts and nature of investments corresponds with those shown in the schedule of investments. In case these securities have been entrusted with some bankers for safe custody the auditor should get a certificate from the bank about the nature of investments held by them and that they are free from any charge.

There may be instances where some of the investments have been sold subsequent to the date of the balance sheet, but prior to the date of audit. In such case the auditor should vouch the transactions.

Investments may be:-

- (1) Registered debentures, stocks and shares, Government Securities.
- (2) Inscribed stocks; and
- (3) Bearer bonds and share warrants

(ii) *Verification of Securities.*-Where securities lie in the custody of the Society the auditor should examine each script carefully. The certificates, warrants or the securities themselves should be examined carefully and seen that they are in the name of the society itself and that they are complete in all aspects and are registered in the name of the Society. Where securities are lodged with any bank for safe custody, a certificate to the effect should be obtained from the bank, specifying charge if any, held by them. Immediately after verifying the security or certificates, the auditor should put his initials or ticks against the particular item in the list of investments so as to prevent its presentation once again.

In the case of bearer warrants, it should be seen that interest coupons are in order and are attached to the script itself. The numbers of such coupons should have been noted on the schedule.

(iii) *Valuation of Securities.*-An accepted basic principle is that profits should be taken to credit, only when the goods are sold and therefore on no account should the stock be valued above cost for the purposes of Balance Sheet. On the other hand, the wise method is to value at cost price or market price whichever is lower. The fact that the market price is higher on the date of balance sheet should in no way be taken into account, but on the other hand if there is a fall in the price of goods which is lower than the cost price, then the market value should be taken as the basis of valuation.

As regards the duty of the Auditor in the valuation of assets, he need not be a valuer. The actual valuation is to be done by the management the auditor is concerned only with the correctness of valuation. He is required to ascertain that the valuation made appears to be fair and reasonable according to the accepted

principles. He must make sure that no circulating asset is valued above the cost price on any account. An auditor is guilty of misfeasance, if he fails to detect the over-valuation of important assets like work in progress when ample evidence is available for checking the accuracy of the figures given to him. (West Minister Road Construction and Engg: Co., Ltd., case)

(iv) *Verification of mortgage deed and time barred cases.*-While verifying the mortgage deeds care should be taken to prevent substitution of bonds. A particular bond may be produced twice before the auditor against payment of two or more of similar amounts. This kind of fraud is quite common and therefore the auditor should be careful to guard against such substitution.

During verification the auditor should locate time barred cases also and spot out cases on which immediate action is required.

4. *Stock in trade:*

(i) *General.*-As the correctness of the profit and loss account of a trading concern depends to a large extent on the accuracy of the valuation of the stock in trade at the date of the Balance sheet, the verification of this form of assets forms a very important part of the duty of the auditor. He has also to see that it is valued according to certain accepted principles of accountancy.

(ii) *Verification of physical existence of stores.*-The stock should be taken on the last day of any particular period. The process of verifying physically the 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, weighing or measuring of all the stock on hand should be made as at the end of the year in the case of all societies which undertake trading or manufacturing activities.

(iii) *Method of stock taking.*-Stock taking means measuring or weighing and counting of goods on hand on a particular day and valuing them. It involves two things.

i) Ascertaining the quantity of goods by means of weighing or measuring or counting as the case may be, and

(ii) Valuing them based on some accepted principles of accountancy. Verification of stocks has to be done immediately after the close of transaction on the last day of the period. One

person should call out the quantities and descriptions and another should enter them on the stock sheets. Later on, the price at which each item is to be valued is noted by a responsible official in the stock sheet and calculation and casting being checked by another. The completed stock sheets should be certified by the Secretary/Manager/Custodian of Stock/Directors as the case may be. While verifying the stock the following precautions are to be taken:-

(1) All goods not in the premises, but in respect of which invoices have been passed through, should be included in the stock sheets.

(2) The items of purchases which have reached the premises, but the corresponding invoices have not been passed through the books, should not be taken into stock. But it should be treated as stock in transit. If such items are taken into stock the cost of the same should be shown as purchases pending payment.

(3) Goods sold and treated as sales in the accounts but not yet delivered to the customers should be excluded from the stock list.

(4) Goods which are held on behalf of third parties, by way of consignment, or agency, should not be included in the list.

(5) Goods which have been sent out On sale or Return and as are not yet accepted or returned by the customers should be included in the stock.

(6) Stocks sent on consignment should be included.

(7) Unsold goods on consignment should be valued at cost price and not at selling price.

The stock sheet should contain the following columns.

- (i) Serial No. and name of goods
- (ii) Quantity actually verified.
- (iii) Quantity as per the Stock Register.
- (iv) Quantity excess or deficit.
- (v) Quantity value excess or deficit.
- (vi) Rate of value per unit.
- (vii) The amount of value.

(iv) *Checking of stock sheets/statements.*-Stock statements, duly attested by the stock verification officers and finally presented to the Auditor should be compared with the balances in the stock accounts and the discrepancies noted should be got clarified.

After examining the whole system of stock taking, the auditor should check the stock sheets as follows:-

- (i) Check the totals of the stock sheets.
- (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 quantities, and also ascertain whether any part of the stock has been held for a long time and obsolete.
- (iv) Examine the Goods Inward Book for the last few weeks of the period and trace any large item into the stock and into the purchase Register.
- (v) Trace any large scale sales towards the end of the period into the Goods Despatched Register and make sure that the goods if undelivered have not been included in the stock.
- (vi) Where quantities can be checked easily, this should be done by deducting the total sales from the total purchases plus opening stocks.
- (vii) Enquire whether any goods belonging to the Society are in the hands of the consignees, selling agents, or distributors or lying in depots or warehouses.
- (viii) While examining stock sheets, it should be seen that no plant, machinery, tools, furniture and similar other capital goods are not included in the stock.
- (ix) After the Trading Account is drawn up and the amount of gross profit arrived at, compare the percentage of gross profit to sales with that of the previous years. If there is any marked difference, the reasons for such shortfall should be enquired into.

(v) *Basis of Valuation:*-Stock in trade is a floating asset and hence realizable value is the basis of its valuation. "Valuation at cost or

market price which ever is lower is the accepted rule. This rule is based on the principle that no profit should be taken to credit until it is actually realised and that provision should be made for anticipated losses.

As regards the Market value, it may mean either the replacement value or realisable value. The replacement value is the amount necessary for purchasing or manufacturing the goods as on the date of the Balance sheet. The realisable value is the value that would fetch if the stock were sold on that date. Which of these two values is to be adopted is determined with reference to the class of inventory. When the market price is lower than the cost price, stock is valued at the former, i.e., loss is anticipated. This method of bringing down the stock into the account at a reduced value is known as, writing down.

(vi) *Evaluation of Pipe Line stock*:-Stock in trade is; valued at cost or market price whichever is less. In the case of retail stock also the same principle is followed.

Maintenance of stock register and stocking of balances in it after issue at godowns is necessary, so that when a physical verification of stock is done, it can be compared with the stock register and reasons for differences, if any, investigated. The Auditor should watch whether goods received first are issued first.

(a) *Inflated price*.-This method can be used only when an item is subject to natural and necessary wastage. The price of such goods is inflated to cover this wastage. This is an important point which should be noted by the Auditor while checking price fluctuation slips. Ex:-Vegetables, fruits, fish etc.

(b) *Abnormal losses*:-This arises due to inefficiency, negligence, mischief or bad luck etc. Such losses are avoidable to a great extent. Therefore the auditor should not allow minus fluctuation in prices of goods in such cases unless he gets satisfactory explanation for the same.

(vii) *Cost-its meaning*.-The elements that constitute cost are-

(a) the purchase price of goods, stores and in the case of purchased stock, materials used in manufacture,

(b) direct expenditure incurred in bringing stock in trade to its existing condition and location and

(c) indirect or overhead expenditure incidental to the class of stock in trade concerned.

Whereas the cost of items (a) and (b) can be worked out with substantial accuracy, the cost towards item (c) i.e., indirect or overhead expenditure can only be a matter of calculation. If indirect or overhead expenditure is expressed as a percentage of actual production the amount added to the stock valuation will fluctuate from one period to another according to the volume produced. To avoid distortion of revenue results, in some cases indirect or overhead expenditure is eliminated as an element of cost when valuing stock in trade or alternately, only that part which represents fixed annual charges is excluded. In other cases, an amount is included which is based on the normal production of the unit concerned.

(viii) *Method of computing cost.* - The following are bases usually adopted in practice for calculating cost.

(a) *Unit cost.*- The total cost of stock is calculated by totalling the individual cost of each article, batch, parcel or other unit. But in some cases it is impossible to identify the stock on hand with the various consignments purchased and it will involve undue time and labor.

(b) *First in and first out.*-This method is adopted on the assumption that the goods are consumed as and when they arrive and those on hand represents the latest purchase.

(c) *Average cost.*-This basis entail averaging the book value of stock at the commencement of a period with the cost of goods added during the period after deducting consumption at the average price, the periodical tests for calculating the average being as frequent as possible having regard to the nature of the business.

(d) *Standard cost.*- This is a predetermined or budgeted cost per unit. It is coming more into use, particularly in manufacturing or processing industries where several operations are involved or where goods are produced on large scale.

(e) *Adjusted selling price.*-This method is used widely in retail business. The stock is valued at the first instance on the basis of selling price and deducting there from a certain percentage representing the gross profit.

(f) *Base stock*.—Under this method an agreed quantity of stock is valued at a fixed price each year, this price being below the original cost price of the “Base Stock”. The excess on this fixed quantity can be valued at cost price or market price whichever is less.

(ix) *Market value*.—The market value is interpreted by some as replacement value, ie. what it would cost to purchase similar quantities at the market price ruling on the day of the balance sheet and by some as realisable value, ie the net amount that would be realised if sold at the price ruling on the day of balance sheet. The general practice as regards stores and raw materials is to value them at the lower cost or replacement value. In the case of finished goods it is the lowest cost or net realisable value which is generally adopted. It is an accepted principle that the assets should be valued for the balance sheet purposes on a going concern basis. So it is suggested that all inventories of stores like, raw materials processed and semi processed and finished goods etc., should be valued at cost or at the net realisable value of the finished goods.

(x) *Auditors’ duty with regard to stock in trade*.—The accuracy of the balance sheet largely depends on the correct valuation of stock in trade. Since falsification of accounts is frequently effected by means of manipulation of the stock list, the auditor should be very careful in the verification and valuation of stock in trade. It is impracticable for the auditor to take, inspect or value the stock himself. He has to rely largely on the internal check in force and on the officials’ Certificate. Therefore, the auditor should exercise reasonable care and skill with a view to satisfy himself as to the correctness of stock taking and valuation. The work of the auditor in most cases may be summarised as follows:-

(1) Casting and a proportion of the calculations of major item in the stock sheet should be checked.

(2) The quantities shown in the book should be compared with the actual stock verified. Differences, if any, should be enquired into.

(3) Where stock is held by agents or warehouses, their certificate should be obtained and compared.

(4) He should verify whether all goods included in the stock are also included in the purchases by examining the Goods Received Books, for the last few days of the period and testing invoices for the new period.

(5) The basis of valuation should be enquired into. It should be seen that the stock is valued at cost or market price whichever is lower on the date of the balance sheet and that the value of the finished goods is below the market price. The items of obsolete and defective stock should be valued at their respective realisable value.

(6) The percentage of gross profit on turnover should be compared with that of the previous period and the causes of marked fluctuation, if any, should be enquired into.

(7) It should be seen that the stock sheets have been properly certified by some responsible official, the parties concerned in the preparation having initiated them.

The most important point to be considered by the Auditor in this matter is to ascertain whether the same basis is adopted from year to year. If consistent basis is not so adopted, the trading results shown by the accounts would become distorted. The Auditor will do well if he states in his report the extent to which he relied on the certificate of the management. Any matter which is not up to the satisfaction should be dealt with in his report.

(xi) *Valuing of by-products.*- In manufacturing and processing societies, which yield by-products, (for example, molasses in sugar factories, cotton waste in spinning mills, oil cakes in oil mills, broken rice in rice mills) it may not 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 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 expenses connected with marketing etc.

5. *Valuation of different classes of stock.*- The method of valuation varies with the nature of the inventories.

(i) *Raw materials.*-Raw materials are, in general, valued at cost or the market price, whichever is less. The proportionate amount of freight and other charges paid for the same is added to the invoice price.

When the stock contains goods purchased at different prices the average price may be taken into consideration. Consequent on the fall in the price of finished products, if any definite loss is anticipated in the succeeding year, it may be desirable that the value of raw materials should be correspondingly written down.

It is the custom in some trade to value the stocks of raw materials above cost when such stocks mature with age and increase in value, eg. wine, timber, tobacco etc. in order to cover the storage charges and interest on capital locked up in such stocks. The auditor should ascertain that the stocks are not valued at an excessive amount and that the values are properly certified and do not exceed the market value of similar stocks.

(ii) *Semi-finished goods or work in progress*.-Work in progress is represented by the materials and work done in respect of incompleted contracts or partly finished goods. This item should be valued at cost price ie. raw materials consumed, wages and direct charges expended thereon up to date with a reasonable sum for over head charges. Provision will have to be made for anticipated loss. Therefore, it is better if these items are valued at current standard cost or at the net realisable value in the form of finished products.

(iii) *Finished goods*.-Finished goods which have been purchased are valued at cost, ie. invoice price. The goods which are manufactured by the concern should be valued in the same manner as semi-manufactured goods. The auditor should see that such finished goods are not valued at a price higher than the price of the similar goods prevailing in the market.

The recommendations of the council of the Institute of Chartered Accountants in England and Wales, on the treatment of stock-in-trade are given below:

“No particular basis of valuation is suitable for all types of business but, whatever the basis adopted, it should be applied consistently, and the following considerations should be borne in mind.

(a) Stock in trade is a Current asset held for realisation. In the balance sheet it is, therefore, usually shown at the lower cost or market value.

(b) Profit or loss on trading is the difference between the amount for which goods are sold and their cost, including the cost of selling and delivery. The ultimate profit or loss on unsold goods is dependent upon prices ruling on the date of their disposal, but it is essential that provision should be made to cover anticipated losses.

(c) Inconsistency in method may have a very material effect on the valuation of a business based on earning capacity, though not necessarily of importance in itself at any Balance Sheet date."

(iv) *Spare parts*:-Spare parts which are used for the upkeep of plant and machinery should be valued at cost. Obsolete spare parts of out-of-date plant and machinery should be written off or written down the auditor should get a complete list of spare parts certified by the Officer in charge of the factory, as to its current use.

(v) *Goods on consignment*.-In respect of goods sold on consignment basis, a certificate should be obtained from the consignee in respect of the stock on hand on the date of Balance Sheet. The unsold consignment of goods mentioned above should be valued at cost price plus proportionate expense etc. The auditor should be careful to see that any balance of stock of consignment inwards is not included in the stock list.

6. *Sundry Debtors*:-"Sundry debtors" include all amounts due in respect of goods sold on credit, services, rendered on 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 "or loans due from members."

(i) *Outstanding advances*.-Outstanding advances are usually included in 'Sundry Debtors'. But many times, it is shown under a separate heading Advances should be given only for specific purposes and the director or employee to whom the advance has been given should render necessary accounts as soon as the purpose, for which the advance has been given, has been served. Where 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. Where there are long pending advances the auditor should make a note of all such cases and obtain the explanations of the management or the

officers concerned. If the explanation given or the clarification furnished is considered not satisfactory, the auditor should keep such payments in his schedule of irregular payments. If the amounts involved are large and no satisfactory explanation has been offered, the auditor should examine whether a case of temporary misappropriation can be made out.

(ii) *Checking of outstanding advances.*-A statement of all items appearing under the heading "Sundry Debtors" "Advances outstanding" etc. should be obtained and agreed with the figures appearing in the Balance Sheet. Sundry debtors for credit sale should be distinguished from other debtors such as debtors for advances, deposits against orders or advances against purchases and advances to directors and officers. The schedules should be checked with the personal ledgers and other records and the total agreed with the amount shown against the items in the balance sheet. While checking ledger balances on the schedules, notes should be made showing the period during which the amount 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. A list of all accounts, which are overdue, should be prepared and checked by the auditor.

(iii) *Deposit 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 Municipalities, Electricity Board etc. In such cases, the auditor should verify the receipt issued by them and should obtain confirmation as evidence of the deposit. Where deposits of a special character or of a substantial amount are made, these should be verified according to the circumstances of each case and their adjustments watched.

7. Loans outstanding-Loans outstanding in Co-operative Societies except those doing banking business, are generally fixed loans which are payable either in lump or in instalments as may be specified. Loans advanced to members would be different according to the nature of the business operations conducted by the society and the nature of the security which, the borrower can offer.

Loans are generally classified according to the nature of securities offered by them. Loans may be grouped under two broad

heads, (i) secured loans and (ii) unsecured loans. All loans which are backed by material securities are considered as 'secured loans' and others are called unsecured loans. Even the unsecured loans are based on the credit worthiness of the borrower and backed by his capacity and willingness to repay. The method of checking loans outstanding is explained below:

The auditor should obtain a list of loans and advances outstanding on the date of the balance sheet and should check it with the loan ledgers and the total of the balances agreed with the balances appearing in the General Ledger. In checking the balances of loans, emphasis should be given on the following points:

(i) *Amount outstanding*. - If the byelaws have prescribed individual maximum limits for different types of loans, the outstanding balances in any account should not exceed such maximum limits. Where special loan or loans in excess of the prescribed limits have been sanctioned to any individual or institutions, authority for the same should be verified.

(ii) *Period wise classification of loans outstanding*. - The auditor should examine whether the loans has become overdue and whether proper extensions have been granted. If the period of repayment have not been extended, how long the loan has been overdue and what effective steps have been taken for its recovery should also be examined.

(iii) *Security for the loans*. - The auditor should examine the nature and adequacy of the security and its realisability. If the loan has been sanctioned against personal security, he should ascertain whether the sureties are alive and good, for the outstanding amount. If they are secured, he should check up whether value of the security offered adequately cover the outstanding balance and also the interest accrued and accruing and also whether it can be easily realised.

(iv) *Reasons for the debts becoming irrecoverable*. - The auditor should also examine the circumstances which indicate the debts becoming irrecoverable, due to death, resignation or removal from service of the borrower or his sureties, insolvency of the borrower, or attachment of the property or salary under any order or decree of a Court. Where the loan is repayable in instalments he should examine whether all the previous instalments have been properly paid as and when they became due.

(v) *Loans to Committee members.* -Along with the Balance Sheet and Profit and Loss Account, the auditor should attach a list of loans, if any, given to the members of the committee and their family members. In the case of loans issued to the members of the committee, the auditor should specially look into the nature of security offered and its adequacy, whether the purpose for which the loan was sanctioned was those contemplated in the byelaws, whether any relaxation in the repayment of instalment has been allowed etc. The byelaws of certain societies stipulate that the loans issued to the members of the committee should be ratified by the General Body. This would ensure that members of the Committee taking advantage of their position do not appropriate large funds of the Society by sanctioning to themselves disproportionate loans. The auditor should therefore ensure that such provision of the byelaws have been complied with.

(vi) *Assessment of bad and doubtful debts.* -The balance sheet and profit and loss account of the Society checked and certified by the Auditor should disclose fairly and accurately the financial position of the Society as on the date of balance sheet. In credit societies, loans outstanding form a major portion of the assets. Therefore examination of debts is one of the most important works of the Auditor. Outstanding loans and advances in banks and credit societies consist of current dues and overdues. An overdue account is one in which the principal outstanding or any portion thereof or any instalment which has become due has been defaulted. A bad debt is one considered to be irrecoverable. Such a debt will have to be written off against the Bad Debts Reserve or any other reserve marked for the purpose. A doubtful debt is one, the recovery of which in whole or in part is uncertain. All such debts should be carefully examined and adequate provision made against such debts.

As suggested by Spicer and Pegler, the following points should also be considered while examining the Debtors' ledger balances for this purpose:-

(a) The term of credit allowed by the Business:-

[The debts, the term of credit of which is not yet expired, can safely be treated as good debts, in the absence of any other circumstances contrary to such course].

(b) The settlement of accounts within the periods of credit, taking advantage of cash Discount whether regular or irregular:-

[The debts which are regularly settled should be considered as good. In the case of debts which are not regularly settled, the causes for such irregularity should be examined].

(c) The age of the debt:-

[Time barred debts should be reserved for in full, Long outstanding debts should be considered with their relevant circumstances to decide whether they are good/bad or doubtful.]

(d) Whether the balance has tended to increase, inspite of payments being made on account:-

[Such cases should be considered carefully and reserves should be created, if necessary.]

(e) Whether an old balance is being carried forward to be paid off in instalments, new goods being supplied for cash:-

[the payment of an old balance by instalment is nearly a sign of weakness. The old balance may be treated as doubtful and necessary reserve created].

(f) If payments are used to be made by acceptance of bills whether any bill has been dishonoured or retired or constantly renewed:-

[Frequently dishonour or renewal of bills is certainly an evidence of weakness. Such cases should require careful consideration].

(g) Whether any cheque received on account have been dishonoured:-

Under this circumstances, the debts should be considered doubtful and reserve created.]

(h) Whether notes appear upon the account such as “Accounts suspended”, “In solicitor’s hands”, “In insolvency”, or “In Liquidation”, “Disappeared and whereabouts unknown”, etc:-

[Notes of suspension of accounts etc, made upon the top of the account provides the best means of information to study the position of the debt].

(vii) *Classification of debts into bad and doubtful.*-To classify a debt as bad or doubtful, the two main considerations are (i) the

security for the debt and (ii) the period for which the debt has been defaulted. For example, if the security for a particular loan is reduced to nil and the loan has been outstanding for a fairly long period, there is every probability of its becoming bad. 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.

(viii) *Procedure for classification of debts into good, doubtful and bad.*-A list of overdues with full particulars regarding age, security, action taken for recovery etc., should be obtained by the Auditor before he examines and classifies them into good, doubtful and bad. This list should be carefully scrutinised with reference to the security available and the age of the overdues. After careful examination of all overdues accounts in the above manner, the auditor should classify the overdues into good, doubtful and bad. In order to enable easy assessment of doubtful and bad debts by the auditors, it is necessary that all the account books and registers are maintained up to date.

(ix) *Procedure for writing off of bad debts statutory provisions.*- Rules 62 of the Kerala Co-operative Societies Rules 1969, reads as follows:-

(1) Such of the dues to the Society including loans and interest thereon which are found irrecoverable and duly certified as such by the auditors appointed under section 63 may be written off with the approval of the General Body and sanction of the Registrar.

(2). Before sanction for the write off is accorded the opinion of the financing bank may be obtained if the Society is indebted to the Financing Bank. (Registrar’s Circular No. 93/75 G3,.11491/75 dated 17-11-1975.)

(x) *Auditor’s responsibility for certifying bad debts.*-The auditor assumes a great responsibility in certifying the loans as bad as all amounts certified by as bad would be written off. He has, therefore, to be very careful in certifying a debt or loss as bad or irrecoverable. In case of irrecoverable loans, it has to be seen that cases of the defaulters were referred to arbitration in time and awards obtained which were sent up in time for execution, but returned by the recovery officer as the Principal debtor . or sureties had no assets or income which could be attached. In the case of debts, which have

become time barred due to inaction or negligence on the part of the Committee/Officers, proceedings should have been instituted against persons found to be negligent.

The following additional conditions are also to be fulfilled for writing off bad debts:

(i) Sanction of the General Body should have been obtained.

(ii) Prior approval of the Registrar and the financing bank to which the society is indebted should have been obtained in writing. If the society/Bank is not affiliated to the Central Bank/state Co-operative Bank, or is affiliated but not indebted to the Central/State Co-operative Bank, prior approval of Registrar should be obtained.

(xi) *Provision for bad and doubtful debts.*-Before arriving at the figure of net profit, adequate provision is required to be made for all amounts required to be written off as bad debts and losses which cannot be adjusted against any fund created out of profits. 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.

8. *Fictitious Assets.*-There are certain assets which sometimes appear in the balance sheet. They may be representing capital expenditure which may not have resulted in identifiable profit earning assets and which still remain to be written off. Common examples of fictitious assets are preliminary expenditure or formation expenditure, development expenses, etc. The Auditor should check the balance carried forward from year to year and ascertain the reasons for their continuance.

9. *Preparation of Financial Ratios.*-A financial ratio is an arithmetical expression of the relationship between two figures produced as a result of normal accounting process. Such figures may include figures of gross profit, net profit, current assets, current liabilities, fixed assets, sales or turnover, working capital etc. The advantage of preparing financial ratio is that performance and financial position can be properly judged. Ratio may be based on the figures in the balance sheet, profit and loss account or in both.

The following are some of the important ratios,-

(i) *Current ratio*.—The current ratio is also called working capital ratio

$$\text{Current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

(ii) *And test ratio or quick ratio*.—This is a part of current ratio and is found by comparing liquid resources, with current liabilities. This ratio is of great importance for banks and financial institutions, but not for ordinary trading and manufacturing concerns. This can be calculated in dividing liquid resources or quick assets by current liabilities.

(iii) *Proprietary ratio*.—The ratio discloses the relationship between the equity of the owners or proprietors and that of creditors. i.e., the ratio of the amount invested by the owners (capital + Reserve and surplus) to the amount invested by creditors. Thus the proprietary or equity ratio is worked out by dividing capital employed by liabilities.

This ratio exhibits the proportion between owned capital and borrowed capital. Any shortfall in the volume of sales or any delay in the collection of bills may create financial difficulties for the business to discharge its obligation promptly. Hence a low proprietary ratio is viewed with much anxiety.

(iv) *Capital employed ratio*.— The ratio of capital to non-current or fixed assets is used to ascertain the extent to which the owners have invested their capital in fixed assets which constitute the maximum structure of the business.

(v) *Stock turnover ratio*.— This ratio exhibits the number of times the average stock is turned (or sold) during a given period. To ascertain the number of times the average stock is turned, the cost of goods sold is divided by the average stock.

(vi) *Debtors turnover ratio*.—The ratio of debtors to Debtor Turnover (Credit sales) shows the average period of credit allowed. The amount due from debtors is divided by the average daily or monthly credit sales.

(vii) *Creditor's Ratio*.— The ratio of creditors to credit purchase amount, shows the average period of credit availed by the institutions.

(viii) *Gross profit ratio.*-The Auditor can calculate the gross profit ratio by using the method $\frac{\text{gross profit} \times 100}{\text{Net sales}}$ The higher the gross profit ratio, the better is the position of the institution.

(ix) *Net profit ratio or margin.*-This measures the rate of net profit earned on sales. The ratio can be calculated by $\frac{\text{Net profit} \times 100}{\text{Net sales}}$

The auditor should bear in mind the above factors in arriving at a decision as to the financial soundness of the institution. He should try these exercises and ascertain the financial soundness, working result etc of the institution and make his observation in the audit report accordingly.

10. *Verification of cash balance.*-(i) Cash on hand.-

This is the first item of work to be attended to by the Auditor while conducting mechanized checking of the accounts. In a village credit society the auditor should see whether the cash book/Day book has been written up to date. If it is incomplete, he should see that it is brought up to-date and balanced. Then he may test check a few receipts and vouchers of the transactions carried out during the last four or five days. He should then verify the actual cash balance and satisfy whether it agrees with the book balance. The result of verification of the cash balance should be recorded in the cash/day book. In the case of a bigger society, it is always convenient to verify the cash balance either before the day's business or after it is over, However, if surprise verification is necessitated in view of the peculiar conditions prevailing, he may visit the society in the course of the working hours and ask the society or any other official who maintain the "scroll" or rough chitta to close it. Therefore if the day book is incomplete at the time of verification, the auditor can verify the cash balance with reference to the cash book/cash scroll maintained by the cashier, and sign it after recording the result.

If there is more than one balance, as will be the case where there is a cashier as well as a petty cashier all the balances should be verified at the same time to avoid one being utilised to supplement/substitute the other.

If the person responsible for custody of cash balance fails to produce it to the auditor for verification, he has to issue a summons and take action as per provisions of the Kerala Co-operative Societies Act.

(a) Specimen form of Summons:

Issued under Section 63 of the Kerala Co-operative Societies Act 21 of 1969.

Whereas I, Shri. have been appointed to audit the accounts of..... Society and whereas documents relating to the Society have to be scrutinized by me for the said purpose, I hereby require you, Shri President/Secretary/Manager of the said Society to be present with the following at a. m./p. m. on in the office of the Society or in the premises of

Given under my hand and seal this day of 19

Signature

Designation

1. Cash balance of the Society.
2. Books do.
3. Records and documents of the Society.

To

Shri

(Full address)

(b) Certificate of verification.

FORM OF CERTIFICATE

'Cash balance of Rs/(in words) was verified by me and found to agree with the day/ cash book balance as at the beginning/close of

Signature with date.

Designation.

NOTE :- The auditor should personally serve the summons.

(C) Auditor's responsibility for verifying cash on 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 asks for the production of cash balance for verification. In addition to the auditor, other inspecting officers of the Department as well as of the Financing Bank can demand production of the cash on hand for verification. 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 considerably 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 in the balance sheet as at the 30th June 19..... represents cash on hand in the Head Office and all the branches, of the Society/Bank situated at different centres in the area of operation of the Society/Bank and custody certificates in respect of all these cash balance have been obtained from the Manager/Accountant/ Cashier/Agent, etc. of the branches concerned. The above certificate has to be got signed by the Chairman/President and the Managing Director or other principal Executive Officer of the Society”.

(ii) *Cash at Banks*.-Every co-operative society will have a Bank account. All co-operative societies are generally permitted to open accounts with District/Central Co-operative Banks of the concerned District. But in certain cases, if circumstances necessitate, the societies may open account with Commercial Banks with the previous sanction of Registrar. All cash balance in excess of the limit prescribed in the byelaws has to be invariably deposited in the Bank Account. Cash in Bank on the date of Balance Sheet can be verified by means of pass Book, bank statements and the bank balance certificate. If the balance does not agree, it will be necessary to prepare a reconciliation statement. The auditor should himself write to the Bank/Post Office for confirmation certificates of all the accounts of the Society with the Bank/Post Office,

(iii) *Counting of cash-Precautions*.-The inspecting officers and auditors have to take certain precautions while verifying the cash balance. If different cash balances are maintained, such as cash with local branches and depots etc. all the cash balances have to be called for simultaneously and verified as there is always the

danger of substitution/supplementing. When coins of different denominations are sorted out and kept in separate bags duly sealed, the bags are not to be opened except in the presence of responsible officers.

(iv) *Measures to be taken for preventing temporary misappropriation.*-Temporary misappropriation can be committed by deliberately delaying payment into Bank. Cash Balance can also be misappropriated temporarily by taking wrong totals and/or by wrong extraction and carrying forward the cash balance. The Auditor should enquire the reasons for payment of advances to the members of staff and directors. It should be seen that advances made are genuine and for proper reasons. Unless the cash/day book is written up to date and the exact cash balance ascertained, counting of cash will have no meaning. It is therefore, necessary for the inspecting officers to see that the Day/Cash Book is written up to date always.

CHAPTER IV

VERIFICATION AND VALUATION OF LIABILITIES

1. *Classification of liabilities-Owned capital and borrowed capital.*-The liabilities of Co-operative Societies are broadly classified under the following heads in the Balance Sheet.

- (i) Share Capital
- (ii) Statutory Reserves.
- (iii) Other funds
- (iv) Deposits from members and non-members
- (v) Borrowings:
 - (a) Secured
 - (b) Un-secured
- (vi) Creditors
- (vii) 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. Excess of current assets over current liabilities indicate the resources available with the society for meeting its day to day requirements.

2. *Share capital-State participation.*-The byelaws of the society have to be examined to ascertain the authorised share capital. It should be seen whether the paid up share capital has exceeded the authorised shares. If the limit has been exceeded the auditor should advise the society to enhance the authorised share capital by suitably amending the bylaws. The authorised share capital should provide also for Government contribution, if any towards shares which are issued to Government only. Conditions regarding payment of dividend, redemption of shares, creation of share capital redemption Fund etc. are prescribed in the Government orders sanctioning share capital contribution. The Auditor should also ensure that conditions prescribed in the Government orders sanctioning share capital contribution have been fully complied with by the society.

3. *Principal State Partnership Fund and Subsidiary State Partnership Fund.*-These funds are required to be created and maintained by the Apex Society and the Central Society respectively. Contributions received from Government to the Principal State Partnership Fund are to be utilised for directly purchasing shares of other societies with limited liability or for providing money to a Central Society to enable that society to purchase shares in other societies or for making payments to the Government in accordance with the provisions contained in chapter VI of the Kerala Co-operative Societies Act 1969.

Subsidiary state Partnership Fund is constituted with the money paid by the Apex Society from out of the Principal State Partnership Fund. The Central Society shall utilise this fund for purchasing shares in Primary Societies or for making payments to the Apex society as contemplated under chapter VI of the Act. (Sections 44 & 45 of the K. C. S. Act).

4. *Meaning of Reserve.*-The term 'reserve' has not been specifically defined in the Co-operative Societies Act. The Indian Companies Act has defined the term 'reserve' as not including any amount written off or retained by way of providing depreciation,

renewals or diminution in value of assets or retained by way of providing for any known liability. The term ‘provision’ means any amount “written off or retained by way of providing for depreciation, renewals or diminution in value of assets as retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy”.

(i) *Statutory Reserve Fund.*-Creation and maintenance of reserve fund out of the net profits are compulsory under the provisions of the Act. No distribution of profits can be made until necessary amounts as required under section 56 of the K. C. S. Act 1969 are carried to the statutory Reserve Fund. The Reserve Fund is indivisible and it can be used only for purposes mentioned in Rule 61 of the K. C. S. Rules, viz. to discharge the debts due to the Government, other debts of the society, the paid up share capital and to pay dividend upon such share capital at a rate not exceeding 10% per annum for any period for which no dividend has been paid.

(ii) *Funds created out of profits.*-The term “fund” strictly speaking denotes investment of a reserve outside the business of the society. 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 are of the view 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 such fund is invested outside business of the company. But, as far as Co-operative Societies are concerned, there is no such distinction made either in the Act or in the Rules. Therefore the term ‘Fund’ is also indiscriminately used to denote all reserves created out of profits.

5. *Provision for anticipated losses and unascertained liabilities.*-Normally a provision is required to be made when a loss is anticipated. But the amount of provision thus to be made cannot be ascertained exactly. As the loss might have been incurred before the date of the balance sheet, the loss so incurred should have been debited to the profit and loss account and a provision created on liability side of the balance sheet. This kind of 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 exactly ascertained. Examples of such losses in the realisation of assets are bad debts, rebates discounts or other allowances. The Auditor should examine whether such losses are written off or adequate provision made in the balance sheet to meet such anticipated losses.

As regards unascertained liabilities, it is likely that bills discounted may be dishonoured, guarantees may have to be fulfilled, or damages under pending actions, claims for which have not been admitted may have to be paid. Losses may also arise as a result of fire or other risks not fully covered. Therefore, the auditor has to see that adequate provision has been made for all such accruing liabilities. But no provision is to be made for liabilities accruing out of acquisition of assets of corresponding value.

6. *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 in the value of an existing asset which will have to be replaced at the end of a specified period. Societies which float debentures are required to maintain a Sinking Fund for the redemption of the debentures at the end of the period for which they are issued. Creation of a Sinking Fund entails a charge on the profit and loss account every year of an amount which if invested outside at compound interest, will yield the amount necessary to redeem the liability or acquire the new asset at the end of the given period. Housing Societies, Land Mortgage Banks and other similar societies are required to create Sinking Fund which is required to be invested outside the business of the society.

7. *Bonus Equalization Fund*.-This is permissive but not mandatory. Discretion vests with the general body to allocate a portion of the net profit to this fund if it is contemplated in the bylaws of the society. The fund is intended for payment of bonus to the members.

8. *Provision for overdue interest*.-Interest accrued on a loan the due date of which has fallen on or before the date of Balance Sheet and remains unpaid till the date of Balance Sheet is called interest accrued and overdue. All interest accrued and accruing and which are overdue as on the date of Balance sheet should be excluded from the amount of net profits. If interest receivable has been included in profits it is necessary that, that portion of interest receivable which is overdue is deducted. This can be done either

by debiting the interest account and by crediting the “Provision for overdue interest receivable account, or by deducting overdue interest pending collection from the total amount of interest collected and due.

In the case of loans which have become fully overdue ie. the entire balance under the loan has fallen overdue, any interest accrued on these fully overdue loan should be classified only as overdue interest. Since the loan itself has fallen in default, it will be prudent to treat any interest accrued on such loans as overdue interest so as not to treat it as a profit item.

9. *Contingent Liability*.-There may be certain liabilities that may arise at a future date though not at the time of closing of books, as a result of the transactions. For example, bills discounted before due dates, calls on shares held and not fully paid up, pending litigation, discounting of hundies etc. The term ‘Contingent Liability’ may be defined as the possible future liability arising from one or more business acts preceding the date of the balance sheet.

Contingent liability may be of two kinds broadly:-

(1) A liability involving an ultimate loss. eg. a liability in a disputed case where damages may have to be paid.

(2) A liability which will involve the acquisition of an asset eg. when goods have been purchased for future delivery or under an agreement of service.

The Auditor should find out such liabilities during the course of audit and enquire into them in detail with a view to see that adequate provision is made in the accounts for these liabilities. Unless the liability is definite, provision is not made in the accounts in the normal course.

10. *Income Tax*.-Section 2 (19) of the Income Tax Act 1961, defines a Co-operative Society as “allow co-operative Society registered under the Co-operative Societies Act ,1912 or under any Law for registration of Co-operative Societies”.

The income of a Co-operative Society is computed according to the provisions of Income Tax Act, just as any other assessee. After computing the gross total income of the Co-operative Society under various Heads of income provided under the Income Tax Act, the following deduction are made as per provisions of Section 80 (P) of the Income Tax Act 1961, to the extent noted against each.

(i) The whole income derived from the following business is exempted:--

- (a) Banking or providing credit facilities.
- (b) Cottage Industry.
- (c) Marketing of agricultural produce.
- (d) Purchase of agricultural implements, livestock or other articles intended for agriculture for purpose of supplying them to its members.
- (e) Processing without the aid of power of agricultural produce of its members.
- (f) Supplying milk raised by its members to a Federal Milk Co-operative Society.
- (g) Labour Contract Societies.
- (h) Co-operative Societies engaged in fishing and other allied pursuits.

In the case of item Nos. (g) and (h), the Tax concession will be available only if the Bylaws of such Societies, restrict the voting rights to its members, State Governments and Co-operative Credit Societies, which extend financial assistance to them.

(ii) In the case of Co-operative Society engaged in activities other than those mentioned in item (I) above, Rs. 20,000 of the profits derived by such activities.

(iii) In the case of every Co- operative Society the whole income it derives by way of interest or dividends from its investments in other Co- operative Societies.

(iv) In the case of every Co-operative Society the whole of income derived from letting of godowns or warehouses for storage, processing or facilitating marketing of commodities .

(v) The whole of income chargeable as “Interest on Securities” (under section 18 of the Income Tax Act) or “Income from House property” (Chargeable under section 22 of the Act) provided the gross total income of the said society does not exceed Rs. 20,000.

This deduction is not however made available to housing societies or transport societies. As per Section 27 (iii) of Income

Tax Act, the member to whom the house is constructed is liable to pay in respect of income from the house property even though the ownership is with the housing society.

11. *Unpaid Expenses*.-Expenses incurred during the year but for which payment has not been effected till the date of balance sheet are called unpaid expenses. This should be first debited to the profit and Loss Account and shown as a liability in the Balance Sheet. Common expenses of unpaid expenses are Rent, Rates, Taxes, Electric charges etc. Before providing these items under “unpaid expenses” the auditor should examine vouchers, invoices etc. relating to such payments.

12. *Unearned Income*.-Instances like rent received in advance which is not applicable to the year under audit should not be credited to profit and loss account of the current period, but should be shown as a liability. The Auditor should examine the vouchers to find out which portion of the amount is to be carried forward as a liability for the subsequent year.

13. *Others*.-Any other item which is not covered by the above should be verified and valued according to the circumstances of each case.

PART IV

CHAPTER I

AUDIT REPORT

1. *Preparation of audit note and certificate*.-As soon as the auditor finalizes the audit for a year, he has to draw up the audit memorandum and the certificate, in the forms prescribed by the Registrar. The audit memorandum is in the form of questions eliciting details and the auditor has to answer those questions with reference to the books of accounts and records of the society, working sheets and final statements prepared in connection with the audit. Before filling up the audit memorandum, the auditor should ensure that the information furnished in the memorandum are correct, brief and specific to the point i. e. the information or details furnished should not be vague. When the audit memorandum is filled up with all details, it should be submitted to the competent authority, along with the draft audit certificate, summary of defects, auditor’s report and special report, if any.

2. *Certification of the Balance Sheet and Profit and Loss Account.*-Sub rule (2) of Rule 64, requires the auditor to submit the audit memorandum in the form prescribed by the Registrar on the accounts examined by him and on the Balance Sheet and final accounts on the date/for the period upto which the accounts have been audited and shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give all the information required by the Act and give a true and fair view:-

(i) in the case of the balance sheet the society's affairs as at the end of the year or any other subsequent date 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 year, or the period covered by the audit as the case may be.

(i) The rule further requires the auditor to state whether he has 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 byelaws of the society have been kept and regularly maintained by the Society so far as it appears from the examination of these books and

(iii) Whether the balance sheet and the final accounts, examined by him are in agreement with the books of accounts and records of the Society.

The auditor has also to furnish a certificate in the form of a 'Report' which is attached to the audit note. The form of Report of the Auditor is as follows:-

REPORT OF THE AUDITOR

I, the undersigned Auditor of the
 Co-operative Society/Bank Ltd., No..... report on the
 Balance Sheet and Accounts of the Society/Bank as at 30th June, I
 have examined the foregoing Balance Sheet of the
 Co-operative Society/Bank Ltd., No
 as at 30th June and the Profit and Loss
 Account of the Society/Bank for the year ended upon that date
 with the accounts relating thereto of the Head Office and with the

returns submitted and certified by the Branch Managers, which returns have been incorporated in the foregoing Balance Sheet and Accounts

I report that:-

- (1) I have examined the overdue debts, have verified the cash balance and securities and have valued the assets and liabilities of the society/Bank as required in section 63 of the Kerala Co-operative Societies Act, 1969.
- (2) In my opinion the balance sheet is a full and fair one, containing all the necessary particulars and is properly drawn up so as to exhibit a true and correct view of the affairs of the Society/Bank according to the best of my information and explanations given to me and shown by the books of the Society/Bank.
- (3) Where I have called for any explanation or information, such explanation and information have been given to me and have been found satisfactory.
- (4) The transactions of the Society/Bank which has come to my notice have been within the competence of the Society/Bank.
- (5) The returns received from the branches of the Society/bank have been found adequate for the purpose of audit.
- (6) The profit and loss account shows a true balance of profit for the year covered by such account.
- (7) In my opinion the Balance Sheet and the Profit and Loss Account are drawn up in conformity with the law, and
- (8) In my opinion books of accounts have been kept by the Society/ Bank as required by Law.

Place:

Signature:

Date :

Name:

Designation.

3. *Schedules required in the audit memorandum.*- Rule 64 (5) of the Kerala Co-operative Societies Rules, requires the auditor to submit along with the audit memorandum, schedules with full particulars of:-

(i) All the transactions which appear to be contrary to the provisions of the Act, the Rules or the byelaws of the Societies.

(ii) all sums which ought to have been, but have not been brought into account, by the Society;

(iii) any material impropriety or irregularity in the expenditure or in the realisation of moneys due to the society .

(iv) any money or property belonging to the society which appears to the auditor to be bad or doubtful debt.

(v) an audit classification statement prepared in accordance with the instructions issued by the Registrar from time to time and

(vi) any other matter specified by the Registrar in this behalf.

4. *Summary of audit defects (discussion with the committee of management before finalization.*- Along with the audit note/memorandum, the auditor should also furnish the summary of defects noticed during audit. It should contain the General observations of the auditor regarding the affairs of the society, the accounts of which he has audited, the irregularities, if any; noticed with specific examples and the suggestions for improving the state of affairs of the Society. The summary of defects should be clearly worded so that there would not be any doubt as to the precise meaning of any point dealt with therein. In short, vague generalisations should be avoided and the observations should be specific, dear and detailed. Every paragraph should begin with a suggestive headline, viz., failure in the collection of overdues, inadequacy of supervision/control, etc.

The summary of defects is prepared and submitted in two parts, Part A and B-Part A containing such of the serious defects requiring immediate attention and warranting quick action by the competent authority, Part B should contain comparatively less serious defects of a routine nature. The summary of defects should be appended to the audit note in triplicate. In case of misappropriation of funds, destruction of records, disappearance of a responsible officer or the society or instances of a serious nature, the auditor has to report the matter immediately to the competent authorities by way of special reports or confidential reports.

The auditors are not expected to record their observations/remarks/ opinion/inferences etc. about the office bearers/working

of the society in the Day/Cash Book or other books of the Society except in the Inspection Register or Defect Rectification Register where the defects are noted. The observations are to be recorded in the summary of defects submitted along with the Audit Note/memorandum.

For quick rectification of defects and to avoid summary of defects becoming needlessly voluminous, the auditors should record the defects in a Defect Rectification Register which should contain two parts, one part for recording the defects noticed by the auditor and the other part for recording the rectification of those defects and for the replies of the Society. Defects of routine nature could be got rectified then and there. Such of the defects which may remain uncertified till finalization of audit should be included in the summary of defects.

Before finalisation of audit, the auditor may arrange to meet the committee of management of the Society/Bank and discuss with them the defects noticed and offer his suggestions to improve the affairs and to take remedial actions. Such a discussion will definitely bring fruitful results and pave the way to improve the affairs and initiating action for rectification of defects on an early date. The committee can also get their doubts if any, cleared and obtain the necessary clarifications required. Future complaints can also be avoided on the part of the Society on the summary of defects.

5. *Audit will be deemed to be completed only when Audit Note together with certificate and enclosures are submitted.*-As soon as the checking of accounts is over the auditor has to draw up the necessary statements required. The audit note and the certificate have to be prepared and finalised at the Headquarters of the Society, on completion of audit of a society the auditor has to certify the closing balance of cash as on the last day of the year under audit, in the Day/Cash Book of the society. He will also certify the checking of accounts as "checked for final audit" (with year) and affix his signature underneath.

Registrar in Circular No. 21/75 [ADL (2)-I0271/75] dated 21.3.1975 has prescribed the period within which the audit note and the certificates have to be submitted to the appropriate authority. (Circular annexed)

[Appendix II (4)]

(6) *Checking of audit Notes -Guidelines.*-Ensure that the opening figures of the audit notes agree with previous years closing figures of the approved audit report. The following procedure has to be adopted in checking the various aspects:-

(1) *Shares.* -Check the correctness of details furnished under share capital with share statement/certified abstract of the auditor. It should also be verified whether the paid up capital has exceeded the authorised capital. Also verify whether confirmation certificate for Government share capital contribution has been obtained and furnished along with the audit note.

(2) *Deposits.*-Check the figures under this head with the statement/or certified extract. Confirmation of balances have to be verified wherever necessary.

(3) *Borrowings:*

(a) *Central Banks.*-Confirmation certificate issued by the bank duly reconciled wherever necessary.

(b) *Government:-* Certification by the auditor, as to the verification of loan ledger/register maintained in the District/Circle Office or Confirmation certificate issued by the Deputy Registrar~ concerned.

(c) *Others.*-Confirmation certificate of the respective financing agency, with reconciliation wherever necessary.

(4) *Interest paid and due:*

(a) On Deposits.-In respect of interest accrued and pending payment, the statement or certified abstract of the auditor.

(b). On Borrowings.-Confirmation certificates of financing institutions.

(5). *Loans.*-Statements or certified abstracts of loans should be checked with the outstandings furnished under loans. It may be ensured whether a certificate from the custodian of bonds has been obtained as to their safe custody.

(6) *Interest received and receivable.*-The statement/certified abstract of interest received and receivable has to be seen.

(7) *Miscellaneous income*.—In respect of miscellaneous income pending realisation, the confirmation or auditors statement indicating details of items has to be checked, along with the realisability certificate of the board or Management.

(8) *Establishment and contingencies*.—For items pending payment, the statement or certificate of the auditor about the correctness of figures, may be verified.

(9) *Staff security and Provident Fund*.— Confirmation certificate from the institution where such funds were invested should be verified.

(10) *Distribution of Profit*.—See whether statutory reserves have been created as required under section 56 of the Kerala Co-operative Societies Act, 1969 and as per bylaws.

(11) *Reserves and Provisions*.—See the correctness of the creation and removal of reserves and provisions made during the year, either by charging the Profit and Loss account or by giving additional credit in the balance sheet direct. It should also be ensured whether full reserves have been provided for interest accrued and overdue. Similarly full reserves for bad and doubtful debts have also to be created, including for unrenewed cash credit. In respect of co-operative institutions coming under the banking Regulation Acts, assessment of bad and doubtful debts have to be made in accordance with the norms prescribed by the Reserve Bank of India. In respect of reserve created out of profits which are not contemplated in the Act or bylaws, the necessary authorisation of the board of Directors may be verified.

(12) *Investment*:

(a) *Reserve fund*.—Verify the confirmation of financing bank where it is invested.

(b) *Shares with other institutions*.— Confirmation/certificate of the auditor about the verification of original scripts.

(c) *Government bonds/Debentures etc.*—Confirmation/certificate of the auditor on the verification of original scripts. In respect of bonds pledged with other banks/financing agencies, their confirmation as to the possession.

(d) *Movable and Immovable properties*.

- (a) *Movables*.—Verify the asset certificate of the custodian of such assets and the verification report of the stock verifying officer.
- (b) *Immovable*.— The possession and enjoyment certificate issued by competent authorities or the certificate of the auditor as to the verification of title deeds and other related documents.

(13) *Depreciation*.—See whether depreciation or depreciation fund is created based on the instructions of the Registrar of Co-operative Societies.

(14) *Bank accounts*.—Confirmation certificates of the concerned banks along with reconciliation statement wherever necessary.

(15) *Maintenance of fluid resources*.—See whether fluid resources were maintained in accordance with the provisions of statute. Verify whether certificate of the auditor is attached.

(16) *Advances due to society*.

- (a) *Advances*.—Statement duly certified by the management and verified by auditor.
- (b) *Sundry debtors*.—Statement duly certified by the management and verified by auditor along with confirmation certificate of the debtors.

(17) *Advances due by*. - The statement of Sundry creditors duly certified by the management and verified by the auditor.

(18) *Reserve for bad and doubtful debts*.—Examine the statement of bad and doubtful debts along with reasons stated by the auditor for treating the loans as bad and doubtful.

In respect of banks coming under the purview of banking Regulation Act for assessing bad and doubtful debts, the auditor has to follow strictly the norms prescribed by the Reserve Bank of India.

(19) *Chitties/Kuries*.—Examine whether the auditor has furnished the profit and loss account and balance sheet separately in respect of different chitties terminated/conducted by the society.

Confirmation of chitty deposits from treasury/banks may also be verified.

(20) *Trading account.*(a) *Closing stock-Valuation:*

(i) See whether the stock statements are duly signed by the stock verification officer, custodian of stock, committee members and the chief executive of the society.

(ii) Ensure that value of stock is worked at cost price or market price, whichever is less. In respect of stocks held by Hantex/ Handloom Weavers Co-operative Societies, see whether valuation has been done in accordance with norms laid down by the Reserve Bank of India.

(iii) See whether the stocks contain damaged and dead stock. If so, see whether necessary reserves have been created to cover such damaged/ dead stock.

(iv) See whether there is any excess or deficit stock in the closing stock. In the case of excess stock, see that necessary reserve/ provision is created so that such excess is not charged to the profit and loss account and profit distributed among the members.

(v) Critically examine the working results of trading activities and see whether it has resulted in trade profit. If so, the profit earned has any bearing on the average profit margin charged by the society on such goods. In case of trade loss the reasons for such loss have to be investigated and remedial measures suggested.

(21) *General:*

(a) Calculation of working capital/sales.-It should be ensured whether the calculation of working capital/sales/loan transactions etc. have been done correctly for the purpose of assessing the audit fees.

(b) Audit fee assessment.- Ensure whether audit fee has been calculated in accordance with the provisions of the Act and Rules. Also see that no audit fee is charged from societies to which, concessions are allowed as per statute.

(c) Audit Classification.-Examine whether marks have been allotted on the actual performance of the society. In the case of banks coming under the control of the Reserve Bank of India, audit classification has to be done strictly following the norms prescribed by the Reserve Bank of India.

No audit classification has to be made in the first two years of starting of societies.

(d) While checking audit notes of societies in respect of first year's working, a copy of the bylaws of the society has to be obtained and necessary verification made in the audit note about the name, area of operation, authorised capital etc.

(e) Also verify the audit note of the previous year to see whether any defects have been noted in the check memo for rectification in next year audit and whether such defects have been fully got rectified in the current note.

(f) *Miscellaneous:*

(i) See whether provision has been made for the payment of affiliation fees, in respect of societies which have not been affiliated till the period under audit.

(ii) See that the auditor has filled in all the relevant columns in the audit note properly and signed.

(iii) See that the authentication of the office bearers have been obtained wherever required.

(iv) See that the totalling is correct.

(v) See that all the required enclosure, statements etc., have been attached.

7. *Publication of audit certificate.*-As per rule 64 (6), the Registrar, shall issue to the concerned society an audit certificate and a copy of the audit memorandum duly signed, within six months of the date of audit. Sub Clause (7), lays down that the society should publish the audit certificate, the statement showing the receipts and disbursements for the year, the profit and loss account/income and expenditure and the balance sheet, in the manner specified by the Registrar. The above documents are also to be kept open for inspection by any member of the society, during office hours.

8. *Efficiency of Auditor.*-The Auditor should be well versed in the fundamental principles and theory of all branches of accounting. This knowledge will help him to differentiate a transaction as correct or wrong and to grasp quickly the technical details of the business. In order to elicit full details of the transaction he may seek advice on technical points, if any, required. The audit will

be more efficient if he has training in business organisations, administration, management of finance and continuous practical experience. He should have also an understanding of the general principles of economics. The efficiency of the auditor will also reflect greatly in the efficient and accurate preparation of the audit report.

9. *Preparation of diary of work of Auditors.*-The diary of work of the Auditor should indicate in detail the specific work done by him during a particular period. Therefore, the diary has to be prepared with due care. It should not be vague or ambiguous. It should exhibit full details of the work done by him on each day specifying clearly the receipts, vouchers, registers etc., checked and the quantum of work turned out. The auditor should not adopt the practice of recording vaguely the work done, say for example “checked receipts or vouchers”, “checked the day book with ledgers” etc., Instead, he should record details of work turned out, say number of receipts or vouchers checked by him during a particular day, indicating clearly the serial numbers of the receipts or vouchers or the period covered as the case may be. The diary should also reveal details of different transactions examined by the Auditor and the names of ledgers checked in that connection.

The diary should be prepared in the form prescribed for the purpose and should be signed by him in token of the correctness of information furnished therein.

10. *Stoppage of audit.*-

(i) *Records with Police or Court* -In the case of records with court or under police custody, the matter has to be intimated to the Deputy Registrar (Audit) concerned who will approach the court or Police authorities concerned, seeking permission to audit the accounts keeping the records under their control. If the records could not be so obtained for audit, the audit can be taken up only after disposal of the case.

(ii) *Records not produced and partly missing.*-In the case of societies which fail to produce the records for audit and where the records are partly missing the concerned head of Department/ Office may institute an enquiry under section 65 and wind up the affairs of the societies which are beyond revival.

(iii) Records not written up.-In these cases, the committee may be superseded by invoking section 32 of the Kerala Co-operative Societies Act, and an Administrator or Administrators appointed to manage its affairs. They will arrange to write up the accounts and produce them for audit.

No ADL2-16551/74

Dated 21st November 1974.

CIRCULAR No. 56/74

Sub:-Audit of accounts of Co-operative Institutions audit held up for want of records-Clearance of arrears-Instructions issued.

I. It is observed that the number of audits held up for want of production of records is increasing year after year. Government as well as Public Accounts Committee have pointed out on several occasions that the tendency of the societies to keep away their accounts, records etc., from being subject to audit should be totally discouraged. Except in genuine cases, the tendency may be due to the fear of detecting mal-practices, negligence, manipulation etc., committed in keeping the accounts and hence the responsibility of the department to get the records promptly in such cases become all the more important. Instructions have already been issued from time to time and again that prompt action should be initiated pursued by the departmental officers in all such cases invoking the relevant provisions of the Kerala Co-operative Societies Act and Rules. The departmental officers are armed with sufficient powers under the act and rules to proceed against the persons responsible for the non-production of records and get the records. These provisions can be made applicable suitably in each case as required by the situation prevailing in the case concerned. A good outline of the action to be pursued in such cases is given below:-

II. The main reason attributed for the pendency of audit in respect or the societies where records are not produced for audit are the following:-

1. Records in court or under police custody.
2. Records destroyed. -
3. Records not written up.
4. Non-co-operation of the management in the production of records.

- 5 . Defunct nature of the Institutions.
6. Records with the Ex-committee.
7. Non-availability of the custodian of records.
8. Records lost or missing.
9. Whereabouts of the society and records not known.
10. Societies unstarted.

III. Action to be pursued by the Deputy Registrar (Audit):.

(1) The Deputy Registrars (Audit) will open a separate file for each society where audit is pending for want of records and action should be pursued in the file till records are made available; or orders are issued for the winding up of the affairs of the society by the authority concerned.

(2) In the case of records in Court or under police custody, the Deputy Registrars (Audit) will approach the Court or police authorities concerned for permission to audit the accounts keeping the records under their control. If the records could not be made available for audit, the matter should be placed under constant correspondence watching the disposal of the case.

(3) In other cases the auditor concerned will make earnest attempts to contact the office bearers concerned and get the records. If he could not get the records, he will, in writing report the fact to the Assistant Registrar (Audit) concerned with details of the attempts made and the address of the office bearers gathered by him.

(4) Immediately on receipt of the report of the Auditor, the Assistant Registrar (Audit) will issue registered summons under Section 63 of the Kerala Co-operative Societies Act to the office bearers concerned for the production of records for audit.

(5) If the society or the person (s) responsible does not produce the records within the time limit specified in the summons issued or the summons returned undelivered, the Assistant Registrar (Audit) concerned will report the fact to the Deputy Registrar (Audit) with full particulars with a copy of the Auditor's report and the returned summons.

(6) The Deputy Registrar (Audit) will, immediately on receipt of the report of the Assistant Registrar (Audit) examine whether the

actions taken by the Auditor and the Assistant Registrar (Audit) are satisfactory. If so, he will refer the matter to the Deputy Registrar (General) concerned for further necessary action in respect of the societies coming under the control of this Department.

(7) In respect of societies coming under the control of other Departments, the Deputy Registrar (Audit) will report the matter to this office in detail with a copy of the letters of the Auditor and Assistant Registrar (Audit) and the returned summons.

IV. Action to be pursued by the Deputy Registrar (General)

On receipt of the report of the Deputy Registrar (Audit), the Deputy Registrar (General) will pursue action as follows:-

(1) He will immediately open a separate file for each such society as reported by the Deputy Registrar (Audit).

(2) He will invoke the provisions under section 32 of the Act in the required cases and appoint a new committee or one or more Administrators to manage the affairs of the society.

(3) Provisions under section 34 of the Act should also be invoked to secure possession of records from Ex-committee, wherever necessary.

(4) The action under 2 and 3 above will be necessary where the societies are working/have been working till recently. In other cases, action under section 65 of the Act may be pursued and ultimately order the winding up of the affairs of these societies, if need be, under section 71 of the Act, if the revival of working of the societies is not possible.

(5) Evidently records are not available in all these societies and without records inquiry under section 65 of the K. C. S. Act which is a prerequisite as per Section 71 (1) for taking a decision whether are not orders be issued for a society to be wound up is not possible. So, in such cases (in which have ceased to work or which remains unstarted) action under section 65 can be dispensed with and the Deputy Registrar can proceed with action under Section 71 (2) (b) straightaway.

(6) If the Deputy Registrar is satisfied that the final winding up of the affairs of the society is not possible on account of destruction of records, he can cancel the Registration of the society immediately

under Section 74 of the K. C. S. Act. In such cases he should collect particulars of Government investments etc., in these societies and take action to write off the dues by the competent authority before ordering such cancellation.

(7) In all other cases, the liquidator appointed under section 72 of the Act will take prompt action and expedite final winding up of the affairs of the societies concerned culminating in the cancellation of Registration.

(i) The audits in respect of these societies will be deleted from the list of arrears in audit by the Deputy Registrars (Audit)/ Assistant Registrars (Audit) as soon as he receives copy of order of the winding up of the affairs of the societies.

(ii) All the Deputy Registrars (Audit) shall hereafter send a separate monthly report narrating the details of action taken in respect of the societies where records are not available. The report should be in the following form and the same should reach this office on or before 15th of every month.

Sl. No.	Name of Society	Description of action taken	Result achieved and present position	Remarks
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(iii) The Deputy Registrars (General) will also continue to forward the monthly report in the above form as already directed in this office letter no. ADL2-26859/73 dated 22-9-1973.

(iv) A Register should be maintained in the form given above allowing sufficient space for each society to record the details of action taken every month.

AUDIT CLASSIFICATION

1. Introduction.-On completion of audit of a society, the auditor should classify it in accordance with the instructions issued by Registrar from time to time. Classification of a society is an important duty vested with the auditor and therefore it should be done most carefully and intelligently. The Auditor has to note that wrong classification into the low orders may weaken the enthusiasm of the office bearers of the society. At the same time he should not give any higher classification than that is actually eligible to the society.

The classification is hereby based on two distinct tests viz.,

- i) The financial stability, economic viability, soundness etc., and
- (ii) The administrative efficiency, general performance etc. of the Society.

Registrar's conference in 1976 laid down certain standards which were adopted by the States with modification to suit local conditions. The Rural credit Survey Committee also stressed that there should be uniform standards of audit classification on an All India basis in respect of different types of Co-operatives since the "existing standards are so varying, as to cause a great deal of confusion". Accordingly the Agricultural Credit Department of Reserve Bank has, in conjunction with the standing Advisory Committee on Agricultural Credit, evolved certain standards, to be followed by the States in classifying the Societies in audit.

2. Broad principles of classification.- The following general standards have been laid down for classifying agricultural credit societies and Rural Banks:-

- (1) Capital structure-The progress made in strengthening the capital structure, own funds etc. and in tapping more deposits when compared with the previous years.
- (2) Credit and Financial stability, economic viability etc.
- (3) Management efficiency, maintenance of accounts etc.
- (4) Undertaking of subsidiary activities.
- (5) General working.

(a) Credit Societies

<i>Particulars</i>	<i>Maximum marks allotted</i>	<i>Marks awarded by auditor</i>
(1)	(2)	(3)

1. *Capital Structure (20)*

The sum total of share capital and deposits at the end of the year should be compared with the loans outstanding against members at the end of the year. If the proportion is 10% and less no marks will be awarded. One mark will be awarded for each 10% of increase over 10.

20

2. Credit (Loans to members) (30)

(a) Work out of the percentage of the total volume of loans issued during the year to the total amount of loans required by member as per normal credit limit. Statements or proportion of the average loan issued per member to individual credit limit. Award one mark for each 5%.

30

6

(b) There should be a *timelag* of at least a fortnight between the date of repayment of a loan by a member and the issue of the fresh loan. Marks will have to be awarded on the basis of the usual time lag noticed.

4

(10 marks)

(c) Percentage of overdues to demand under principal for the year.

10

(If the percentage of overdues to demand is 30 no. marks. If it is less than one mark for each 3% reduction. If the percentage is more than 30 minus one mark for each 6% increase upto a maximum of 5 marks.)

- (d) Percentage of overdues to demand under interest. 5

(If the percentage of overdues to demand is 20, no marks. If it is less than 20, one mark for each 4% decrease. If the percentage is more than 20, minus 1 mark for each 8% increase upto a maximum of 5 marks).

- (e) Percentage of number of defaulters to total number of borrowers. (If the percentage of defaulters to total number of borrowers is 20 or more, no marks. If the percentage is less than 20, one mark for each 4% reduction). 5

- (f) *Financial stability cover for bad and doubtful debts.*

The total of the reserve fund and bad debts reserve should completely cover 100% of the Bad debts plus 50% of the doubtful debts. Work out the percentage of the former to the latter and award marks at the rate of 1 mark for each 6%.

10

3. *Management (15)*

- (a) Rectification of defects pointed out in audit and inspection progress. 4

- (b) Effective action against defaulting members (including legal steps). 3

- (c) Holding of meetings-once a month at least to discuss ways and means to develop the business of the Society. 4

- (d) Maintenance of accounts (ledgers should be properly posted upto date and correct monthly and quarterly statements of receipts and payments should be prepared promptly and placed before the Board either by the Secretary or by full-time or part-time clerks). 4

4. General working of the Society including supply, marketing and processing functions trained office bearers or employees, committee members and educational activities. Marks to be awarded in the assessment made by the auditor.

	25
Total	100

Classification proposed for the year.

In the case of other Societies except those noted above and except District/Central Co-operative Banks, the classification is done on the following basis. *Class A*-The Society which requires no help from official and non-official staff for its working (excepting annual audit) comes under 'A' Class. An 'A' class Society does not want any supervision from the Union or Central Banks. Overdues of loans with members should not be more than 10% of the total outstandings with members. The Society maintains its own paid and qualified staff. It must also be working at profit.

Class B-The overdues in a 'B' Class Society should not be above 25%. Its accounts may not be entirely faultless. The general co-operative vitality of the Society must be reasonably high. Its management should be one that takes keen interest in remedying its defects.

Class C -A Society which does not fall under A, B and D classes is to be classified as 'C'. Its overdues should not be above 40%. Its financial position should be ultimately sound.

Class D-Societies the overdues of which exceed 40% and which are moribund are to be classified as 'D'. No Society should be classified as 'D' so long as it is considered it to receive loans on any terms whatever from the financing institutions. If a Society remains in 'D' class for 2 or three years continuously it will have to be liquidated.

The above are the standards generally adopted to classify credit Societies.

(b) Non-credit Societies

There are many types of non-credit societies, but separate standard for each type is not indicated here. But from the principles narrated above, the auditor can find out which type of measuring rod should be applied to a particular type of society. Among non-credit societies, audit classification of consumer and industrial societies are discussed here.

(i) *Consumer Societies.* -The main object of a consumer society is the distribution of consumer goods to its members. The auditor has to verify the loyalty of members to the society by verifying whether or not the members are purchasing all their requirements from the Society if the society is ready to meet their demands. Efficient and economic management of the Society, adequacy of working capital, proportion of owned capital to borrowed capital, supervision exercised by the Committee over the employees, gross income and net income, proportion of establishment and contingent charges to gross income, purchase policy, rotation of funds, service to the customers, maintenance of registers and records etc., are some of the factors to be considered by the auditor in deciding the audit classification. Dependence on owned funds and deposits, if any from members, insistence on cash sales, system of internal check are still other important points to be borne in mind by the auditor in awarding the classification.

Consumer Societies must be subjected to the above tests and those societies which possess a very high standard and come out successfully in all the tests can be classified under 'A', if no serious defects are noticed in their working. Class B can be given to the societies who are when applied with the above tests keeping less standards, than that of A in making steady profits whose owned capital is not less than 50% of the working capital, and where more than 40% of the members purchase their requirements from the society and where the overdues on credit sales to members do not exceed 20%. Societies which are incurring loss either due to bad management or lack of sufficient volume of business and where not less than 25% of the members are purchasing their requirements from the Society and where the overdues on credit sales do not exceed 40% can be classified as 'C'. All other societies which do not fall on the above classes will be classified under 'D'.

The auditor may remember that these are only indications and broad directions to arrive at the proper classifications.

(ii) *Industrial Societies*.—Over and above the general principles already enunciated the following points are also to be considered in awarding audit classification to Industrial Societies.

Industrial Societies are generally producers' Societies. So there must be adequate arrangements to purchase economically the raw material required by the producers. The Society should be in a position to purchase and sell the finished products of its members, on agency basis. There must be a good system to check the quality of finished goods. The Society must have adopted sufficient safeguards to effect compulsory savings for its producer members. Industrial Societies are given substantial financial assistance from Government, and therefore proper utilisation of such assistance has to be verified by the auditor. The books of accounts of the Society should be maintained correctly and promptly. The members of the staff must be trained and qualified. Loans, if any, advanced to the members should have been utilised properly. The overdues should not exceed 10% of the outstandings.

A Society fulfilling the above conditions and in which no serious defects are seen can be classified under 'A'. A Society can be classified under 'B', where 50% of the members take part in the production activities of the Society and where the overdues do not exceed 20% of the outstandings.

A Society which is financially weak, where the overdues exceed 20% of outstandings, and where not more than 25% of the members are engaged in production activities, is to be classified under 'C'.

All other societies come under 'D'.

The auditor has to award suitable marks in the audit more in accordance with the above broad norms and to submit the same to the Deputy Registrar/Assistant Registrar along with the audit certificate. While checking the audit note and connected records the Deputy Registrar/Assistant Registrar has also to check the reason behind the marks awarded by the auditor before approving the audit certificate. The audit classification should be indicated in the audit certificate at the time of issue.

Audit Classification of non-credit Societies

<i>Sl. No.</i>		<i>Maximum marks allotted</i>	<i>Marks awarded by Auditor</i>
1	Capital structure	10	
2	Enrolment of members	5	
3	Extent of business done	25	
4	Subsidiary activities	10	
5	Provision for bad and doubtful assets	10	
6	Maintenance of accounts	10	
7	Rectification of audit and inspection defects	10	
8	Holding of committee and General Body meetings.	5	
9	General working including working results, service to members, trained office bearers or employees, committee members, Educational activities etc.	15	
		100	

(c) Co-operative Central Banks

The Reserve Bank of India provides financial accommodation to the agricultural credit Societies, through the Kerala State Co-operative Bank, who route them through the District Co-operative Banks. Under Section 17 of the Reserve Bank of India Act, District/ Central Co-operative Banks, to become eligible for the assistance should conform to contain well defined standards. One of the norms fixed is that Central Co-operative Banks falling under A and B classes alone are eligible for Reserve Bank of India assistance on the security of two signatories. The following norms are adopted for the audit classification of the District/Central Co-operative Banks.

A' Class Central Banks:

(1) The arrears under principal should not exceed 20% of demand and arrears under interest should not exceed 5% of the demand.

(2) The total of the entire bad debts and 50% of the doubtful debts should not exceed the Bad debts Reserve of the Bank.

(3) The short term liabilities of the Bank should not exceed the short term investments exclusive of overdues.

(4) The Bank should have maintained the required standard of fluid resources throughout the year in accordance with the rules in force in the State concerned.

(5) At least 50% of the loans issued during the year should be for short term purposes.

(6) Not more than 35% of the Societies indebted to the Bank should be defaulters.

(7) The Bank should have worked at profit.

(8) The management of the Bank should be efficient and the staff duly qualified.

'B' Class Central Banks:

These Banks must satisfy item Nos. 3, 4, 7 and 8 of the standards prescribed for 'A' Class Banks and must in addition satisfy the following standards.

(1) The arrears under principal may exceed 20% but should not exceed 40% of the demand. There may be interest overdues but it should not exceed 10% of the demand.

(2) The total of Bad and doubtful debts should not exceed the Bad debt Reserve and Reserve Fund of the Bank.

(3) Not less than 40% of the loans issued to Societies during the year should be for short term purposes.

(4) Not more than 50% of the Societies indebted to the Bank should be defaulters.

'D' Class Central Banks:

(1) The overdues under principal exceed 60% of the demand and under interest exceed 15% of the demand.

(2) The Bad and doubtful debts exceed the owned capital ie. the Reserve Fund, the Bad Debts Reserve and paid up share capital.

(3) The required standard of fluid resources is not maintained on several days during the year.

(4) The long term and medium term loans issued during the year exceed 75% of the loans issued to Societies.

(5) More than 60% of the Societies indebted are defaulters.

(6) The Bank has worked at loss.

(7) The management of the staff is not satisfactory.

'C' Class Central Banks:

The Banks which do not fall under A, B or D Class.

[Revised standards for audit clarification of Central Banks are appended (Appendix II 5)]

3. Classification on the basis of marks obtained:

When audit classification has to be made based on the marks obtained, the auditor has to prepare a statement showing the marks allotted under each head and sub head, to determine in what audit class the Society has to be placed. Where a system of awarding mark has been prescribed, the auditor should use his discretion as to the extent of fulfilment of the various conditions/criteria and award marks. Based on the total marks obtained, the societies may be classified as under:

1. Societies getting 60% and above and working on profit will be classified under 'A'. Those getting more than 50% but less than 60% under 'B', those getting more than 35% but below 50% under 'C' and those getting less than 35% will be classified under 'D'.

(a) No Society shall be classified as 'A' whose overdues to demand under principal exceed 20% (Here specify the percentage).

(b) No Society shall be classified as 'B' whose overdues to demand under principal exceed 25% (Specify the percentage).

(c) In the case of service societies, suitable marks for non credit activities should be allotted out of the marks assigned for general working (Under item 4 above).

(d) New Societies will not be classified for the first 2 years and they will be shown as "unclassified".

4. *Submission Of Special Reports:*

The defects, if any, noticed by the auditor are to be listed in a classified and consolidated form on separate sheets, which will be called "Schedules of audit defects" or summary of defects. In case any defect is of very serious nature and requires special attention of appropriate authorities, the auditor should submit a separate special (confidential) report in the matter immediately on detection of the defect.

The Special report should immediately be submitted to the Deputy Registrar of Co-operative Societies (Audit), concerned, or to the concerned superior officer in the following cases also.

(a) Misappropriation of funds or other properties of the Society (Including temporary misappropriation).

(b) Imprudent or irregular advances of loans and cash credits, benami loans, loan against inadequate or non-existing security or disproportionate loans to the members of the Committee, to their relatives, close associates etc.

(c) Non production of cash balance even after the service of summons, by the auditor, destruction of records, disappearance of a responsible officer of the Society etc.

(d) Expenditure which are objectionable and are disproportionate to the financial position or economic viability of the Society.

(e) Cases in which important provisions of the Act, Rules or byelaws of the Society have been infringed, such as failure to hold timely annual general meeting, non conducting of election, continuance of an invalid or disqualified Committee, failure to hold committee meetings regularly etc.

(f) Cases in which office bearers involved in the transactions and which have brought avoidable losses to the Society due to their negligence or due to their wilful action to bring benefit to themselves by such deeds.

(g) Any other serious irregularity warranting immediate action.

While preparing special report the auditor has to bear in mind certain vital principles. Firstly, he should satisfy himself that circumstances exist which warrant the submission of a special report. Such special reports should therefore, be restricted to

important matters on which some immediate administrative action is called for. Secondly, the auditor should have conducted thorough investigation into the matter and gathered sufficient materials for launching, both Civil and Criminal action against the delinquents after satisfying himself of the serious defect. Mere mention of suspicious circumstances without adequate proof will not be sufficient. In case the auditor is unable to carry out a complete investigation by himself, he may then suggest for a statutory enquiry by the Administrative Department for a detailed investigation into the matter. But before he suggests for an enquiry attempts should be made to investigate the matter and collect all available evidences.

CHAPTER III

ASSESSMENT AND LEVY OF AUDIT FEES

1. *Procedure for levy of audit fees*- Statutory provision.- Audit of Co-operative Societies is the statutory responsibility vested on the Registrar. In order to carry out this responsibility effectively, the Registrar has to maintain sufficient number of staff, in different categories, the cost of which is met from out of Public revenue.

Every Co-operative Society, whose accounts are audited by the Department, is required to pay to the Government audit fees according to the scale fixed under the provisions of the co-operative Societies Act and Rules. The audit fees payable by a Society is calculated soon after the audit is over, and the amount payable is to be specified in the audit certificate. The basis of levy of audit fee is different for different types of societies,

Rule 65 of the Kerala Co-operative Societies Rules, 1969 governs the payment of audit fees for the different types of societies, which are as follows:

(1) Every Co-operative Society shall pay to Government within one month of receipt of the annual audit certificate an audit fee calculated on the working capital as on the last day of the co-operative year to which the audit relates or on the total sales during the year or on the gross income during the year, as the case may be, as shown below.

(i) Credit Societies (excepting primary Land Mortgage Banks Housing Societies and House Mortgage (Banks) on the working capital.

(ii) Primary Land Mortgage Banks, House Mortgage Banks, Housing Societies – on the aggregate of loans issued and that recovered during the year under audit.

(iii) Societies having credit and non credit activities – On working capital or on sale proceeds of goods whichever is higher.

(iv) Societies dealing in goods (excepting Coir Societies) – On sale proceeds.

(v) Coir Co-operative Societies – On proceeds of Coir sold as owner as well as on the commission realised on goods sold as agents.

(vi) Transport Societies – On hire charges collected and sale proceeds of articles.

(vii) Other Societies- On gross income.

Audit fees will be calculated at the rate of 30 Paise for every one hundred Rupees or part thereof on the working capital, the value of sales or gross income, as the case may be up to Rs. 5lakhs and thereafter at the rate of 20 Paise for every next one hundred rupees or part thereof. The maximum audit fees payable by a Society should not exceed Rs. 3000.

2. *Exemption from payment of audit fees.*- The following classes of Societies are exempted from the payment of audit fees.

(a) All Co-operative Societies of which all or a majority of the members are Harijans.

(b) All farming societies.

(c) All social welfare societies.

(d) Any society or group of societies which has its accounts audited at its own expense by an officer of the Co-operative Department, as per provisions contained in Sub rule (2) of Rule 65 of the Kerala Co-operative Societies Rules or under an agreement approved by the Registrar to audit the accounts of such Society.

(e) Any weavers' Society or coir co-operative Society, or housing society or primary society formed for the benefit of Fishermen until

it has completed the sixth co-operative year after commencing business.

(f) Any Society for the first year of audit, irrespective of the date of commencement of business.

(g) Any credit society the working capital of which does not exceed Rs. 2,000 and any other society the sales or gross income of which does not exceed Rs. 10,000.

Audit fees payable by a Society is to be remitted into the Government Treasuries under the proper head and the receipted chalan issued by the Treasury Officer, should be sent to the Assistant Registrar (General) Deputy Registrar, concerned, who will watch the proper collection of audit fees.

CHAPTER IV

1. *Offences under the Kerala Co-operative Societies Act.*-Section 94 of the Kerala Co-operative Societies Act, 1969 deals with offences:

(i) No person other than a society shall carry on any business or trade under any name or title of which the word 'Co-operative' is part, without Government sanction.

(ii) Section 35 of the Act confers on the Co-operative Societies certain privileges. One of the privileges is the conferring of first charge on certain special assets of the members. Therefore if any member disposes of property in respect of which the Society has got a first charge it is an offence under the Act.

(iii) Wilfully making false returns, furnishing of false information failure to produce cash balance on demand, failure in making available the records for audit, inquiry, inspection etc., wilfully or without any reasonable excuse disobeying any summons, requisition or lawful written order, issued under the K. C. S. Act, etc., are offences under the Act.

(iv) Section 37 of the Act empowers the pay disbursing officers to recover from the salary of the employee the dues of the society, in which he is a member, subject to his executing an agreement authorising the employer to deduct the dues. After the execution of such an agreement by the member if such employer fails to

deduct any amount as required, or fails to pay to the Society the amount so recovered within seven days from the date on which such deduction was made, have been made offences under the Act.

(v) Failure of any person to deposit the money collected for the formation of a society in the State Co-operative Bank, Central Co-operative Bank, or Post office savings account, or in any other approved Bank within 14 days of its collection, constitute an offence. Misapplication of such share money is also an offence.

(vi) Misappropriation or unauthorised retention of money belonging to a society also constitute an offence. The offences under the Kerala Co-operative Societies Act are in addition to the offences under the Indian Penal Code or any other Act. The offence under the Indian Penal code is distinct from the offences under the Act.

2. *Theft*.-In order to constitute an offence, existence of certain essential factors have to be provided or established. Therefore to establish an offence of theft, it has to be proved that any movable property like cash, negotiable instruments or valuables contained in a safe or strong room of the Bank or Society have been removed or goods have been removed from its godown by any person intending to take it dishonestly.

3. *Criminal misappropriation*.- The offence commonly met within Co-operative society/Bank in the misappropriation of its funds. 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. Dishonest intention to appropriate illegally is the basis for institution of criminal proceedings. Therefore, to sustain a charge of misappropriation the prosecution has to prove that the accused dishonestly misappropriated or retained for his use movable property. It is not required to prove the quantum of money misappropriated to prove the guilt. The dishonest intention to appropriate the property of another is common both in theft and misappropriation.

The fact that the accused was given time to remit the money misappropriated will not vitiate a conviction for criminal misappropriation, or show that the matter is one to be dealt with the civil court only.

4. *Criminal breach of trust.*-To constitute the offence of criminal breach of trust there must be dishonest misappropriation by a 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 to one's own use, or use in violation of any legal contract and the misappropriation or conversion of money must be with a dishonest intention. The principal ingredient being entrustment of property, dishonest misappropriation or converting to own use. A failure for breach of any obligation to account for the property entrusted, will justifiably lead to an inference of dishonest misappropriation.

5. *Fraudulent Deeds*:-Section 421 to 424 and 206 to 210 of the I. P. C. deal with fraudulently dealing with one's property to defeat creditors. On an analysis it is seen that sections 421 to 424 deal with the following topics:-

(a) Fraudulent concealment of property in one's possession. (Sn.421 and 424 of IPC).

(b) Fraudulently preventing debt being available for creditors (Sn. 422 of IPC)

(c) Fraudulent execution of a deed of transfer (Sn. 423 of IPC)

(d) Fraudulent release of a debt (Sn. 424 of IPC.)

All the above frauds are, as the above sections indicate, committed without reference to any proceedings in court by means of transactions between individuals acting in collusion with each other.

6. *Duty of Auditor to help Police.*- Whereas a case of misappropriation of funds of a society is reported to the Police for investigation, it is the duty of the Auditor to render possible assistance in making out a case. As Co-operative accounts are of a technical nature, the auditor will be able to help the Police to a very great extent.

Reported Cases

1. *Bad debt or loss to the society.*-In order to term a particular amount as bad debt or loss to the society, it must be shown that it is irrecoverable and all reasonable attempts were made to recover

it. Circumstances such as limitations, insolvency of the party etc., will have to be considered M. C. T. 1964–Sohanlal Vs. Melghat Agricultural Sale Society).

2. *Payment of dividend out of Capital:-*

Leeds Estate Building and Investment Co.,

Vs .
Shepherd

Where there were no profit and dividends to share holders and fees and bonuses of the directors and the Managers were paid out of capital, the directors and even the auditor, who had certified the inaccurate balance sheet were held liable.

3. In P. R. Pai Vs. Malwan Co-operative Bank it has been held that if the management or a board entrusted with management were to act flouting the express instruction lawfully issued, and on a result of such action loss has resulted, the action can by no means be regarded as prudent or bonafide.

4. The bye-laws of a Co-operative Society are in a way a document of incorporation of the society from which it derives its powers. As the society derives its powers from the bye-laws, it, cannot appoint the Managing Director in the absence of the provisions in the bye-laws with regard to such appointment.

The observation of the Tribunal is as follows:

“The payment of honorarium or advance referred to above is certainly in contravention of the bye-laws and hence the same is illegal and invalid and the Defendant is not at all entitled to the same. The receipt of such amount is in the nature of misapplication of the funds and the “Defendant is liable to refund the same. (M. C. T. Laxman Vs. Amalnor Peoples Co-operative Credit Society).

Appendix - I

Appendix I
AUDIT SCHEDULES
SCHEDULE NO. I

Share capital held at the end of.....19

Sl. No.	Member No.	Name of member	Opening balance		Received during the year 19. 19.		Total	
			No. of Shares	Amount	No. of Shares	Amount		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

SCHEDULE NO. I - (Contd.)

Repaid/transferred during the Year 19.....	Balance at the end of the year		Arrears		Remarks	
	Amount	No. of Shares	Amount	No. of Shares		
(10)	(11)	(12)	(13)	(14)	(15)	(16)

(*) Shares contributed by Government and other institutions should be shown distinctively in the statement.

Abstract

	No. of shares	Amount
(i) Opening balance
(ii) Received during the year
(iii) Total
(iv) Repaid/transferred during the year
(v) Balance at the end of the year
(vi) Arrears of shares, if any
(vii) Of (v) above		
(a) Shares held by Government
(b) Individuals
(c) Others
(d) Total

SCHEDULE NO. II

Deposits held at the end of the year.....

Sl. No	Name of Depositor	Held at the beginning of the year		Received during the year		Total			
		Members	Non-members	Members	Non-members	Members	Non-members		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
		Total	Total	Total	Total	Total	Total	Total	Total

SCHEDULE NO. II - (Contd.)

	Paid off during the year	Held at the end of the year	Payment of interest		Remarks				
			Due	Paid					
(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)
			Total			Balance			

* Separate statement is to be prepared in respect of different types of deposits, viz., fixed savings, current etc.

Abstract of Schedule No. II

Sl. No.	Type of deposit	Held at the beginning of the year	Received during year	Total	Paid off during this year	Held at the end of the year	Remarks
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

Total

SCHEDULE NO. III

Abstract of Borrowings:

Sl. No.	From whom borrowed.	Opening balance.	Received during the year	Total	Repaid during the year	Outstanding at the end of the year	Remarks
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	(a) Financing bank						
	(b) Government						
	(c) Others						
	Total						

SCHEDULE NO. IV
Loans outstanding against members as at the end of the year

Sl. No.	M.No.	Name of Loanee	Loan No.	Outstanding at the beginning of the year	(5)	Issued during the year	(6)	Total	(7)	Repaid during the year	(8)	Outstanding at the end of the year	(9)	Of which over due	(10)	Of which arrears	(11)	Interest											
																		Due	Collected	Balance									
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)															
Total																													

Total

Note: Separate statements should be prepared for each type of loan.

Abstract

- (1) Outstanding at the beginning of the year
- (2) Issued during the year
- (3) Total
- (4) Repaid during the year
- (5) Balance at the end of the year

SCHEDULE NO. V

Investments as at the end of.....

Sl. No.	(2) Nature of investment	(3) Held at the beginning of the year	(4) Invested during the year	(5) Total	(6) Withdrawn during the year	(7) Balance at the end of the year	(8) Accrued	(9) Collected	Interest		Remarks
									(10) Balance	(11) Remarks	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	

Total

Abstract

- (1) Investments held at the beginning of the year
- (2) Investment made during the year
- (3) Total
- (4) Investment withdrawn during the year
- (5) Balance as at the end of the year

SCHEDULE NO. VI

Provident fund contribution as at the end of.....

Sl. No.	Name of Employee	Designation	Held at the beginning of the year	Contribution made during the year	Balance at the end of the year	
(1)	(2)	(3)	(4)	(5)	(6)	(7)
			Employees contribution	Employee	Employee	Society
			Society contribution	Employee	Employee	Society
			(4)	(5)	(6)	(7)
					(8)	(9)
						(10)
						Remarks

Total

SCHEDULE NO. VII

Establishment strength as on.....

Sl. No.	(1)	Name of employee	(2)	Date of birth and age	(3)	Designation	(4)	Scale of pay	(5)	Date of entry in service	(6)	Qualifications	(7)	Total emolu- ments p.m	(8)	Security prescribed			Security furnished			Remarks	(15)	
																Cash	Property	Fidelity	(9)	(10)	(11)			Cash

SCHEDULE NO. VIII

Closing stocks as on

(a) *Where item war stock register is maintained*

Sl. No.	Item of stock	Book stock	Verified stock	Value		Excess stock		Deficit stock		Remarks
				Rate*	Amount	Quantity	Value	Quantity	Value	
Total										

* Cost price or market price whichever is less to be the basis of valuation.

SCHEDULE NO. X

Chitty collection and payment made during the year

(a) *Chitty war details to be furnished*

Sl. No.	Chittal No.	Collections		Arrears if any	Payments		Deduction (€€€€€€€€€€)	Total	Details of Deposit under bid amount	Remarks	
		Cash	Veetha palisa		Cash	Commission					Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)

SCHEDULE NO. XI

Schedule on divided payable as on.....

Sl. No.	M. No.	Name of member	Dividend		Payable		For the year			Total
			19	19	19	19	19	19	19	
(1)	(2)	(3)	(4)	(4)	(5)	(5)	(6)	(6)	(7)	(8)

Total

SCHEDULE NO. XII (a)

Working Sheet for estimating bad and doubtful debts

Sl. No.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	Name of society	*Date of financial particulars	Principal outstanding to the bank	Of which overdue for more than 3 years	Total	Of which overdue	Other outside liabilities	Cash and bank balance	Investments in Government and other trustee securities	

SCHEDULE NO. XII (a) (contd.)

Value of shares held in	Total loans	Interest receivable from members		Other assets realisable	Arbitration references filed but pending		Action against defaulters	
		Outstanding against members	Total		Of which overdue for more than 3 years	No.	Amount	No.
Central Co-operative Bank	[11 (a)]	[12]	(14)	(15)	(17)	(18)	(19)	(20)
Other institutions	[11 (b)]	(13)	(14)	(15)	(17)	(18)	(19)	(20)

SCHEDULE NO. XII (a) - (concl'd.)

Decrees sent for execution	Amount	Cash retained for long periods by present or ex-office bearers	Amount involved in frauds / mis- appropriation, etc.	Society's Auditors estimate	Bank Supervisor's estimate	Year of latest audit report	Audit classification	Remarks
No.	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)

* The financial particulars may relate to the latest day of the year for which the latest audit report is available or as on the date of audit.

SCHEDULE NO. XII (b)

Societies having overdues to the bank for 3 years and over as at the end of the Co-operative year 19....

Name of Society: _____ Particulars of their individual members.

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Sl. No.	Name of the member	Loan account No.	Type of loan	Date of advance	Amount advanced	Due Date	Total amount outstanding	Of which overdue	Only pronote of the member	Pronote of the member with one or more sureties	Charge on land which has been duly regd. plus one or more sureties	Mortgage of the land of the member having prior encumbrance	Mortgage of land having prior encumbrance	Collateral security in the form of marketable securities (goods including gold and silver)
					Rs.		Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.

Classification of loans outstanding according to the nature of security

SCHEDULE NO. XII (b) (contd.)

Sl. No.	Particulars of assets of the borrower		Land Mortgaged to the society		Others		Value of other Unencumbered properties			Shares held in the society	Deposits and other funds with the society
	Land cultivated owned	Leased (acreage)	Acreage	Estimated value	Acreage	Estimated value	Immovable	Movable	Estimated value		
(1)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)
	Acreage	Estimated value		Acreage	Estimated value	Acreage	Estimated value	Immovable	Movable		

SCHEDULE NO. XII (b) (contd.)

Sl. No.	Action taken against the borrower			Standing of sureties			Land owned		Value of unhypho- cated tangible assets				
	Arbitration reference	Execution petition	Surety No.	Total liability as surety	Average	Total	Of which mort- gaged to the society or others	estimated value					
(1)	(27)	(28)	(29)	(30)	(31)	(32)	(33)	(34)	(35)	(36)	(37)	(38)	(39)
	Date of filing	Amount	Date of decree	Amount decreed	Date of sending for execution	Amount since recovered	Loans outstand- ing to the society	Of which overdue	Total liability as surety	Average	Total	Of which mort- gaged to the society or others	Value of unhypho- cated tangible assets

SCHEDULE NO. XII (b) (contd.)

Standing of sureties		Land owned		Amount considered bad/doubtful of recovery	
Surety No. 2		Estimated value		Value of unhyponthecated tangible assets	Bank's estimate
Rs. (40)	Loans outstanding to the society	Rs. (41)	Of which overdue	Rs. (46)	Rs. (48)
		Rs. (42)	Total liability as Surety	Rs. (47)	Society's estimate
		Rs. (43)	Acreeage	Rs. (48)	Rs. (49)
		Rs. (44)	Total		
		Rs. (45)	Of which mortgaged to the society or others		

SCHEDULE NO. XII (c)
Schedule of bad and doubtful debts in respect of credit societies/banks, as on

Loans Account No.	(1)	Name of the member/loanee	(2)	Amount of loan advanced	(3)	Amount out- standing	(4)	Of which over- due	(5)	Period for which it is overdue	(6)	Nature of security (personal/land building etc.)	(7)	Doubtful	(8)	Bad	(9)	Reasons for doing so	(10)

Note:- (For guidelines on the assessment of bad and doubtful debts Circular letter ADL (2) 26588/76 of 16-6-1976 appended.)
 [Appendix II (b)]

Appendix - II

Appendix II (I)

IMPORTANT PROVISIONS OF KERALA CHITTIES, ACT OF 1975

3. Prohibition of chitty not sanctioned or registered under this Act. (1) No chitty shall, after the commencement of this Act be started and conducted unless the previous sanction of the Government or of such officer as may be empowered by the Government in this behalf is obtained therefore and unless the chitty is registered in accordance with the provisions of this Act.

Provided that the previous sanction under this subsection shall lapse unless the chitty is registered before the expiry of six months from the date of such sanction:

Provided further that such previous sanction shall not be necessary for starting and conducting any chitty by-

(i) a company owned by the Government of Kerala; or

(ii) a co-operative society registered or deemed to be registered under the co-operative societies Act for the time being in force; or

(iii) a scheduled bank as defined in the Reserve Bank of India Act 1934; or

(iv) a corresponding new bank constituted under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (Central Ac: 5 of 1970)

(2) The previous sanction referred to in subsection (1) shall not be granted if-

(i) the foreman has been convicted of any offence under this Act, or under any of the Acts repealed by this Act; or

(ii) the foreman has defaulted in the payment of fees or the filing of statements or records, required to be paid or filed under this Act, or has violated any of the provisions of this Act or the rules made thereunder; or

(iii) the foreman has been convicted of any offence involving misappropriation, forgery, counterfeiting, falsification of accounts

or any other offence involving breach of trust and sentenced to imprisonment for any term, unless a period of five years has elapsed since his release;

Provided that before refusing previous sanction, the foreman shall be given an opportunity of being heard.

(6) *Variola*.-In every chitty there shall be a variola in duplicate signed by, each of the subscribers or by a person authorised in writing by the subscriber in that behalf and such signature shall be attested by at least one witness.

(7) *Particulars of variola*.-(1) The variola shall contain the following particulars and shall not contain any other particulars inconsistent with the provisions of this Act.

- (i) the full name and residence of every subscriber;
- (ii) the number of tickets or the fraction thereof held by each subscriber;
- (iii) the number of instalments and the amount payable for each ticket at every installment;
- (iv) the date on which the chitty is to begin and the date on which it is to terminate ;
- (v) the mode of ascertaining the prize winner at the successive instalments;
- (vi) the amount of discount which a prize winner at any instalment has to forego;
- (vii) the mode and proportion in which the discount is distributable by way of veethapalisa, foreman's commission and other expenses if any;
- (viii) the time and place at which the chitty is to be conducted;
- (ix) the instalment at which the foreman is to get the prize;
- (x) the approved bank Or banks in which chitty moneys shall be invested by the foreman under the provisions of this Act;

- (xi) the consequences to which a non-prized or prized subscriber or the foreman will be liable if he violates any of the provisions of the variola;
- (xii) the conditions under which a subscriber will be treated as a defaulting subscriber;
- (xiii) the nature and particulars of the security offered by the foreman under section 15;
- (xiv) the name of the nominees of the subscriber to whom benefit accruing to the subscriber under the chitty may be paid in case of death of the subscriber; and
- (xv) any other particulars that may, from time to time be prescribed by the Government.

(2) Provision shall also be made in the variola that Veethapalisa shall be distributed among both the prized and non-prized subscribers, other than prized defaulter subscribers in respect of defaulted instalments of subscription.

*Explanation:-*For the avoidance of doubts, it is hereby declared that no provision shall be made in the variola for forfeiture by a non-prized defaulter subscriber of his right to obtain veethapalisa.

(3) Where the prize winner is to be determined by auction and more than one person bids for the same amount, the prize winner shall be determined by lots among them.

(4) The amount of discount in a chitty shall not exceed thirty per cent of the chitty amount.

8. *Registration.*-(1) Every variola with its duplicate shall be filed by the foreman with the Registrar along with the order sanctioning the starting of the chitty (where such sanction is necessary under section 3) and the Registrar shall register and return the variola with an endorsement that the chitty is registered:

Provided that the Registrar may refuse to register the chitty on any of the following grounds, namely:-

(i) that the security offered by the foreman under section 15 is insufficient: or

(ii) that the foreman has been convicted of any offence under this Act or under any of the Acts repealed by this Act; or

(iii) that the foreman has defaulted in the payment of fees or the filing of statements or records, required to be paid or filed under this Act or has violated any of the provisions of this Act or the rules made thereunder; or

(iv) that the foreman has been convicted of any offence involving misappropriation, forgery, counterfeiting, falsification of accounts or any other offence involving breach of trust and sentenced to imprisonment for any term, unless a period of five years has elapsed since his release:

Provided further that before refusing to register a chitty the foreman shall be given an opportunity of being heard.

10. Copies of variola to be given to subscribers and acknowledgements to be filed.~ (1) After the variola is signed by a subscriber or by a person authorised in writing by the subscriber in this behalf, the Foreman shall supply a true copy of the variola certified as such by him to such subscriber or person authorised by the subscriber, who shall acknowledge receipt of the same, and the foreman shall file the acknowledgments with the Registrar within fourteen days of the first drawing of the chitty.

12. Time and place of conducting chitty.-(1) Every drawing of prizes in a chitty shall be conducted at the time and place mentioned in the variola and in accordance with the provisions contained therein.

13. Minutes of proceedings of drawing of chitty.-(1) The minutes of the proceedings of every drawing shall be kept in a book and shall be signed.-

(a) by the foreman and by at least two subscribers; and

(b) in cases where the prize amount is determined by auction, by the prize winner or his agent.

(2) The minutes mentioned in subsection (1) shall state clearly.

(a) the date and hour when, and the place where, the proceedings began and ended;

(b) the number of the particular instalment of the chitty of which the proceedings are recorded;

(c) the names of the subscribers present;

(d) the person or persons who obtained the prize:

(e) the amount of discount; and

(f) full particulars regarding the disposal of the prize amount in respect of the preceding instalment and disposal of unpaid prize amount, if any, in respect of any previous instalment.

14. *Copy of minutes to be filed with Registrar.*-(1) A true copy of the minutes of the proceedings of every drawing certified as such by the foreman shall be filed by him with the Registrar within *fourteen days* from the date of the instalment to which it relates or before the date of the next succeeding instalment, whichever is earlier.

(2) If the foreman makes default in complying with the requirements of subsection (1) of section 13, he shall be punishable with fine which may extend to one hundred rupees for every day during which he continues so to make default.

15. *Security to be given by foreman.*-(1) Every foreman shall, before the first drawing of the chitty.

(a) Execute a bond in favour of or in trust for the other subscribers for the proper conduct of the chitty, charging immovable property sufficient to the satisfaction of the Registrar for the realization of twice the chitty amount; or

(b) Deposit in an approved bank an amount equal to the chitty amount or invest in Government securities of the face value or not less than one and a half times the chitty amount and transfer the amount so deposited of the Government securities in favour of the Registrar to be held in trust by him as security for the due conduct of the chitty.

(2) If any foreman makes default in complying with the requirements of sub section (1), he shall be punishable with fine which may extend to five hundred rupees.

(3) The security given by the foreman under subsection (1) or any security substituted under subsection (6) shall not be liable to be attached in execution of a decree or otherwise until the chitty is terminated and the claims of all the subscribers are fully satisfied.

(4) The Registrar shall, after the termination of a chitty and after satisfying himself that the claims of all the subscribers have been fully satisfied, order the release of the security furnished by the foreman under subsection (1) or the security substituted under subsection (6), as the case may be, and in so doing he shall follow such procedure as may be prescribed on that behalf.

(5) The security furnished under subsection (1) shall, subject to the provisions of subsection (6), be kept intact during the currency of the chitty and the foreman shall not commit any such act with respect thereto as are calculated to impair materially the nature of the security or the value thereof.

16. *Rights of foreman.*-(1) The foreman shall be entitled.

(a) to obtain his prize at the instalment specified in the variola without deduction for discount:

Provided that a foreman shall not be eligible to get more than one prize in a chitty without deduction for discount;

(b) to such commission or remuneration not exceeding five per cent of the chitty amount as may be fixed in the variola for the conduct of the chitty:

(c) to receive and realise all subscriptions from the subscribers and to distribute the veethapalisa among them.

(d) to demand reasonable security from any prized subscriber for the amount or future subscriptions payable by him.

Explanation: A security is reasonable within the meaning of this clause if its value exceeds twice the amount due from the prized subscriber;

(e) to substitute subscribers in the place of defaulters subject to the provisions hereinafter contained; and

(f) to do all other acts that may be necessary for the due and proper conduct of the chitty.

2. Where there is any dispute between the foreman and a prized subscriber regarding the value of the property offered as security for the amount of future subscriptions payable by him, a valuation certificate in respect of the property issued by the Tahsildar of the taluk in which the property is situated shall be accepted by the foreman.

3. Any foreman who does not accept a valuation certificate as required by sub section (2) shall be punishable with fine which may extend to five hundred rupees.

17. Duties of foreman :- (I) The foreman shall, on a prized subscriber furnishing security as provided for in clause (d) of sub section (1) of section 16 for the payment of the future subscriptions, be bound to pay him the prize amount and shall be entitled to get from him an acknowledgement in writing evidencing such payment:

Provided that the foreman shall, on demand by a prized subscriber; pay him on the due date the amount which represents the difference between the prize amount and the amount of the future subscriptions without any security whatsoever, and in such case the foreman shall, before the date of the next succeeding instalment, deposit in an approved bank mentioned in the variola the amount or future subscription and he shall not withdraw the amount so deposited except for payment of future subscriptions.

(2) If, owing to default of a prized subscriber, the prize amount due in respect of any drawing remains unpaid before the date of the next succeeding instalment, the foreman shall deposit the same forthwith in any approved bank mentioned in the variola and intimate in writing the fact of such investment together with the following particulars of the investment to the prized subscriber, namely:-

- (a) the number, year and office of registration of the chitty;
- (b) the particular instalment Of the chitty;
- (c) the amount due to the subscriber;
- (d) the approved bank in which the amount is deposited;
- (e) the date of deposit;
- (f) the reason for the deposit and
- (g) the conditions of disbursement.

(3) Payment of the prize amount or the investment of the amount of future subscriptions under sub section (1) or the investment of the prize amount under sub section (2) shall be intimated to the subscribers at the next succeeding instalment and such payment or investment entered in the minutes of proceedings of that instalment.

(4) The foreman shall not admit any person as a subscriber to a chitty if, by such admission, the total number of ticket is mentioned in the variola is increased.

24. *Removal of defaulting subscribers.*-(1) If a non-prized subscriber defaults to pay his subscription in accordance with the terms of the variola for a period of one month, the foreman may, after intimating him by written notice, remove his name from the list of subscriber and substitute any other person in his place:

Provided that if the defaulter pays up the defaulted instalment with interest at the rate of nine per cent per annum within one week of receipt of such notice, his name shall not be liable to be removed.

25. *Amount due to defaulting subscriber how dealt with.*-(1) When a substituted subscriber draws the prize amount, the defaulting subscriber shall be entitled to recover from the foreman his subscriptions subject to such deductions as may be provided for in the variola.

Appendix II (2)

No. ADL (2)-43976/69.

4th January 1910.

CIRCULAR MEMORANDUM

*Sub:-*Audit-Confirmation certificates-Instructions-Regarding.

*Ref:-*Government Circular Memorandum No. 413/C3/69-8/AD dated 8-12-1969.

It has been brought to the notice of this office that the auditors very often complain that they do not get confirmation certificates from the various Departments and others from whom they are due, despite repeated requests. As a result they find it difficult to finalise the audit of accounts of a number of Co-operative Societies. Confirmation certificates are essential for the purpose of audit.

Government were pleased to issue necessary instructions in this regard to the concerned Departments and Institutions in their Circular memorandum referred to above. It is expected that other Departments and Institutions will extend their co-operation and that the difficulties now experienced by the auditors will be minimized to a great extent in the light of the directions from Government.

Nevertheless, the following instructions to the auditors are issued so as to enable them to get over the difficulties, if any, they may have to face in this regard in future.

(1) The auditors will make requests for confirmation certificates, in form No. I attached herewith, *under certificate of posting*, to the concerned Departments and Institutions including those in the administrative wing of this Department at the District level, fixing a time limit, say, a fortnight.

(2) If the auditor does not receive the confirmation certificate even after the expiry of the above time limit, he will immediately send a reminder in Form No. II, *again under certificate of posting*, fixing a time limit of again a fortnight.

(3) If the auditor does not get the information on or before the expiry of the time limit fixed in his letter in Form No. II, he will accept the balances disclosed by the books of the society as correct and proceed to finalise the audit accordingly. But however he should specifically indicate in the Audit Report of the fact the confirmation could not be obtained on such items in the Balance Sheet.

(4) Requests for confirmations in respect of a particular society should go before the auditor starts his work in that society, so that he can be in a position to take a decision in the matter in the light of the correspondence with those concerned before the completes the audit of the Society.

The Deputy Registrars (Audit) will instruct the Auditors accordingly. The Deputy Registrars are also requested to stencil and supply sufficient copies of the forms to the Auditors before the 15th July every year.

The Deputy Registrars are also requested to refer to item (5) in page 3 of the circular cited above and bring to the notice of the Registrar such specific cases.

[Immediate]

UNDER CERTIFICATE OF POSTING

No.

Office Of the Circle Officer of Co-operative
Societies (Audit),

Station:

Date:

From

.....

To

.....

Sir,

*Sub:-*Confirmation Certificates-Request for.*Ref:-*Circular Memorandum No. 413/C3/69-8/AD
dated 8-12-1969 of Government.

I write to inform you that
 Co-operative Society Ltd., No is indebted to Government/S.P. W.R. Fund/Khadi & Village Industries/
 District Co-operative Bank Ltd
 on account 01 the items noted at foot, I require a confirmation certificate regarding the balance pending realisation from the society as on 30th June so as to finalise the audit of the society. I, therefore, request you kindly to oblige me with the certificate within a fortnight's time.

Yours faithfully,
 Auditor of Co -operative Societies.

*Items.**Pl.**Int.*

- (1) Loans.
 Share Capital. Working Capital
 Godown
 others (Specify)

(2)

.....

.....

FORM No. II

[Immediate] UNDER CERTIFICATE OF POSTING
 No. Office of the Circle Officer (Audit)
 Station
 Date

From

.....

To

.....

Sir,

Sub:-Confirmation certificate-request for.

Ref:-My letter of even No. dated

I may bring to your kind attention that the information requested for in my letter under reference has not been received as yet.

I may therefore, inform you that the balances as revealed in the books of accounts of the society will be treated as correct for purposes of audit, in case I do not receive your confirmation within a fortnight of the date of this letter, and that I shall not be held responsible for incorrectness, if any, of the concerned balances appearing in the audit certificate to be issued to the society shortly.

Yours faithfully,
 Auditor of Co-operative Societies.

Appendix II (3)

RULES FOR THE ESTABLISHMENT AND USE OF AGRICULTURAL CREDIT
 STABILISATION, FUNDS AT VARIOUS LEVELS

(Vide G.O.Ms. 269/67 Ad/22-7-1967)

1. *Aims and objects*:

“The object of constituting agriculture credit (Stabilization) Funds at different levels of the structure for agricultural credit is to facilitate (1) the conversion of short-term loans for agricultural purposes into medium term loans; and (2) the grant of relief in

the repayment of instalment of of Medium term loans issued for agricultural purposes in circumstances in which total or partial failure of crops resulting from wide spread natural calamities renders the repayment of such loans impossible without dislocation of the structure and without hardship to individual agriculturists. The principles and procedure set out below shall govern the establishment and utilisation of the stabilization Funds”.

2. Establishment of funds:

Agricultural Credit Stabilisation Funds are to be established and maintained as follows:-

(1) By a Central Financing agency for its area of operation. The Central Co-operative Bank Agricultural Credit (Stabilization) Fund.

(2) By the State Co-operative Bank for the State as a whole. The State Co-operative Bank Agricultural Credit (Stabilization) Fund.

(3) By the Reserve Bank of India at the national level-The National Agricultural Credit (Stabilization) Fund.

3. Resources for establishing and maintaining funds:

The funds at various levels shall be established and maintained by crediting contributions from different sources as indicated below:

(i) The Central Co-operative Bank Agricultural Credit (Stabilization) Fund shall be constituted as follows:

(a) Annual appropriation at a rate not lower than 15 % of the net profits of the Central Bank; so that this together with the contribution to the statutory reserve fund will work out to a total of 40% of the net profits of the Co-operative Banks.

(b) transfer of the amount of dividend payable on the share holding of the Government in the Central Bank over and above 3%.

(c) Credit of interest at 3 percent per annum on the balance to the Credit of the Fund as at the commencement of the year; and

(d) transfer of any other sums which the Central Bank may contribute or receive for the purpose.

(ii) The State Co-operative Bank Agricultural Credit (Stabilisation) Fund shall be constituted as follows:-

(a) Outright grants received for the purpose from State Government;

(b) loans received for the purpose from State Government.

(c) Annual appropriation at a rate not lower than 15% of net profits of the bank, so that this together with the contribution to the statutory reserve fund will work out to a total of 40% of the net profits of the bank.

(d) transfer of dividend over and above 3 percent payable to State Government on its share holding in the apex Bank.

(e) Credit of interest at 3 per cent per annum of the balance to the Credit of the Fund as at the commencement of the year; and

(f) transfer of any other sums which the State Co-operative Bank may contribute or receive for the purpose.

(iii) The National Agricultural Credit (stabilisation) Fund shall be constituted by contributions from the profits of the Reserve Bank of India as provided for in the Reserve Bank of India Act.

4. Investments of Fund:-

(a) The stabilization Funds at the level of the Central Co-operative Banks, to the extent that they have not been used for converting short-term loans and for granting relief in the repayment of medium term loans, shall be, either wholly or partially invested in Government or Trustee securities. That portion of the Fund which is not invested in Government or Trustee securities shall be placed in fixed deposit with the State Co-operative Bank.

(b) The entire Stabilization Fund of the State Co-operative Bank shall be invested in Government or Trustee Securities.

(c) The income from the investment of the Fund in loans, in Government or Trustee securities or in fixed deposits, shall be appropriated by the Central Banks and the Apex Bank to their respective profit and loss accounts.

(d) The Central Banks and the Apex Bank shall pay to the Fund interest at 3 per cent per annum on the amount to the Credit of the Funds at the commencement of the year and the apex Bank shall pay interest on the loan part of the assistance provided by the Government from out of the general income by debit to its profit and loss account.

(e) Any depreciation in the investments of the Funds shall be made good by the Bank concerned out of its general income.

A. *Repayment of Government loan.*- The instalment of principal in respect of the loans due to Government shall be paid by debit to the funds.

5 . *Procedure for determining the circumstances for the use of funds and terms and conditions of operations:*

A *Primary Society level*:-(1) On the occurrence of a natural calamity such as drought, floods, eyelong attack of pests or locusts, resulting in failure of crops and before the harvesting of such crops standing in the field, every individual member of a Primary agricultural credit society (1) who is not in a position to repay the short-term loan taken by him from the society and who desires that the short-term loan due from him be converted into a medium term loan or (2) who is not in a position to repay the instalment under a medium term loan taken by him from the society for agricultural proposes and who desires that the instalments be converted into a medium term loan shall apply in writing to that effect to the societies providing such particulars regarding estimated value of his crop, the amount which he may be able to repay etc, as may be prescribed.

(2) As soon as possible thereafter, a meeting of the General Body of the society or of its Managing Committee shall be convened to consider the requests for conversions or extensions and to determine the extent and period for which conversions may be granted and to pass necessary resolutions in that behalf.

No conversion facilities shall ordinarily be considered in respect of medium term loans issued for the purchase of electric motors and pump sets or oil engines and for sinking of new wells or for repair to the old wells. However, relief may be provided if it is proved to the satisfaction of the general body or the Managing Committee as the case may be; that the well of the borrower remained dry for the major part of the year or that the crops were washed away by floods. The loans issued for purchase of milch cattle or agricultural machinery like tractors shall not be eligible for any relief.

(3) Every primary Agricultural Credit society which seeks conversion of short-term loans for Agricultural purposes into

medium term loans and/or conversion of medium term instalments into medium term loans shall make an application to that effect to the Central Co-operative Rank supported by a resolution of the General Body or the Managing Committee as the case may be.

(4) Only on the receipt of Advice in writing from the Central Bank that the conversion has been granted shall the Primary agricultural credit society proceed to take necessary action as follows:-

(5) Short-term loans upto Rs. 1,000 may be converted into medium term loans against personal surety, loans between Rs. 1,001 to Rs. 1,500 against charge on land and all loans above Rs. 1,500 shall be secured by mortgage of land.

(6) The ultimate borrowers shall be required to furnish fresh time promissory notes in favour of the societies which shall correspond to the plan of repayment of medium term loans or of the converted medium term loans as the case may be and such undertaking in regard to the sale of produce through marketing Co-operative society as may be prescribed by the credit societies.

(7) Where a borrower is unable to offer a charge on land, or mortgage his property as the case may be, owing to encumbrances on land or property for other prior borrowing from Co-operative agencies the condition in (5) above may be dispensed with, and conversion allowed as a special case against the personal sureties.

(8) The short term loan account of the borrower shall be credited with the amount of principal due by a corresponding debit to a medium term loan account to be opened.

“In the case of relief in the repayment of medium-term loans, the medium-term account of the borrower shall be credited with the amount of instalment due by a corresponding debit to a medium term conversion loan account to be opened.”

(9) All recoveries in respect of medium term loans thus advanced for conversion or in respect of repayment of medium-term conversion loans granted by the Central Bank shall be credited straight away to the respective loan accounts.

(10) All sums received in repayment of converted medium-term loans or of medium-term conversion loans (in the case of relief in

the repayment of instalment under medium-term loans) granted by the Central Bank shall be remitted to the Bank without any delay.

(11) Separate accounts shall be maintained in respect of such converted medium-term loans received or advanced by the society so as to distinguish them from other loans received or granted by it.

B. Central Bank Level:

(1) The Central Co-operative Bank shall be competent to decide whether crop failure of the area of operations of any applicant society is such as to justify (1) the conversion of short-term loans into medium term loans and (2) the conversion of the instalment due under medium-term loans into medium-term loans. No conversion facilities shall ordinarily be considered in respect of medium term loans issued for the purchase of electric motors and pumpsets or oil engines and for sinking of new wells or for repairs of old wells. Relief however may be provided if the Central Bank is satisfied that the wells of the borrower remained dry for the major part of the year or that the crops of the borrower were washed away by floods. The loans issued for purchase of milch cattle or agricultural machinery like tractors shall not be eligible for any relief.

(2) On receipt of applications from the affiliated societies or suo-moto to the Central Co-operative Bank may request the Collector of District concerned for a Certificate to the effect that crop out-turn in the affected area is less than 37 paise or 50% of the normal out-turn. The District Collector shall issue such a certificate of evidence of natural calamity after satisfying itself, about the position within a fortnight of receipt of requisition from the Central Co-operative Bank.

(3) The Central Banks shall proceed to sanction conversion facility only after obtaining the Certificate from the Collector of District [referred to in the Sub-clause (2) above] to the effect that the crop out-turn in the affected area is less than 37 paise or 50% of the normal out-turn.

(4) The Central Co-operative Banks shall be deemed to be in a position (1) to meet 15% of the amount of short term dues intended to be converted into medium-term loans and (2) to meet the amount of medium term installments intended to be converted

into medium-term loans from out of the drawable resources of stabilisation fund maintained by it and/or out of its other resources.

(5) For the balance of amount required, the Board shall pass a resolution and apply for assistance from the apex Bank in the form prescribed by the Reserve Bank of India.

(6) On receipt of advice from the apex bank the conversion of short-term loan into medium-term loans or the conversion of medium-term instalments into medium-term loans has been granted, the central co-operative banks shall proceed to grant similar conversion facilities to the affiliated primaries against their promissory notes which shall be furnished by them to correspond to instalments for repayment fixed by it in: each case.

(7) The Central Banks shall give effect to the conversion by crediting the short-term loan account of the concerned society with the amount of principal due by a corresponding debit to the fresh medium term loan account of the borrowing society.

“In the case of conversion of medium term instalments the Central Bank shall credit the medium-term loan account of the concerned society with the amount of instalment due by corresponding debit to a fresh medium-term conversion loan account of the society”.

(8) “All recoveries in respect of medium-term loans or medium-term conversion loans as the case may be, shall be remitted to the apex bank without any delay and corresponding credit provided to the account of borrowers or borrowing societies concerned”.

(9) The Central Bank shall maintain separate accounts in respect of converted medium-term loans received or advanced by it so as to distinguish them from all other loans received or granted by it.

(10) The Central Bank shall be free to pledge securities or fixed deposits representing the investments its stabilisation fund, to the extent necessary, for raising the funds required for granting conversions

C. I. Apex Bank level:

(I) The State Co-operative Bank shall determine after scrutiny of the application of the Central Co-operative Banks and such investigation as it may undertake (i) the amount of short-term

loans [ii) the amount of Medium Term instalments which, in its opinion, may be justifiably converted into medium term loans.

(2) (i) "The Apex Bank shall sanction the conversion of medium term instalments into medium term loans to the extent possible from out of the resources available from its stabilisation fund. No loans shall be available to the Apex Bank from the Reserve Bank of India for the relief provided by them in respect of medium term loans" .

(ii) "In the case of conversion of short-term loans, if the apex bank cannot sanction such conversion in full from the resources available from its stabilisation fund. It shall forward the applications of the concerned Central Co-operative Banks to the Reserve Bank of India and at the same time shall itself apply in the prescribed form, to the Reserve Bank along with a resolution of its Board of Directors seeking from the Reserve Bank conversion facilities for the amount of short-term loans due to the Reserve Bank which it cannot convert from its stabilisation fund. The application to the Reserve Bank of India shall be routed through the Registrar of Co-operative Societies who should secure and forward to the Reserve Bank the willingness of the State Government to guarantee the Reserve Bank in respect of repayment of principal and payment of interest, the loans recommended by him to the Reserve Bank for sanction out of the National Agricultural Credit (Stabilization) Fund. He shall also arrange to furnish the Reserve Bank the State Government's Guarantee Deed in the prescribed form."

(3) On the Reserve Bank sanctioning the conversion of loans the Apex Bank may approach the Manager, Reserve Bank of India at the office of the Reserve Bank where its principal account is maintained, and furnish the necessary time promissory notes of Central Bank duly countersigned.

(4) On the Manager, Reserve Bank of India carrying out the adjustments for conversion of short-term loans into medium-term loans corresponding action will be taken by the apex bank to convert the short-term loans of Central Banks into medium-term loans by crediting their short-term loan/accounts by the amount of conversation sanctioned by it by debiting a fresh medium-term loan account.

(5) Separate accounts shall be maintained by the Apex Bank in respect of loan received or given by it for purposes of conversion so as to distinguish them from all other loans received or given by it.

(6) All repayments in respect of converted loans shall be remitted without delay to the Reserve Bank of India and corresponding credit furnished in the converted medium term loan accounts.

(7) The Apex Bank shall be free to pledge the securities representing the investment of its Stabilization Fund to the extent necessary, for the purpose of raising resources required for granting conversion facilities.

(8) The State Co-operative Bank (stabilization) Fund shall be deemed as fully utilised as soon as the overdraft facility enjoyed by the State Co-operative Bank against the Government and trustee securities of the fund is fully utilised.

9. *National Level:*

(1) The application of an Apex Bank for conversion of short-term loan into medium-term loan shall be made to the Agricultural Credit Department of the Reserve Bank of India in the form prescribed for the purpose and shall be forwarded through the Registrar with the required accompaniments.

(2) The Reserve Bank will consider the application subject to such investigations as it may undertake in regard to the need for conversion, amount of conversion required, the financial position of the institutions and such other matters.

(3) All loans granted from the National Agricultural Credit (stabilization) Fund shall be fully guaranteed as to the repayment of principal and payment of interest by the State Government.

(4) The loans shall carry interest at 1½ per cent below the bank rate.

(5) The loans will ordinarily be granted for periods not less than 15 months and not exceeding 3 years, though, in exceptional cases, Bank might sanction such loans upto 5 years,

(6) Short-term loans will be converted into medium term loans on the due date of repayment.

(7) The Reserve Bank of India shall have the right to refuse a loan and to prescribed returns or undertake inspections as it may consider necessary and to vary the terms and conditions for granting conversion facilities.

Appendix II (4)

ADL. (2). 10271/75.

21st March 1975.

CIRCULAR 21/75

It has been brought to my notice that the auditors are not submitting the draft audit reports of Co-operative Societies within a reasonable period after the completion of audit. In spite of repeated instructions, the number of audit reports pending with the auditors remains alarmingly high. It is pointed out that the reports pending with the auditors as on 31-1-1975 was 2320, whereas the number of audits completed during January 1975 was only 835. The Deputy Registrars (Audit) and Assistant Registrars (Audit) are therefore informed that the time limit prescribed below for the receipt, scrutiny, approval etc. of the audit reports should be strictly adhered to in future.

- (1) Submission of the Audit report by the auditors to the Assistant Registrars (Audit) or Deputy Registrars (Audit) as the case may be, after completion of audit :-
 - (a) Apex/Central/District Societies and societies having single concurrent auditors. 15 days from the date of completion of audit.
 - (b) Other societies. 5 days from the date of completion of audit
- (2) Submission of the audit report by the Assistant Registrars (Audit) to the Deputy Registrars (Audit) after checking [In case where the reports have to be approved by the Deputy Registrars (Audit)]. 5 days from the date of receipt from the auditors.

- (3). Submission of the audit report by the Deputy Registrars (Audit) to the Registrar of Co-operative Societies after checking [In case where the reports have to be approved by Joint Registrar (Audit).]. 10 days from the date of receipt from the auditors.
- (4) Resubmission of the audit report by the auditors after rectification of defects. 5 days from the date of receipt of check memo.
- (5) Approval of or checking the Audit reports by the Deputy Registrar (Audit)/ Assistant Registrars (Audit) :-
- (a) Apex, Central. District Societies and societies having single concurrent auditors. 10 days from the date of 1st receipt or 5 days from the date of receipt of rectification report.
- (b) Other societies. 5 days from the date of receipt.
- (6) Issue of audit certificates after approval of the audit report. 2 days from the date of approval.

The Deputy Registrar (Audit) and Assistant Registrars (Audit) should watch whether the time limit prescribed above is adhered to in each and every case, personally examine the cases where the instructions have been violated and take appropriate action against the delinquents.

The officers inspecting the officers of the Deputy Registrars (Audit) and Assistant Registrars (Audit) will verify whether the above instructions have been strictly followed by the Auditors, Assistant Registrars (Audit) and deputy Registrars (Audit) as the case may be.

Appendix II (5)

ADL (I) 39823/78.

7th July 1979.

CIRCULAR No. 36/79.

Sub:- Audit-Audit classification of Central Co-operative Banks-revised standards-adoption of.

Ref:- Letter No. ACD.ID(A)617/J 34-78/9 dated 8-8-1978.

The audit classification of Central Banks is now being made on the basis of the standard fixed by the Reserve Bank of India in the year 1952. The need for revision of the existing standards is now felt by the Reserve Bank of India in the context of significant changes which have since taken place in the field of rural credit and other allied activities. Further, with the sizeable increase in advances by the Banks, their overdues have also been mounting. Hence Reserve Bank of India considered it necessary to replace the existing generalised approach adopted hitherto for making an assessment of the working of a bank by a 'marks' system so as to have a better qualitative assessment of the Bank's overall performance. With these objects in view Reserve Bank of India has set out revised standards for audit classification of Central Banks and *communicated the same in the the reference cited for adoption from the year 1978-1979 onwards.*

In the circumstances mentioned above, following instructions are issued to all concurrent Auditors of the Central Banks for strict compliance.

1. Revised standards viz. "Mark System" for the audit classification will be applied from the audit for 1978-1979 onwards.

2. Assessment of the working of the Central Bank is to be made under the eleven broad heads mentioned in the revised standards which are detailed in the annexure, and marks given on the basis of specific norms indicated under each head.

3. While awarding marks to the items, the basis/authority (with working sheets where necessary) are also to be detailed under the items for further verification in this office.

4. The audit classification of the Bank shall, thereafter, be arrived at on the basis of the aggregate marks secured, by it, as indicated in the annexure.

Annexure

REVISED STANDARDS FOR AUDIT CLASSIFICATION OF CENTRAL COOPERATIVE BANKS

Allotment of marks

An assessment of the working of a central cooperative bank may be made under the eleven broad heads mentioned below and marks given on the basis of specific norms indicated under each head. The audit classification of the bank may, thereafter, be arrived at on the basis of the aggregate marks secured by it, as indicated in this note.

(i) Overdue 22 Marks

Under this head, marks may be given on the basis of the following norms :

Percentage of overdues at the end of the year to the demand for that year (in respect of principal amount only)

	<i>Marks to be given</i>
Upto 20	22
Above 20 and upto 40	11
Above 40 and upto 60	5
Above 60	Nil

If the bank had hidden the position of its overdues by resorting to facile extensions or book adjustments 2 marks may be deducted from the eligible number of marks under this head.

Overdues under interest need not be taken into consideration as the banks are expected to make necessary provision there for.

(ii) Number of defaulting Societies 3 Marks

Marks may be given to the bank on the basis of percentage of defaulting societies to the total indebted societies as at the end of the concerned cooperative year on the basis of the following norms:

<i>Percentage of defaulting societies to total indebted societies</i>	<i>Marks to be given</i>
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Upto 30 per cent	3 Marks
31 to 40 per cent	2 Marks
41 to 50 per cent	1 Mark
Above 50 per cent	Nil

(iii) *Observance of seasonality discipline* 5 Marks

The Reserve Bank has stipulated that central Co-operative banks should recover a specified portion of its demand in respect of short-term agricultural loans before the close of each agricultural *Season viz. Kharif and rabi* and pass on the entire recoveries to the apex bank. Failure to comply with this discipline results in the bank not being able to make further drawals on the short-term credit limit for seasonal agricultural operation till the time the prescribed conditions are fulfilled.

The bank may be given full 5 marks if it had complied with the prescribed seasonality discipline at the end of March and June, while only 2 marks may be given if it had complied with the prescribed discipline in respect of only one season. A bank not complying with the prescribed seasonality conditions may not be given any marks under this head.

(iv) *Reserves/Provisions to cover erosion in the value of assets* 15 Marks

The banks are expected to make full provision in respect of the estimated erosion in the value of its assets which includes bad and doubtful debts as well as other assets considered doubtful of realisation. Depending upon the extent to which the erosion in the value of assets is covered by corresponding reserves and provisions marks may be given on the basis of the following norms:

<i>Extent to which erosion is covered by reserves/ Provisions</i>	<i>Marks to be allotted</i>
100 per cent	15
75 per cent and above but less than 100 per cent	12

50 per cent and above but less than 75 per cent	8
25 per cent and above but less than 50 per cent	5
Below 25 per cent	Nil

(V) & (vi) *Maintenance of cash reserve and liquid assets under sections 12 and 24 of the Banking Regulation Act, 1948 (As Applicable to Cooperative Societies)* 5+5= 10 marks

Five marks each are allotted for the maintenance of required cash reserve and liquid assets. Full marks may be given to the bank if it had maintained the required cash Reserve/liquid assets throughout the year. No marks are to be given if there is default in any day during the course of the year. However, if the default/should have been avoided, had the cash-in-transit, if any, been reckoned towards cash reserve and liquid assets, such default/s should be ignored.

(vii) *Efforts towards mobilization of deposits* 10 Marks

The marks under this head may be given taking into account the extent of increase in deposits achieved by the bank over its previous year's level, on the basis of the following norms:-

<i>Extent of increase</i>	<i>Marks to be given</i>
If the increase in total deposits is over 15 per cent	10 Marks
If the increase in total deposits is between 10 per cent and 15 per cent	5 Marks
If the increase is less than 10 per cent	Nil

If, however, any targets for deposit mobilization for the bank have been fixed by the Department/Apex Bank, marks may be given on the basis of the following norms.

<i>Extent of achievement in relation to target fixed</i>	<i>Marks to be given</i>
100 per cent	10
75 per cent and above but less than 100 per cent	8
50 per cent and above but less than 75 percent	5
Less than 50 per cent	Nil

(viii) Operational efficiency *20 Marks*

The operational efficiency of the bank may be examined under the following five broad heads and marks given on the basis indicated against each head:

(a) <i>Observance of necessary financial discipline</i>	<i>No. of Marks to be given</i>
(i) If there were no defaults in repayments due to financing agencies/institutions/Government	1
(ii) If there were no deficits in non-overdue cover.	1
(iii) Reasonable correlation between (a) Borrowings and lendings	2
(b) Recoveries and repayments:	
(iv) Compliance with the terms and conditions stipulated by apex bank/Reserve Bank, such as reduction in borrowings to the stipulated level, minimum involvement, advancing loans to small and economically weak farmers upto the prescribed minimum level, no unwarranted drawals from the apex bank, observance of prescribed limit for retention of deposits with commercial banks etc. (One mark may be deducted for the breach of each stipulated condition):	6

(b) Rationalization of loan policy and procedures including implementation of the crop loan system of the Reserve Bank of India.	2
(c) Proper maintenance of the prescribed books of account and registers	2
(d) Timely and regular submission of statutory returns.	2
(e) Timely submission of compliance report in respect of.	4
(i) Inspection Report issued by the Reserve Bank of India.	
(ii) Audit report.	
(iii) Directives (applicable, if any) issued by	
(a) Reserve Bank of India.	
(b) Co-operative Department	
	<hr/>
	20
(ix) <i>Profit earned</i>	<hr/> <i>5 marks</i>

The bank may be given marks under this head on the following basis.

<i>Extent of profit</i>	<i>Marks to be given</i>
(a) If the profit is adequated to provide for overdue interest, contribute to various reserves as per bylaws and declare dividend of not less than 3 percent.	5
(b) If the profit is adequate to provide for overdue interest contribute to various reserves as per by-laws and declare dividend of less than 3 per cent.	3
(c) If the profit is adequate to provide for only the overdue interest and contribute to various reserves as per bylaws but does not enable the bank to declare any dividend.	2

d) If the profit is not adequate to make various provisions and reserves. Nil

(x) *Efficiency of Management.* 5 Marks

Marks as indicated against each of the items below may be given taking into account the interest evinced by its Board of Management/Executive Committee in the affairs of the banks:

<i>Aspects</i>	<i>Marks to be given</i>
(a) If meetings were held regularly as per bylaws provisions of the bank.	½
(b) If appropriate steps were taken to formulate policy for mobilization and judicious deployment of resources and periodic review of progress in respect thereof.	1½
(c) If appropriate steps had been taken for recruitment of requisite qualified staff and their framing particularly at the executive level.	1½
(d) Overall efficiency of the staff in the discharge of day-to-day functions.	1½

5

(xi) *Developmental role played by the bank.* 5 Marks

The bank may be given marks for the developmental role played by it as indicated below:-

<i>Aspect</i>	<i>Marks to be given</i>
(a) If adequate steps had been taken to develop backward areas so as to cover economically weak farmers and to provide finance to them	1
(b) If adequate steps had been taken to promote and finance small-scale industries, poultry farming, dairying, etc., wherever there is scope for such activity.	1

(c) If appropriate steps had been taken to draw up branch expansion programme and for its implementation	1
(d) If adequate progress had been achieved in implementation of the scheme of linking of credit with marketing	1
(e) Adequacy of progress achieved in the reorganization of primary agricultural credit societies and rehabilitation of the banks, if applicable. Otherwise the mark may be apportioned among other points equally.	1
	<hr style="width: 100px; margin-left: auto; margin-right: 0;"/> 5 <hr style="width: 100px; margin-left: auto; margin-right: 0;"/>

Audit classification

Depending upon the aggregate of marks secured by the bank, audit classification may be made on the basis of the following norms:

<i>Marks secured</i>	<i>Audit Classification</i>
60 and above	A
45 and above but below 60	B
30 and above but below 45	C
Below 30	D

A bank not satisfying the provisions of section 11 of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) may be classified as 'D' irrespective of the aggregate of marks secured by it.

Appendix II (6)

No. ADL (2) 26588/76.

16th June 1976.

From

The Registrar of Co-operative Societies,
Trivandrum, P. B. No. 185.

To

All the Deputy Registrars (Audit)
All Assistant Registrars (Audit) [Through the Deputy Registrar
(Audit) concerned]

General Manager/Secretary, All District Cooperative Banks
Secretary, Kerala State Co-operative Bank, Trivandrum.

Assistant Registrar/Concurrent Auditor of Kerala State Co-operative Bank and All District Co-operative Banks.

All Assistant Registrars (Audit Squad)

All other single/group concurrent auditors [Through Deputy Registrars (Audit) concerned]

Sub:- Assessment of bad doubtful debts and other assets of Primary Agricultural Credit Societies and Central Banks- Revised standards-Regarding-

Ref:- Letter No. ACD. ID. 10585/J. 17-75/6 dated 12.-4-1976 from the Chief Officer, Reserve Bank of India, Bombay.

The Reserve Bank of India has observed that the guidelines for estimating bad and doubtful debts and other assets of Central Banks and primary agricultural credit societies are not being followed uniformly by the Departmental Auditors and Central Banks and that wide disparity is noticed between the estimates of the bad and doubtful assets at the society level and the Central Bank level and also between the estimates made by the Reserve Bank of India and those made by the Auditor at the Central Bank level. Therefore it is considered necessary to review the standards for the assessment of bad and doubtful debts and other assets at the levels of the Central Banks at the Societies indebted to them.

Although, the guidelines now in force are by and large adequate to guide the Auditors, the Reserve Bank of India has felt that some of the aspects covered in the guideline needed revision with a view to making them simple and easy for application and at the same time realistic. Accordingly the Reserve Bank of India has revised the guidelines for the assessment of the bad and doubtful debts and other assets both at the level of primary agricultural credit societies and Central Co-operative Banks, which are given in the enclosed note.

All the Deputy Registrars (Audit), Assistant Registrars (Audit) and General Manager/Secretary of Kerala State Co-operative Bank and District Co-operative Banks are requested to bring to the notice of all the subordinate officers, the revised guideline and

take immediate necessary steps to implement the suggestions contained in the guidelines for estimation of bad and doubtful debts and other assets of Primary Agricultural Credit Societies and Central Banks systematically.

GUIDELINES FOR ESTIMATING BAD AND DOUBTFUL DEBTS AND OTHER
ASSETS OF PRIMARY AGRICULTURAL CREDIT SOCIETIES AND
CENTRAL CO-OPERATIVE BANKS

The Co-operative Societies Acts in force in different States provide that the annual audit of a co-operative society shall include the examination of overdue debts, if any, and valuation of the assets and liabilities of the society. The valuation of assets implies an estimation of the realisability of the loans and advances and other assets of the institution. In some States, the departmental instructions require central co-operative banks themselves to make an estimate of the bad and doubtful debts and other assets at the end of each co-operative year. In its Circular letters Nos. ACD. Plan 202/PR 264-64/65 dated 28 July 1964 and No. ACD. Insp. 5085/F. 15-70/71 dated 12 June 1971, the Reserve Bank gave certain broad guidelines for the valuation of the assets of the primary agricultural credit societies and the central co-operative banks respectively for use by auditors and banks. These guidelines have now been revised to some extent in the light of the comments received from and the discussions the Reserve Bank had with some of the Registrars of Co-operative Societies on 18th November, 1975. The revised guidelines are given in the following paragraphs divided into two sections section 'A' relating to the primary agricultural credit societies and section 'B' relating to central banks. These guidelines are not exhaustive but indicative of the line of approach to the task of estimation of bad and doubted debts and other assets of primary agricultural credit societies as well as central co-operative banks.

A. AT THE LEVEL OF PRIMARY AGRICULTURAL CREDIT SOCIETIES

2. The scope of audit of a primary agricultural credit society generally includes the following:-

- (a) Verification of cash, bank balances and securities;
- (b) Verification of the balances at the credit of the depositors and creditors and of the amounts dues from the debtors of the society;
- (c) Examination of overdue debts, if any ;

- (d) Valuation of assets and liabilities;
- (e) Determination of the extent of reserves and provisions required to be built up against erosion of the value of assets and
- (f) Examination of the statement of accounts and balance sheet prepared by the managing committee of the society.

It must be emphasized that the audit report to serve a useful purpose, should disclose accurately the financial results of the dealings of the institution. It is the auditor's duty in preparing the balance sheet to see that all the assets which are shown in the books appear at their proper value, that they exist in fact and that no assets have been disposed of or charged in any way without the transactions being recorded in the books of the society. In this context an examination of all loans due and their classification into good, doubtful or bad constitutes a very important aspect of audit. It is also necessary to verify and evaluate the other assets including the amounts shown under sundry debtors and see from the records available with the society whether any of the assets have become irrecoverable or eroded in value either wholly or in part and determine the extent of such erosion on a rational basis with reference to all the available information. The profit or loss of a co-operative society has to be arrived at after taking into account the erosion in assets and provision made therefore. An attempt is, therefore, made in the following paragraphs to refer to certain possible situations when the value of the assets of a society have to be considered as having diminished and to indicate a rational and practical approach to determine the extent of erosion of such assets.

(a) *Cash in hand:*

3. If the cash balance produced for verification includes currency notes/coins which have ceased to be legal tender for reasons such as being defective, torn, mutilated, defaced, etc., such amount would have to be treated as bad. Any shortage between the cash balance as shown by the books of the society and the actual cash balance should be investigated in detail immediately. If the difference is due to misappropriation/ fraud/ defalcation by an office bearer or an employee of the society the amount that is likely to be recovered from the person concerned will have to be

ascertained in the light of his financial standing and the security, if any, furnished to the society. Amounts misappropriated and not covered by any insurance or security deposit or fidelity guarantee of the employee involved in misappropriation should be considered as bad. If, however, the misappropriated amounts are covered by insurance claims, security deposits or fidelity guarantee or attachment of property on obtaining awards, they may be treated as good or doubtful depending upon the circumstances of each individual case. The amount that is not likely to be recovered will have to be treated as a bad asset.

(b) *Balances with banks :*

4. Ordinarily, agricultural credit societies are required to keep their funds only with the central bank to which they are affiliated, but in some cases they are permitted by the Registrar to keep their balances with commercial banks and other Co-operative banks. In cases where the banks with which the funds have been kept have gone into liquidation, the auditor may treat the entire amount with such banks as doubtful in the first instance and after getting confirmation from the liquidator regarding the amount that the society may realize, he may classify the unrealisable part as bad assets.

(c) *Investments:*

(i) *Shares:*

5. Agricultural credit societies are required to invest a part of their owned funds in the shares of the central co-operative bank. They are also required to buy shares of co-operative marketing societies. In some states, the agricultural credit societies have also invested in the shares of other co-operative institutions like co-operative sugar factories, co-operative spinning mills, co-operative printing presses, etc. The auditor will have to verify these investments and see whether any of the institutions in which the society holds shares of co-operative institutions have already gone into liquidation or were functioning in a very bad way, incurring heavy losses. The break-up value of the investments in such cases will have to be worked out on the basis of a proper assessment of the bad and doubtful assets of the marketing and processing societies and other types of societies in which the investments are made. At present, in many of the States, no proper assessment

of the bad and doubtful assets of such societies is made by the auditors. The Registrar of Co-operative Societies of each State has been requested to issue instructions to the audit staff to properly estimate the bad and doubtful assets of the marketing/processing societies and to clearly indicate the estimates in the audit report as also the break-up value of the shares of these societies as on the date of audit. To determine the break up value of shares, the real and exchangeable value of the paid up capital of the marketing/processing society may have to be arrived at. It is ordinarily taken as equal to the realisable value of its assets minus outside liabilities. The real and exchangeable value of shares may be apportioned to arrive at the intrinsic worth of each share which would be its break-up value. However the shortfall in the break-up value of shares in relation to the paid up value may be ignored during the first three years following commencement of business or production of a new Co-operative venture. The difference between the paid up value and the break up value of shares held by an agricultural credit societies in other marketing/processing societies will represent the depreciation in the value of its investment in the shares of such societies.

(ii) Government and other trustee securities:

6. Societies may have also invested a part of their funds in government and other trustee securities. During the physical verification of the securities, it should be examined whether they are held by the society in its own name, that the endorsements on the securities are in order and that interest is collected on them periodically. The investments in government and other trustee securities should be valued on the basis of their market price on the date with reference to which the audit is conducted and the market value or the book value whichever is lower should be taken as the realizable value.

(d) Other investments:

7. The auditor will have also to examine other investments of a society such as those made in buildings, furniture, land, etc., and see whether adequate depreciation has been allowed on such investments. If no depreciation had been allowed on buildings, furniture, etc. earlier, depreciation should be worked out at the rates indicated in para 34 to arrive at the realizable value of the assets. In the case of buildings as also land acquired in satisfaction

of claims, the title of the property will have to be carefully examined to see that it is clear and free from any encumbrances. With regard to lands acquired in satisfaction of claims, it should be ascertained if they are in the clear possession of the society or still in the possession of the debtor, whether they were offered for sale and, if so, why they could not be sold and whether the current land laws operate against the sale. Where the lands so acquired are not in the possession of the society or there is difficulty in selling the same, then the debt in satisfaction of which the land was acquired together with costs has to be treated as doubtful of recovery.

(e) *Loans and advances:*

8. The major activity of an agricultural credit society relates to loans and advances. Classification of these as good, doubtful or bad is an important duty of the auditor. Bad and doubtful debts may be generally defined as follows.

The bad debt is one which is considered as clearly irrecoverable on the basis of available information. Such a debt may have to be written off eventually since it is 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. A prudent institution should make provision even against a doubtful debt.

9. Although there does not appear to be uniformity in the instructions in force in the different states in regard to the classification of a debt as bad or doubtful, two main considerations, viz. security behind the debt and the period of default in the repayment of the debt have been uniformly emphasized in estimating the bad and doubtful debts. Wherever it is possible to analyze realisability of debts in individual cases with reference to the security offered, financial conditions of the principal borrower, his surety and the past performance of repayment and the stage of legal action taken to recover the overdues, it should be attempted and the realisability and otherwise of each case has to be determined. But, in actual practice, it is found that the number of cases of overdues is quite large and there is no complete information about the financial conditions of individual borrowers except what is available on the records of the society by way of pronote, executed land or other assets offered as security by mortgage or by creation

of charge under the Co-operative Societies Act with the result that it is very difficult to have complete and correct assessment of the realizability of dues in all cases. In the course of the discussions at the meeting convened by the Reserve Bank on 18 November, 1975 on this subject to which some of the Registrars were invited, it was agreed to adopt the following procedures in respect of the cases for which full details are not available. This procedure will facilitate, to a reasonable extent, the classification of dues into good, bad and doubtful with reference to the period for which amount remained overdue (ie. reckoned from the due date) and nature of security offered.

(a) The auditor will have to first satisfy himself that the overdue position of loans has been correctly worked out and that no attempt has been made to conceal the real position of overdues by resort to book adjustments or unauthorised extensions. The auditor should thus arrive at the correct age of an overdue loan.

(b) Further, each primary agricultural credit society should be asked to maintain a separate register showing the overdues from members and the nature of security against each such loan. This register should be written as at the end of each co-operative year. On the basis of this register, a statement should be prepared by the society as at the end of each year showing overdues for 1 to 3 years, 3 to 6 years and above 6 years which should be checked by the auditor. The financing bank should ensure through its supervisory staff that the register referred to above is maintained by all societies and the statement of overdues prepared every year before the audit is undertaken. In the absence of a full time or part time paid Secretary, however, it may be difficult for a society to maintain the register and prepare the list of overdues for the purpose of audit. In such circumstances, it will be necessary for the auditor himself, to write the register and prepare the statements in question. The statements of overdues showing the names of borrowers and the nature of security would be useful not only for audit purposes but also to the Co-operation Department and the financing bank in their recovery campaigns, particularly where large amounts are involved and the overdues are old the Registrar of Co-operative Societies may include the register in the list of the prescribed registers and devise a suitable proforma for the register and also for the statement of overdues to be attached to the audit report broadly on the lines of Proforma-1 enclosed to this note.

10. The criteria for classification of overdue loan as doubtful or bad on the basis of security and the age of overdue may be as under.

(a) Ordinarily loans which are overdue for less than one year need not cause undue alarm. The crops during the previous year might have failed or the member might have utilized the sale proceeds of this crop to meet certain unforeseen expenditure. But the member may be honest and may be expected to repay out of the next harvest. It may not, therefore, be ordinarily necessary for the auditor to treat any part of overdue debts for less than one year and doubtful of recovery or bad unless there are other compelling reasons to do so.

(b) Where the overdues are for 1 to 3 years and if these are secured against mortgage or declarations of land or in the case of surety loans the borrower or the surety possesses land and the same is clearly recorded in the property register, they can be classified as good. Where, however, the overdue loans are against personal security and neither the borrower nor the surety has any land as per the property register of the society, they will have to be treated as doubtful.

(c) In the case of overdue loans exceeding 3 years but not 6 years, if the borrower has provided tangible security they will have to be treated as doubtful. If, however, no tangible security is available for the overdue loans under this category, they should be treated as bad.

(d) All overdue loans for more than 6 years from the due date, whether they are secured or unsecured, should be treated as bad.

(e) Apart from the treatment of overdues as doubtful or bad on the basis of age and nature of security, those overdue loans in which cases bonds decrees or execution petitions have become time barred or documents are lost and the borrowers refuse to execute fresh documents admitting their liability or where the debts has not been recovered even after award has been obtained and the execution proceedings have proved futile, they have to be treated as bad. Similarly, where the member and his sureties are declared insolvent or have died leaving no tangible assets to proceed against them or where the member has left the area of operation of the society leaving no property and his sureties have also no means to pay the dues, the debts may have to be considered as bad.

To sum up, the auditor may generally classify a debt as doubtful or bad under the following circumstances :

Doubtful Debts:

11. Where the loan is overdue for a period exceeding one year but not three years, and it is against personal security, neither the borrower nor the surety having any land as per the property register of the society, it will have to be treated as doubtful. Also, loans overdue for more than 3 years but not 6 years may have to be treated as doubtful notwithstanding provision of tangible security by the borrower.

Bad Debts:

12. In circumstances such as the following the debts may be treated as bad: (1) where the member and his sureties are declared insolvent or have died leaving on tangible assets; (ii) where the member has left the area of operation of the society, has no property and the sureties have also no properties or Income to pay the dues; (iii) where no tangible security is available for loans overdue from 3 to 6 years; (iv) all loans overdue for more than 6 years from the due date whether they are secured or unsecured; (v) where a debt though not overdue for more than 6 years, has not been recovered even after an award has been obtained and an execution proceeding instituted has proved futile; (vi) when the pronote and other documents have become time-barred or the documents are lost and the borrower has refused to execute fresh documents admitting his liability.

13. While actually estimating the bad and doubtful debts due from a member, such amounts as the share money or deposits of the member with the society may be deducted and the balance alone considered as bad or doubtful as the case may be provided the Co-operative Societies Act of the State concerned permits the societies setting off the share money and deposits of the members against their dues. In order to have a degree of uniformity in the presentation of data regarding bad and doubtful debts, the auditors may tabulate the data as shown in Annexure-II to this note.

Interest receivable:

14. In respect of the loan accounts in which the amounts under principal are considered bad or doubtful of recovery, the

outstanding amounts due under interest may also generally become unrealizable. Such unrealizable interest should, therefore, be included in the estimate of erosion in the value of the assets of the society.

Sundry debtors:

15. In most societies the asset side of the balance sheet includes a certain sum under the head 'sundry debtors' or 'adjusting heads'. This item may include amounts advanced to office bearers for attending meetings etc., accounts for which might not have been rendered for a long time, amount recoverable from members in respect of goods supplied to them on credit and items of expenditure which have not the sanction of the requisite authority etc. In some cases the item may even conceal fictitious assets. The auditor will have to carefully examine all the items under this head and particularly those that have been outstanding for long. Where it is found on the basis of such scrutiny that there are items which are not realisable; then to that extent the amount shown under the head will have to be treated as bad.

16. In the evaluation of the various assets listed above, the auditor may in certain cases find that the realisability of the amount is in doubt. At the same time, he may not be reasonably certain that they will turn out bad. For instance, an office-bearer or an employee of a society may have misappropriated some funds of the society. He may be a person of some means and if legal proceedings are instituted the amount may be expected to be realised. But the society may not have all the necessary evidence to formally establish the case and there may be a chance of the office bearer's or the employee's acquittal. Similarly, an agricultural credit society may have invested its funds in shares of co-operative sugar factories or other processing societies. The factory may not have declared dividend year after year. But there may be chances of, reviving it under, proper management for which necessary steps are being taken. In such cases, the difference between the paid up value and the break-up value of the shares held by the agricultural credit society may be considered as doubtful asset.

Reserves and provisions:

17. Since the full amount of bad debts and other assets and ten per cent of the doubtful debts and other assets would constitute

the amount of erosion in the value of assets of an agricultural credit society, it is necessary that corresponding provision should be made there against. It should however, be noted that where a society has got bad debt reserve etc., such reserve should not be adjusted at the stage of working out realisability of the assets. It will, however, be reckoned while working out the real or exchangeable value of the society's owned funds and determining the provision necessary to cover the estimated erosion in assets.

Maintenance of books of account:

18. To facilitate the assessment of bad and doubtful debts by the auditors, it is essential that primary agricultural credit societies should maintain all their books duly posted up-to-date. In particular, the property register of members, surety registers record of pronotes, arbitrations, etc; should be kept up-to-date. The societies should also maintain systematic records to indicate the progress in the execution of awards. They should obtain pass books or statement of accounts from banks with which deposits are kept. Certificates in respect of their investments in the shares of Central banks, marketing societies, etc., should also be obtained and made available for scrutiny by the auditor at the time of audit.

B. AT THE LEVEL OF CENTRAL CO-OPERATIVE BANKS

In the case of Central Banks also, the auditors will have to evaluate each item of the assets to determine its realizable value. The following broad guidelines are given to facilitate the work of officers auditing Central Banks.

Cash on hand:

19. If the cash balance produced for verification includes currency notes/ coins which have ceased to be legal tender for reasons such as being defective, torn, mutilated, defaced, etc, such amount would have to be treated as bad. After verification of the cash balance, if any shortage in cash balance from that shown in the books of the bank at the head office or its branches is detected, the matter should be closely investigated in detail immediately. Inquiry should be made from the officials or office bearers responsible for the custody of cash for the reasons for shortfall. An extract of the cashier's scroll (cash receipts/payments scroll/register) and also of the cash balance book showing denomination wise cash balance particulars for that date, duly authenticated by

the concerned officials may be taken for record. If the shortfall is found to be due to misappropriation/fraud/ defalcation by an office-bearer or an official of the bank or due to negligence on the part of an employee, the likelihood of the amount being recovered from the persons concerned and from the insurance company should be ascertained in the light of the relevant factors such as security furnished by the concerned person and his other assets etc. That part of the shortfall which is not likely to be recovered should be treated as a bad asset. If the bank itself had earlier detected any shortage, it might figure either under cash balance or under sundry assets in the balance sheet. In such cases also, the possibility of recovering the amount from the concerned persons and from the insurance company should be examined and that part of the amount which is not likely to be recovered should be treated as a bad asset. In certain cases, shortage in cash found over a period of time might be shown under sundries' or miscellaneous and the bank might not have taken any action in view of the smallness of the amounts involved. Full particulars of such cases should be collected and the amount likely to prove bad either because of the bank not taking action in time or because of the unrealisability of the amount inspite of action, estimated as such.

Balances/deposits with other banks:

20. The balances held in deposit accounts with other banks should be verified with reference to the pass book, statement of accounts or certificate of balance received from the banks and the periodical reconciliation statements. All items outstanding for long should be examined in detail as under:

- (i) the extent of the amount involved;
- (ii) the period for which the item was outstanding;
- (iii) whether the bank had taken up the matter with the bank concerned and if so with what result ;
- (iv) if the bank had not taken up the matter with the concerned bank, the reasons for the same.

In case of doubt: the auditor will have to satisfy himself about the genuineness of the transaction by examining the relevant paying-in-slips, counter foils of cheques, drafts, transfer advice etc. If necessary, he may himself get the balances confirmed by

the concerned banks with which balances are shown to have been held.

Debit entries passed by the bank/other banks and remaining unresponded to in the other banks/the bank's books should be thoroughly investigated. If, after examination of the long outstanding items, it is found that any transaction is fictitious, the amount that cannot be recovered from the persons responsible for the transaction should be treated as a bad asset.

If the banks with which the amounts had been deposited had either suspended payment or gone into liquidation, the extent of realizability of such deposits should be estimated and the unrealisable part of the deposits treated as a bad asset. A perusal of the correspondence with the liquidator of the concerned bank may indicate the instalments/last instalment payable which would help estimating the realisability of the amount involved.

Investments in Government and trustee securities, shares and debentures:

21. After a physical verification of the securities and shares with reference to the details in the investment register, it should be examined whether they are held by the bank in its own name and also in its custody or have been lodged with other banks against overdraft or other arrangement. The investments in government and other trustee securities should be valued on the basis of their market price on the date with reference to which the audit is conducted and the market value or the book value whichever is lower should be taken as the realisable value. Securities like debentures of land development banks which are not quoted in the market would have to be evaluated at the market price of comparable securities of the same maturity and guaranteed by the same government which are quoted in the market and this evaluation taken if it is lower than the book value. In evaluating debentures, it may not be prudent to be merely guided by the interest rate on the basis of comparable State Government Securities as debentures for the same period carry a slightly higher rate of interest. The estimated value of the particular series of debentures carrying a similar rate of interest or as near thereto related to the maturity of government securities of the same state which had guaranteed the debentures ought not to exceed the value of government securities. If such an evaluation is not possible, the debentures may be taken at their book value.

22. Shares and debentures of joint stock companies which are quoted regularly on the stock exchange should be taken at their market price or book value whichever is lower. If they are not quoted on a recognised stock exchange, they should be valued on the basis of the financial position of the company and the dividend paid during the past few years.

In the case of shares of co-operative sugar factories, spinning mills, printing presses, etc. which are not quoted on the stock exchange, break up value of the investments should be worked out having regard to the financial position of the institutions and their working results. For this purpose, from the realisable value of the assets of such societies in which shares are held, their outside liabilities should be deducted to arrive at the value of their paid up capital. The real value of shares may be apportioned to arrive at the worth of each share which would be its break up value. If the book value is more than the break up value of the share, the difference will represent the depreciation in their value. The shortfall in the break up value of shares may be ignored during the first three years of commencement of business (production, not registration) of a new co-operative venture, treating it as the inevitable gestation period for a new institution and shares of such institutions may be taken as good for the paid up value. But after the expiry of the first three years, the shortfall should be treated as a bad asset. In case, it is not possible to work out the break up value of investment, the entire amount invested in such shares may be considered as bad particularly if the institutions have been put under liquidation or have stopped functioning or have continuously incurred heavy losses over a number of years and no steps taken to revive them.

As indicated in Section A of this note, the Registrar of Co-operative Societies has been requested to issue circular instructions to the audit staff of marketing societies, Co-operative sugar factories and other such types of societies to work out the break-up value of the shares and indicate the same in the audit reports of such societies. The banks may be guided by such break up value already worked out and given in the latest available audit reports and need not attempt an independent valuation.

23. The investments in post office certificates, treasury saving deposit certificates and other similar securities should be taken at their surrender/ encashable value if the bank had not taken to profit

and loss account the difference between the encashable value and the paid up value by debiting the amount to interest receivable account. Where they do not have encashable value or if the interest received thereon was transferred to the interest receivable account (which would be the desirable accounting procedure) these may be evaluated at their book value or paid up value whichever is less.,

If the bank has got an investment depreciation reserve, such reserve should not be adjusted against erosion/depreciation in the value of assets in government/trustee securities and shares etc. while estimating the realisability of the asset.

Loans and advances:

24. For assessing the bad and doubtful debts of primary agricultural credit societies, the auditor of the central bank will make use of the overdue list of the indebted societies attached to the respective audit reports referred to in para 9 of Section A of this note. If the bank's loans' against any society are covered by good loans outstanding from members to the society or if the owned funds of the society have not been eroded, the bad and doubtful debts of the society will not affect the dues to the central bank. The central banks auditor need not ordinarily examine each individual entry in the society's overdue list, but may take the total position of good, doubtful or bad assets as arrived at by the society's auditor. The realisable value of assets of the society has to be arrived at after deducting the entire amount of bad assets and 10 per cent of the doubtful amount. If the amount so arrived at is more than the outside liabilities of the society, the central bank's due, from the society would be unaffected. If, on the other hand, the realisable value of the assets of the society falls short of outside liabilities, the central bank's dues are affected. The extent of the erosion of the dues to the central bank will be determined after taking into account the dues to the government, any 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 a pro rata basis among all the creditors having like claim.

As far as possible, the auditor of the central bank should work out the erosion in the assets of the indebted primary agricultural credit societies on the basis of the audit report for the year in respect of which the central bank also is audited. If, however, the audit of the society has not been completed, the audit report of

the previous year may be taken for the purpose of working out the erosion after making due allowance for the subsequent transactions in the account or accounts, if any. Subsequent inspection reports of bank's supervisor/inspector will be useful in this regard. With a view to making a realistic estimate, the necessary particular may be collected from the balance sheet/trial balance, audit report etc. in respect of the concerned societies and tabulated in a statement (proforma in Annexure III).

If a central bank has been brought under a scheme of rehabilitation, the progress made in the recovery of its dues and in the assessment of its bad and doubtful debts may be taken into consideration while making an estimate of the bad debts of the bank. It would also be desirable to take into consideration the programme, if any for the revitalization of primary agricultural credit societies in the bank's area of operation and the progress in the implementation of the programme. It should be ascertained whether any of the concerned societies is covered by the programme. If so, the outstanding amount due from such societies may not normally be considered as bad or doubtful of recovery unless there are other compelling reasons for holding a different view.

25. The dues considered bad and doubtful of recovery during the previous year should continue to be treated as such during the subsequent audit also if there is no significant improvement in such accounts like sizeable recoveries, improvement in the financial position of the society and of its working etc.

26. Co-operative societies engaged in trading activities such as marketing societies and consumers stores and those engaged in production such as processing societies (rice mills, oil mills etc.), weavers and other industrial societies generally obtain funds from the central bank for working capital purposes. An estimate of the reliability of the advances outstanding against these types of societies should be made with reference to the repayment performance from the day the advances were made, periodical stock and other financial statements submitted by the society, audit report, inspection notes, etc. It is possible that such an indebted society might have ceased working: might be in a moribund condition or might be otherwise in a bad way and its accumulated loss and fictitious assets exceed its owned funds. In

the case of these societies, an important item of their assets will be the stock-in-hand. The audit reports and the reports of the bank's inspectors should make a thorough examination of the stocks to find out if the actual stocks tally what is shown in the books/stock statements or the stocks have deteriorated in quality due to passage of time or due to other reasons and have thus become unsaleable or could be sold only at much reduced price. It should be noted that the auditor of the central bank should not classify the dues of such societies as bad or doubtful merely because the borrowings from the central bank are not supported by adequate cover. He will have to examine the realisability of all the assets of the society in question to ascertain whether it has the capacity to repay the central bank's dues.

27. Another important item which has a bearing on the estimate of realisability of the dues to the bank from some of the non-credit societies will be their fixed assets such as land and buildings, machinery, etc. This item assumes all the more importance if the bank has made advances to a processing/industrial society for purchasing and erecting plant and machinery etc. In such a case, it has to be ascertained whether the machinery purchased was new or old, whether there is demand for such machinery and the approximate price it would fetch if sold. In some cases, the society might have stopped production and the machinery kept idle for a long time making it unusable or saleable at a nominal price. After examination of all items of tangible assets of the indebted society, the claims of preferential creditors will have to be sorted out. (Generally, Government will have first charge on the assets of the society for loans granted by it, if any). After providing for any preferential creditors, having the first charge, the remaining realisable assets may be considered for distribution on a pro-rata basis among other creditors, if it is found that such assets are insufficient to payoff fully the balance of the outside liabilities. That portion of the bank's loan which is thus not covered by the pro-rata distribution of realisable assets may be treated as bad.

28. In the case of non-agricultural credit societies such as urban banks and employees' credit societies, it should be seen whether the repayment of the overdue loans to the central bank are satisfactory and whether the societies would be able to meet their obligations to the central bank within a reasonable period. If this is not so, it may be seen whether the outstanding to the central

bank are covered by corresponding outstandings against members and whether the latter are supported by bonds which are not time barred, that necessary action is being taken by the societies for recovery of dues from the defaulting members, that no indented member has left the place or is untraceable or (in the case of a salary earners' society) has left the service of the concerned institution and is without any tangible asset and, in such an instance, whether the dues could be recovered from his sureties. In the case of urban banks particularly, the tangible security, if any, for the loans to its members has to be considered. In short, after examining the net financial position of the indebted society with reference to the latest balance sheet, audit report, supervisor's inspection report, etc, the deficit in its realisable assets to meet the liabilities to the bank may be considered as a bad asset.

29. The dues from societies under liquidation will have to be examined with reference to the liquidator's reports, if any. Generally before the registration of a Society is cancelled, a statutory enquiry is held. The enquiry report estimates the bad and doubtful assets of the society and indicates how much of the outside liabilities could be discharged. Such an assessment is contained in the cancellation order of the department which may be taken as the base and checked with the subsequent realisation performance under the liquidator. The latest position in regard to the realisability of the bank's dues should be ascertained from the liquidator whose assessment may normally be accepted. In the absence of any information in this regard other sources such as audit reports, supervisors' reports, etc, may be seen. In some States like Tamil Nadu and Andhra Pradesh societies under liquidation are audited and a copy of the report sent to the liquidator from which necessary particulars may be obtained. Where no information is available and no progress is reported although a period of two years has elapsed after placing the society under liquidation, the outstanding dues from such societies may be treated as bad. In making the evaluation of the dues from these societies, their investments in the shares of the central bank may be set off against their dues to the bank.

Interest receivable:

30. In respect of the loan accounts of a bank in which the amounts under principal are considered bad or doubtful of recovery, the outstanding amounts due under interest may also

generally become unrealisable. Such unrealisable interest should, therefore, be included in the estimate of erosion in the value of the assets of the bank.

Bills purchased and discounted:

31. The bank may have discounted sight as well as usance bills. The parties may have defaulted in the payment of bills discounted at maturity with the default continuing for long periods. The financial position of the defaulting parties should be ascertained. Some parties not being in a position to retire bills at their maturity might have got fresh bills discounted to enable them to pay the bills on due dates. The bank might have agreed to accommodate them to avoid showing them as defaulters and getting the amount blocked. Such cases of clean/accommodation bills should be thoroughly examined. The financial position of the parties and their reported liabilities to parties other than the bank, the value of security, if any, held by the bank etc., should be examined to estimate the realisability of the bank's dues.

Building, furniture, vehicle, etc.

32. The other investments of the bank such as building, furniture and fixtures, vehicles etc., should be examined to see whether adequate annual depreciation has been allowed on those items. The extent to which depreciation had not been allowed should be treated as bad. In the case of buildings, there might have been damage to it due to fire, floods, etc., and the property may not have been adequately insured against such risks. Valuation of the property (based on its market/realisable value) may have to be made in such cases and the shortfall if any, in relation to the book value treated as a bad asset. If a bank had revalued its building and shown it at the appreciated value in its books on the ground that its market value had gone up considerably, the asset may be valued at book value or cost price less depreciation.

33. In respect of land and buildings, acquired from borrowers in satisfaction of the bank's claims, if the title to the property is not clear or the property is not free from encumbrance or the property is not in actual possession of the bank or there were no bidders when the property was put to auction, the investments may be treated as doubtful of realisation. Otherwise, the value of such properties may ordinarily be taken at their market value or Book value, whichever is lower.

34. Furniture and fixtures, vehicles and other similar items which are tangible in nature may be taken at their book value provided normal depreciation has been allowed on such items. Here also, if the bank had not allowed adequate depreciation or any depreciation at all, the book value of these assets may, in ordinary circumstances, be reduced to the extent of the depreciation that the bank should have normally allowed on them for the respective years.

35. The value of missing/unserviceable articles of dead stock may also be treated as bad.

36. The rates at which annual depreciation is normally charged are indicated below;-

Buildings	2½%	
Furniture and fixtures	5%	
Vehicles	20%	and in the case of heavy duty vehicles like trucks which are put to constant use and whose life may not be more than 5 years, depreciation at 40% for the first year of usage.

37. In some cases the book value of assets, viz., building, furniture, vehicles etc., is not reduced every year on account of depreciation, but instead separate depreciation reserves are built up. For the evaluation of these assets, their book value should be reduced after providing for depreciation at normal rates.

Other assets:

38. These include such items as 'sundry debtors', 'suspense', miscellaneous items, adjusting heads etc. The long-outstanding items under these heads should be scrutinised with reference to all the relevant particulars. If no particulars regarding any item are available or if no documents have been executed for any amount due from an outside party or if no steps have been taken by the bank to realise the amount and the bank itself is diffident about the recovery of the dues, then to that extent the amount shown under the head may be treated as bad asset.

39. 'Branch adjustment' shown on the assets side of the balance sheet of a bank could be taken at the book value as the

amount normally relates to assets in transit. However, it should be examined from the reconciliation statement that it does not contain items of a doubtful nature or outstanding for unduly long periods and reasons therefore. If the account includes any item of a doubtful/fictitious nature, the same should be included in the estimate of erosion in the value of assets of the bank.

Accumulated losses:

40. The accumulated losses appearing in the balance sheet may be treated as unrealisable asset.

Reserves and provisions:

41. The primary agricultural credit societies will have to provide for 100 percent of bad debts and assets and 10 percent of doubtful debts and assets as indicated earlier. However, central banks have to provide fully for the entire erosion.

PRO FORMA I
Register showing the overdues of more than one year to the society

Sl. No.	Name of the member	Type of loan	Date of loan	Amount advanced Rs.	Due Date	Amount overdue as on 30 June Rs.	Only pronote of the member Rs.	Pronote of the member with one or more sureties Rs.	Charge on loan which has been duly registered plus one or more sureties Rs.	Mortgage of land of the member having no prior encumbrances Rs.	Mortgage of land of the member having prior encumbrances Rs.	Collateral security, if any, in the form of marketable goods including gold and silver Rs.
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Classification of loans outstanding according to the nature of security												

Particulars of the assets of the borrower

Sl. No.	Land holding	Land mortgaged to the society*	Other unencumbered properties	Shares held in the Society	Deposits and other funds with the society					
	Owned	Leased	Immovable description	Movable description	Value					
	Acres	Estimated value	Rs.	Rs.	Rs.					
(14)	(15)	(16)	(17)	(18)	(19A)	(19B)	(20A)	(20B)	(21)	(22)

* Includes lands on which charge is created.

Sl. No.	Action taken against the borrower		Standing of sureties		Amount considered bad/doubtful of recovery									
	Arbitration reference	Execution petition	Land owned	Estimated value	Bad	Doubtful								
Date of filing	Amount Rs. (24)	Date of decree	Amount decreed Rs. (26)	Date of sending for execution	Amount since recovered Rs. (28)	Loans outstanding to the society Rs. (29)	Of which overdue Rs. (30)	Total liability as surety Rs. (31)	Acreeage Rs. (32)	Total Rs. (33)	Of which mortgaged to the society or others Rs. (34)	Value of unhypothecated tangible assets Rs. (35)	Rs. (36)	Rs. (37)

ANNEXURE II

..... CO-OPERATIVE CREDIT SOCIETY

Statement of bad and doubtful debts as at the end of the year 30 June 19

(Amount in Rs.)

Name of the member	Type of loan	Amount outstanding	Due date	Of which overdue	Period for which it is overdue	Name of security*	Amount considered		Reasons
							Doubtful	Bad @	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)

* Indicate here _____
 'personal', 'land', 'building', etc.

@ While giving reasons indicate the amount of share money, deposits etc. adjusted in arriving at the estimate.

ANNEXURE. III

Work sheet for estimating the bad and doubtful debts at central bank level

Sl. No.	Name of the society	Date of financial particulars *	Outstanding against members	Total loans	Book value of assets	Bad debts/assets (100%)	Doubtful debts/assets (10%)	Erosion in the value of assets				
								Of which overdue for more than 1 year	(6)	(7)	(8)	Total (Col. 7+2)
(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)					
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)

Of which Overdue	Borrowings, from the Government	Other borrowings if any	Other outside liabilities	Total (Col. 11+ 13+ 15+16+ 17)	Amount considered as bad +
(14)	(15)	(16)	(17)	(18)	(19)

N.B. - Particulars in this statement may be filled in from the audit reports on the societies, supervisor's inspection/visit notes etc.

- * The financial particulars may relate to the last day of the co-operative year for which the latest audit report is available.
- + 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, any 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.