DEPARTMENT OF CO-OPERATION

GOVERNMENT OF KERALA

KERALA CO-OPERATIVE AUDIT MANUAL

PART - 1

PREFACE TO THE REVISED AUDIT MANUAL

We have immense pleasure in bringing out this revised audit manual. The Kerala Co-operative audit manual was earlier published in 1983, which was a very useful hand book for Co-operative Auditors. The Co-operative sector had undergone significant changes during the past 37 years. The number of Co-operative institutions, their branches as well as their business has increased. The membership in Co-operatives has increased unprecedently. The number of employees in Co-operatives has also increased. Business Accounting has also undergone certain changes. Computer has been used as a tool for conducting business. In the changed environment, the Government of Kerala, has realized the need for the revision of Kerala Co-operative Audit manual.

As per sub section (5A) of section 63 of Kerala Co-operative Societies Act, it shall be the duty of the Director of Co-operative Audit in consultation with the Registrar to revise, amend or update audit manual in every five years, as may be prescribed. In the above circumstances,the Government of Kerala has appointed a working group for the revision of Kerala Co-operative Audit manual with the following members:

1) Sri.Jose Phillip, Additional Registrar (Rtd) Chairman
2) Sri.R K Menon, Director, ICM Thiruvananthapuram
3) Sri.M S Mukundan Nair, FCA
4) Sri.AnilkumarParameswaran, FCA
5) Sri.UdayabhanuKandeth, Rtd Senior Audit Officer AG's office
6) Sri.RSankar, DGM, NABARD, Thiruvananthapuram
7) Sri.S.Jamal, Joint Director of Co-operative Audit (Rtd) Convener

The working group met several times and had detailed discussions. Several workshops and meetings were organized to make the revision more effective and useful. The working group came to the conclusion that as the delayering process in Co-operative credit structure is going on, the revision of audit manual can be completed in a phased manner. The first part of the manual containing the general audit guidelines applicable to every Co-operative institution will be published at first.

The Second part consisting of the detailed guidelines for the audit of Credit Co-operatives, agricultural credit, both for short term and long term structures andnon agriculturalcredit will be brought out later.

The third part will be dealing with the audit of all non-credit Co-operatives, Apex, Federal and primaries and the audit of different Co-operative Boards. As the Government of Kerala has appointed a committee to propose changes in the existing structure of Dairy Co-operatives in Kerala, the outcome of that process also needs to be considered while revising the Co-operative audit manual.

The working group has attempted to present the audit guide lines in a simple and lucid manner. The basic concepts and principles in the previous manual, which do not have any changes are included in the revised first part of the manual. The accounting process in Co-operative banks has changed consequent to computerization. Hence, we have incorporated a Chapter on computerized auditing, which we hope, will be much useful for the auditors and department officials.

We would like to place on record our whole hearted appreciation and gratefulness to the Government of Kerala especially to Honourable Minister for Co-operation, Devaswom and Tourism Sri.KadakampallySurendran for entrusting this ardent task on us.

We would like to place our gratitude to Sri.PVenugopal, IAS, Special Secretary Co-operation for his valuable support and guidance.

It is quite satisfactory that the officials of department of Co-operation, Registrar of Co-operative Societies, Director of Co-operative Audit, Joint Registrar and Joint Directors and all others have contributed much for the fulfillment of this academic work.

In future also the whole hearted cooperation of the officials of the department of Co-operation is highlyessential for the accomplishment of this venture.

We extend our sincere thanks to each and every person who has contributed towards this endeavour.

To err is human, this work may also have some errors or omissions, which may kindly be pointed out for rectification. Any suggestions for the improvement of this manual are most welcome.

On behalf of the Working Group of Kerala Cooperative Audit Manual Revision

JosePhillip
chairman

KERALA CO-OPERATIVE AUDIT MANUAL

PART - I

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PART - 1

CHAPTER - I

INTRODUCTION

1.1Introduction

The Kerala Co-operative Audit Manual published in 1983 was a useful guide to the Departmental auditors as well as the people related to cooperative sector. Enormous changes have taken place in the Co-operative sector. The number of co-operatives has multiplied manifold and the activities also diversified to a great extent. Hence, a revised audit manual is essentially needed.

The State Government was always patronizing Co-operatives with liberal financial assistances like share capital, loans, subsidies, guarantees etc. The State Government is making financial assistances to the co-operatives with a view to make them viable and sustainable so as to influence the local economic development in particular and whole state in general. The plan fund allocation is growing year by year in the co-operative sector. Therefore, the auditors of the department have to shoulder added responsibilities for safeguarding the interest of the State. They have also to ensure that Government funds are properly utilized by the Co-operatives. All these necessitate that the auditors should equip themselves with the required knowledge so that they can perform their duties with skill and due diligence.

Over a period of years, the techniques of accounting haveundergone immense changes. 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 requires a thorough knowledge of the latest developments in Accounting and Book-keeping.

Co-operativeshas strengthened its hold in most of the sectors of human life. Co-operative Societies are organized in the areas of Productive sector such as Production, Manufacturing processing and Marketing, Animal husbandry, Dairy, Poultry, Fisheries and Industries etc.

Similarly in Service sector also Co-operatives are formed in thefields of Consumer, Transport, Tourism, Education, Hospitals and Dispensaries, Art and Culture etc.

In Infrastructure sector too, co-operatives have strengthened their influence by forming Co-operative societies in the areas of labour contract, Housing etc. The Co-operative sector has deep rooted presence in the marginalized sections of society such as SC/ST, disabled, women and employees/workers and hence, the auditors have to audit complicated transactions. This requires 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. The Kerala Co-operative Audit Manual was prepared and published in 1983 by the Government. But the enormous changes in the Act & Rules, the nature of functions of Co-operative societies and accounting patterns havenecessitated the revision of audit manual. Vast numbers of Co-operatives have beencomputerized and the system of book keeping has undergone tremendous improvement.Auditing in computerized environment has got much significance.Hence we have added a new chapter on Audit inComputerized Environmentin this revisedManual.This manual will be of considerable helpin the task of equipping those who are engaged in Audit and management of Co-operative institutions with theknowledge of co-operative auditing.

1.2*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-operatives and to those who are responsible for the 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 high standards of audit.

(iv) To help to adhere to the international co-operative auditing standards throughout the auditing process.

(v) To have a better understanding with respect to the audit of co-operative institutions which have computerized its functions.

1.3 *Scope andauthorityof the 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.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 program, charging of depreciation, creation of reserves, Audit Classification etc. Every effort has been made to make the manual exhaustive wherever possible.Sub section 5 of section 63 of Kerala Co-operative Societies Act 21of 1969 lays down that “ The procedure to beadopted in auditing the accounts of different types of Co-operative societies should be in the manner specified in the audit manual approved by the Director of Co-operative Audit or guidelines, directions as may be issued from time to time by the Registrar, the National Bank for Agricultural and Rural Development or Reserve Bank of India, as the case may be, from time to time”. Hence auditors of Co-operative Banks/Societies should be wellversed and up to date with reference to the circular directions of Registrar of co-operative societies, RBI & NABARD.

1.4 Revision of Audit Manual

Sub Section 5A of section 63 the Act 1969 lays down that “ It shall be the duty of the Director of Co-operative Audit in consultation with Registrar to revise, amend or update audit manual in every five years as may be prescribed.”

The present Kerala Cooperative Audit Manual was prepared 37 years back. The number of Cooperatives at that time was only less than 7500. Nowit has increased to more than25000. Not only the number of Co-operative Societies, but the magnitude of the transactions has multiplied to a great extent. The nature of business transactions as well as accounting pattern has also changed. Many of the cooperatives are computerized and accounting has become too easy and time saving.TheSwitchoverfrom ManualAuditing toComputerized environment hasbecome a challenge to the Auditors. Hence, thismanual has given prime importance for theguidelines of audit in computerized Co-operative Societies.

1.5Audit - 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 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 fillip 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”.

In Kerala Co-operative Societies Act, auditing is defined in section2(ab) as follows“Auditing of accounts of Co-operative Societies” means a close examination of financial transactions, overduedebts if any, maintenance of books of accounts, documents and other records of business, preparation of audit report and includes an inquiry in to the affairs of the society and subsidiary institutions, in order to ascertain the correctness of accounts and the extent to which its activities were useful in promoting the economic welfare of the members in accordance with the co-operative principles.

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 merely a verification of the records maintained, but involves also an exhaustive verification of the 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 any other organization as shall enable the Auditor to satisfy himself whether or not the Balance Sheet and the profit and loss account have been properly drawn up, so as to exhibit a true and fair view of its financial operations. An audit may therefore be described as a "critical examination by an auditor, of the documentary and other evidence from which the profit and loss account and the balance sheet of an organization have been drawn up, in order to enable him to report that they present a true and fair view of the summarized transactions for the period under review and of the financial position of the organization as at the end of the period.The co-operative auditor has as per the above definition got a wider responsibility of examination of the functions of the Co-operative society with respect to economic welfare of members and Co-operative Principles.

Section 64(1) 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 concerned and such other audit matters, as may be prescribed".

1.6*Main objectives of audit*

The main objectives of audit are:

(i) To detect clerical errors and errors of principles
(ii) To detect fraud, ifthere exists any
(iii) To prevent fraud and errors.
(iv) To ascertain true and correct state of affairs of the institution/organization.

1. Detection of errors: Sometimes errors which might appear at first sight to be innocuous are ultimately found to be due to fraudulent manipulation.

Errors can be classified into the following groups:

(a) Errors of omission.-These arise when a particular transaction is omitted from entry either wholly or partly in the books, Example;

(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 commission: 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. Example;

(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 balance.

(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.

Inspite 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. ie. a round sum may be due to wrong totaling. If the difference is in Rupees or Paisa 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 ie. 32 for 23, 52 for 25 etc.

1.7Advantages 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. It is a fact that audit 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 general body 0f the members about the management of their committee and institution. Audited accounts are usually relied upon for the purpose of assessing the income tax andGST and also for the disbursement of Government assistance. An efficient audit is a safeguard to the creditors whose investments enable the institutions to conduct their 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.The financial ratio analysis by the auditor will enable the cooperative to have realistic assessment on the financial Strengthsand weaknesses of the institution which will help them to take future course of action.

1.8 Different ways of Auditing:

The different ways of audit now in vogue are the following:-

(1) *Concurrent or continuous audit:*

A concurrent or continuous audit is one where the auditor visits the institution dailyor 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 businessand huge daily transactions.

(a**)** *Single concurrent audit*:To conduct a concurrent audit, individual societies can get the fullservices of Departmental Auditors at their cost on request.If the full service of an auditor is availed by a society for the audit of its accounts, it is termed as single concurrent audit.

(b)*Group concurrent audit*:If a group of societies share the service of a departmental auditor to conduct the audit at their cost on request, it is called Group concurrent audit. Hence the society gets a part/proportion ofthe service of an auditoron regular intervals at a lesser cost than ina single concurrent. The societies having an above average volume of business can opt for this type andget auditedby joining a group.

Advantages of concurrent or continuous Audit:

(1) Mistakes and frauds can be detected 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.

1.8.2Team audit:Always ateam is formed to accomplish a task effectively and efficiently with in a time limit.The ability, knowledge and diverse skills of team members are pooled togethertoavoid defects in fulfilling the task,whichis envisaged in the team audit. The composition of team of auditors and the society to be audited will be decided bythe Director of Co-operative Audit. The main advantage of this type of audit is thata society having fairly large volume of business can be audited within a short span of time and can engage auditors having domain expertiseto that particular type of institution.

1.8.3Unit Audit:-All the co-operative societies registered in the department and with the functional Registrars are listed to the office in due course for audit. From this list, all the auditable societies are evenly grouped in units according to the strength of auditors available in the office at the beginning of the financial year. The number of societies in a unit will be around thirty toforty and it varies according to the volume and type of societies. The volume of societies is comparatively small and includesnewly started societies also. The audit of societies included in the unit will be entrusted to each auditor. The unit auditor arranges the societies for audit by giving priority for completion, if necessary, part checking can also be done for achieving the monthly physical target of the auditor and prepare an annual/monthly program for audit. This arrangement is for the timely and systematic completion of the audit during the year. Audit fees is levied from the societies as per Government notifications.

1.9 Different kinds of Audit:

i) Interim audit

Interim audit is the one performed before the final audit. It helps the auditor to get the final audit done easily and quickly. Interim audit report has to be submitted with copies of receipts and disbursement statements for the period with the summary of defects if any.

ii) Test Audit

Test audit is something special to the Co-operative department.The Director/Joint Director/ Assistant Directorisexpected to test audit a few societies to ascertain whether the auditor has done the audit correctly or not, which is termed as the “Test Audit”.

This involves a re-checking of the accounts of the Society, at least one society audited by each Auditor should be selected for test audit. If such a test audit reveals serious defects the work of the Auditor concerned should be checked 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. The audit certificate of the society selected for test audit should not be issued before it is test audited. Test audit is to be conducted side by side with the final audit.

iii)*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, to detect the weakness of the system, procedure and improvement. 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 minimize chances for committing frauds, errors and omissions. In apex and federal/ regional level institutions, the internal audit wing should be constituted and the work should bereviewedand monitored by the management/ Audit Committee periodically.

(iv) FinalAudit/Statutory Audit

Final audit is the statutory annual audit. It is the obligation imposed on the institution by the statute. It is legally required to review the accuracy ofthe financial statements.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 a Balance Sheet is being prepared. The valuation and verification of assets are also done by the Auditor. Final audit of societies is generally takenup for a financial year ie. fromAprilevery year. "Year shall ordinarily mean the period commencing on the first day ofAprilof any year and ending with 31st of Marchof the succeeding year". 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 the certified Balance Sheet and his report in the prescribed form to the issuing authority, viz. Director/Joint Director/ Assistant Director as the case may be.The Additional Director/Joint Director/ Assistant Directorwillscrutinize the audit report, make necessary modifications, if required, 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.

Difference between internal audit and statutory audit:(l) 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 (31^{st} March).i.e. the last day of the financial year.

(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 the best results.

1.10 Audit approaches:

*(*i) *Co-operative Audit:*-Itnormally means an examination of the accounts of an institution with a view to testify their accuracy. Co-operative audit is a statutory obligation of theDirector of co-operative audit. 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 societyconcernedand such other audit matters, as may be prescribed. Unlike any other kind of audit, the Co-operative auditor has to go beyond books and records and make personal enquiries in order to investigate the actual state of affairs of a particular issue, if he deems fit.

Co-operative Audit involves Administrative audit also. Departmental auditors are well aware of the administrative matters of Co-operative institutions; they maybe able to do justice to the administrative audit of Co-operative institutions.

(ii) *Audit by the Accountant General*:Accountant General's audit is mainly the audit of expenditure. It is aimed 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.The 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) *Audit by the State Audit Department*:Like Co-operative Audit, audit by theStateAudit Departmentis a statutory one. In this audit, the accounts of institutions which are maintained wholly or partly from Government Grants are Audited.TheState Auditdepartment examines the financial position of the Local bodies and brings to notice wastefulness in administration and infructuous expenditure. As in Co-operative Audit, the Auditors of the State Audit Department are 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 Auditor of the State Audit Department 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.

(iv) *Audit by Chartered Accountants*: A chartered Accountant means a chartered Accountant as defined in the chartered Accountants Act, 1949 (Central Act No. XXX VIII of 1949) and Auditing firm means of more than one Chartered Accountant within the meaning of chartered Accountants Act 1949. The chartered Accountant verifies the accounts and statements of the institutions and gives a report to the managementswith his certification.

Co-operative audit is basically different from the commercial audit, which is done by Chartered Accountants appointed by theshare 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.

CHAPTER-II
CO-OPERATIVE AUDITING STANDARDS

2.1 Introduction

According to the Preamble to the Kerala Co-operative Societies Act,21 of 1969, the Co-operative Societies are organized in accordance with co-operative principles as self-governing, democratic institutions, to achieve objects of equity, social justice and economic development, and to promote scientific and technological development, health care, market intervention and management excellence in the Co-operative sector as envisaged in the directive principles of State Policy of the Constitution of India.

Co-operative audit is instituted to protect the financial interests of the Co-operative Societies and of the members who are shareholders by examining and assessing the operational efficiency, financial soundness and Co-operative character of different types of cooperatives. In this process, in order to establish the authenticity of Co-operative Audit, it is required that Co-operative Auditors shall adhere to a universally acceptable Code of Ethics and are governed by internationally acceptable Auditing Standards.

2.2. Need to attain international standards

In the modern era when not only auditors, but authorized functionaries in every sphere all over the world are trying to attain international standards, it will be worthwhile for Cooperative Audit to adopt the Code of Ethics and Auditing Standards prescribed by the International Organization of Supreme Audit Institutions (INTOSAI), by adopting it to suit the needs of the Cooperative Sector Audit.

2.3Concept, background and purpose of code of Ethics

A code of ethics is essential for the Auditors of Cooperative Sector. INTOSAI has deemed it essential to establish an international code of Ethics for auditors in the public sector. A code of Ethics is a comprehensive statement of the values and principles which should guide the daily work of auditors. The independence, powers and responsibilities of the public sector auditor including a Co-operative Auditor place high ethical demands on the audit institution and the staff it engages for audit work. A code of ethics for auditors in the Cooperative sector should consider the ethical requirements of civil servants in general and the particular requirement of cooperative auditors, including the latter's professional obligations and social responsibilities.

2.4 The Code of Ethics for Co-operative Auditors

Adopting and suitably adapting the INTOSAI Code of Ethics, the following are the ingredients for the Code of Ethics for Co-operative Auditors.

- *Trust, Confidence and Credibility*

  It is of fundamental importance that the Cooperative Audit institution and the Cooperative Auditors are looked up on with trust, confidence and credibility.

- *Integrity*

  Integrity is the core value of a Code of Ethics. Cooperative Auditors have a duty to adhere to high standards of behaviour (eg. honesty and candidness) in the course of their work and in their relationship with the staff of audited entities, viz., cooperative institutions.

- *Independence, objectivity and impartiality*

  Cooperative Auditors should strive not only to be independent of audited entities and other interested groups, but also to be objective in dealing with the issues and topics under review. It is essential that auditors are independent and impartial, not only in fact but also in appearance.

2.5Basic Co-operative values

It is of supreme importance that the Co-operative Auditors should hold high the basic cooperative values of self help, self responsibility, democracy, equality and solidarity.

- *Ethical values*
  The Co-operative Auditors should adhere to the ethical values like honesty, openness, social responsibility and caring for others.
- *Political neutrality*
  It is important to maintain both the actual and perceived political neutrality of the Cooperative Audit institution and the Cooperative Auditors.
- *Conflict of Interest*
  Cooperative Auditors should protect their independence and avoid any possible conflict of interest by refusing gifts or gratuities which could influence or be perceived as influencing their independence and integrity.
- *Professional Secrecy*
  Cooperative Auditors should not disclose information obtained in the auditing process to third parties.
- *Competence*
  Cooperative Auditors have a duty to conduct themselves in a professional manner at all times and to apply high professional standards in carrying out their work to enable them to perform their duties competently and with impartiality.
- *Professional development*
  Cooperative Auditors should exercise due professional care in conducting and supervising the audit and in preparing related reports. Auditors should use methods and practices of the highest possible quality in their audits.

2.6 Cooperative Principles

The principles of cooperation are guidelines by which co-operatives put their values in to practice.

First principle:- Voluntary and open Membership:-Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social , racial, political or religious discrimination.

Second Principle: Democratic Member Control:-Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions . Men and women, serving as elected representatives, are accountable to the membership. In primary co-operatives, members haveequal voting rights (one member one vote) and cooperatives at other levels are also organized in a democratic manner.

Third Principle: Member Economic Participation:Members contribute equitably to, and democratically control, the capital of their cooperative . At least part of that capital is usually the common property of the Cooperative. Members usuallyreceive limitedcompensation, if any, on capital subscribed as acondition of membership. Members allocate surpluses for any orall ofthe following purposes. developing their co-operative , possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative ; and supporting other activities approved by the membership.

Fourth Principle: Autonomy and independence:Co-operatives are autonomous self help organizations controlled by their members. If they enter in to agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

Fifth Principle: Education, Training and Information:-Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public – particularly young people and opinion leaders – about the nature and benefits of co-operation.

Sixth Principle:- Co-operation among Co-operatives:Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.

Seventh Principle: Concern for Community:Co-operatives work for the sustainable development of their communities through policies approved by their members.

2.7Co-operative Auditing Standards

The Co-operative Auditing Standards, adopting the INTOSAI Auditing Standards consist of four parts:

(i) Basic Principles
(ii) General Standards
(iii) Field Standards
(iv) Reporting Standards

The Cooperative Auditing Standards are developed by adopting the INTOSAI auditing standards to provide a frame work for the establishment of procedures and practices to be followed in the conduct of an audit in the Co-operative Sector, including audits of computer-based systems.

2.7.1 Basic Principles:

The basic principles for cooperative auditing standards are basic assumptions, consistent premises, logical principles and requirements which help in developing cooperative auditing standards and reports, particularly in cases where no specific standards apply.

Cooperative Auditing standards should be consistent with the principles of Cooperative auditing. They should also provide minimum guidance to the auditor that help determine the extent of auditing steps and procedures that should be applied in the audit. Auditing standards constitute the criteria or yardstick against which the quality of the Cooperative audit results is evaluated.

Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of Government and audited entities should develop specific and measurable objectives and performance targets. The Cooperative Auditor should be aware of the basic principles.

2.7.2 General Standards for Cooperative Auditing

The General Auditing Standards are that the Cooperative Audit institution that is in charge of audit, should adopt policies and procedures to:

(a) recruit audit personnel with suitable qualifications;

(b) develop and train auditors to enable them to perform their tasks effectively;

(c) prepare manuals and other written guidance and instructions concerning the conduct of audits;

(d) support the skills and experience available within the Audit Institution and identify the skills which are absent; provide adequate distribution of skills to auditing tasks and assign sufficient number of persons for the audit;

(e) review the efficiency and effectiveness of the internal standards and proceduresof the Audit institutions.

The Generalstandards for co–operative Auditing include:

1. Independence:

The Cooperative Auditor and the Cooperative Audit institution must be independent. An adequate degree of independence from both the legislature and the executive branch of Government is essential to the conduct of audit and to the credibility of its results.

While the Cooperative Audit institution must observe the laws enacted by the legislature, adequate independence requires that it is not otherwise subject to direction by the legislature in the programming, planning and conduct of audits. The Cooperative Audit institution needs freedom to set priorities and program its work in accordance with its mandate and adopt methodologies appropriate to the audits to be undertaken.

The Audit institution should seek to create among audited cooperative institutions an understanding of its role and function with a view to maintaining amicable relationships with them. Good relationships can help the audit institution to obtain information freely and frankly and to conduct discussions in an atmosphere of mutual respect and understanding.

2. Competence:

The General Standards for the Auditor and the Audit institution mandate that the Audit and the audit institution must possess the required competence.

Since the duties and responsibilities borne by the Audit institution are crucial to the concept of public accountability, the Audit institution must apply to its audits, methodologies and practices of the highest quality.

The Audit institution needs to command the range of skills and experience necessary for effective discharge of the audit mandate whether the nature of the audits to be undertaken under that mandate, the audit work should be carried out by persons whose education and experience is commensurate with the nature, scope and complexities of the audit task. The Audit institution should equip itself with the full range of up-to- date audit methodologies, including systems based techniques, analytical review methods, statistical sampling, and audit of automated information systems. Whenit comes to Cooperative Society, the primary objective is to find out how far the society has been carrying on its business on sound cooperative lines and aiming at the material and moral improvement of its members. The Cooperative Auditors should imbibe this spirit.

3. Due Care:

The General Standards for the Auditor and the Audit institution prescribe that the Auditor and the Audit institution must exercise due care and concern in complying with the Cooperative Auditing Standards. This embraces due care in specifying, gathering and evaluating evidence and in reporting findings, conclusions and recommendations.

The Audit institution must be, and be seen to be, objective in its audit of entities. It should be fair in its evaluations and in its reporting of the outcome of audits.

2.7.3 Field Standards in Auditing:

The purpose of Field Standards is to establish the criteria or overall frame work for the purposeful, systematic and balanced steps or actions that the auditor has to follow. These steps and actions represent the rules of research that the auditor, as a seeker of audit evidence, implements to achieve a specific result.

The Field Standards applicable to all types of cooperative audit are:

(a) The auditor should plan the audit in a manner which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner.

(b) The work of audit staff at each level and audit phase should be properly supervised during the audit, and the documented work should be reviewed by senior officers of Audit department (Director/Joint Director/Assistant Director).

(c) The auditor, in determining the extent and scope of the audit should study and evaluate the reliability of internal control.

(d) On conducting regularity audit, a test should be made in relation to compliance with the applicable laws and regulations.

(e) Competent, relevant and reasonable evidence should be obtained to support the auditors judgment and conclusions regarding the organisation, program, activity or function under audit.

(f) In financial audit and in other types of audit whichever is applicable,the auditors should analyse the financial statements to establish whether acceptable accounting standards for financial reporting and disclosures are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements.

2.7.4 Reporting Standards:

The Reporting Standards shall be to assist, and not to supersede, the prudent judgment of the auditor in framing and reporting audit findings, conclusions and recommendations.

The Reporting Standards are:

(a) The report should be complete, accurate, objective, convincing, clear, concise, constructive and timely.

(b) The form and content of all audit opinions and reports need to be consistent with the principles laid down with regard to (i) objectives and scope, (ii) completeness, (iii) address, (iv) identification of subject matter, (v) legal basis, (vi) compliance with standards and (vii) timeliness.

(c) In formulating the audit opinion or report, the auditor should inter alia give due regard to the materiality of the matter keeping in view the amount, nature and context.

(d) Compliance Audits, besides reporting on individual cases of non-compliance and abuse, also require reporting on weaknesses that exist in systems of financial management and internal control.

CHAPTER- III

CO-OPERATIVE AUDIT

3.1. Definition of Co-operative Audit:-

(i) Section 2(ab) of the Kerala Co-operative Societies Act define co-operative audit as "Auditing of accounts of Co-operative Societies means a close examination of financial transactions, overdue debts,if anymaintenance of books of Accounts, documents and other records of a business,preparation of audit reportand includes an inquiry into the affairs of the societyand subsidiary institutions in order to ascertain the correctness of accounts and the extent to which its activities were useful in promoting the economic welfare of the members in accordance with the co-operative principles".

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

(iii) In the words of the Maclagan 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 Maclagan 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 summarized transactions for the period under audit and of the financial position of the society as at the end of the co-operative year.

3.2. Statutory provision

Sub section (4) of section 63 of Kerala Co-operative Societies Act lays down that "it shall be the duty of managing committee cause to audit the accounts of every society at least once in every year. Provided that the accounts of every society shall be audited within 6 months of the close of the financial year to which such accounts relate"and subsection (9) of section 63 lays down that "Every Co-operative society shall cause to be audited by an Auditor or Auditors or team of auditors referred to in Sub Section (8) appointed by the general body or special general body from among the panel of auditors approved by the Director of Co-operative AuditProvided that if there are no auditors available from the above panel, the general body of a society may appoint auditing firms from among a panel approved by the Director of Co–operative Audit."and Sub- section (10) of section 63 lays down that "The financial accounts of all apex societies shall be audited by auditing firms from among the panelapproved by the Director of Co-operative Audit and the administrative matters and related accounts of assisted apex societies shall be audited by the departmental auditors from among the panel approved by the Director of Co-operative Audit as may be prescribed and submit the audit reports to the Director of Co-operative audit"

From the above provisions it is very clear that the Director of Co-operative Audit is responsible for enabling the audit of Co-operative institutions of our state in a time bound manner.

3.3.*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.

3.4*Arrangement and set up for audit*-For the efficient and timely audit of Co-operative Societies there is a separate set of staff 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, Coir, Khadi& Village Industries) is also attended to by the above audit staff in the Co-operative Department.

The present set up of Co-operative Audit wing is depicted below:

STATE LEVEL OFFICE

DIRECTOR OF CO-OPERATIVE AUDIT

Additional Director – 1
Joint Director – 1
Deputy Director – 1
Assistant Director - 1
Senior Auditors - 8

Concurrent
Auditors of Apex Institutions
(JD/DD/AD)

DISTRICT LEVEL OFFICE

JOINT DIRECTOR OF CO-OPERATIVE AUDIT

Assistant Director of Co-operative Audit – 1
Senior Auditors -2

Concurrent Auditors of Federal/Taluk level Institutions (DD/AD/Spl.Gr./Sr./Jr. Auditors

TALUK/CIRCLE LEVEL OFFICE

ASSISTANT DIRECTOR OF CO-OPERATIVE AUDIT

Senior Auditor - 1

UNIT AUDITORS
Spl. Grade/
Sr. /Jr. Auditors

CONCURRENT AUDITORS
Spl. Grade/
Sr./Jr. Auditors

The Director of Co-operative Audit shall be an officer on deputation from the Indian Audit and Accounts service not below the rank of Deputy Accountant General or an officer from the Indian Administrative Service.

The Additional Directorat the Head Office is in overall control of the audit staff of the state and exercises all powers of theDirector. Apart from Additional Director, the head office consists of one Joint Director, one Deputy Director, one Assistant Director and eight senior auditors and concurrent auditors forapex societies having state wide jurisdiction.

At the District Level, there areJoint Directors of Co-operative Audit, one for each district and his office has one Assistant Director and two senior auditors and concurrent auditors – Deputy Director and Assistant Director for major societies.

At taluk/Circle level there are Assistant Directors of Co-operativeAudit,one for each taluk/Circle. One Senior/Junior Auditor assists the Assistant Director in his office. TheseAssistant Directors closely supervise and guide the work of the unit/concurrent auditors working in the respective taluks/Circle. In major Co-operative institutions, Deputy Directors/Assistant Directorsare working as concurrent Auditors, where asspecial grade /Senior/Junior Auditors are working as concurrent auditorsin other co-operatives.

3.5. 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.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 By-laws 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.

3.6. 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 managing committee shall cause to audit the accounts of every society at least once in every year by a person authorised by the Director of Co-operative Audit by general or special order in writing in this behalf. The audit of a joint stock company is conducted as per sections 139 to 148(as per amendment of company act 2013) of the Indian Companies Act, 1956. Thus the Co-operative audit is state controlled, while audit of a joint stock company is an annual obligation left to the company itself.

(ii) The appointment of auditor of a Co-operative Society is made by the General Body from the panel approved by the Director of Co-operative Audit while in a joint stock company it is made by its shareholders. As observed by Maclagan 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 Registrarand 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 Registrarand submits his reports to the Director of Cooperative Audit, 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 principles and aiming at the material and moral improvement of its members.

iv) Usually in a joint stock company the statement of accounts are prepared by theCompany themselves, whereas in a Co-operative Society chief executive is liableto prepare all the statements of accounts, which will be certified bythe Auditor. Even though the societies are bound to file the annual accounts in such form as may be specified by the Director,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 section64 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.

3.7. *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 of Co-operative Societies/Director of Co-operative Audit/RBI/NABARDfrom time to time.

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 physical verification of assets should also be done.Verification of the titles of the documentssuch as negotiable instruments, share certificates, securities, debentures etc may be done to ensure the genuineness of the balance sheet.

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 organized and how far it has succeeded in improving the material and moral well being of its members, based on the internationally accepted Co-operative Principles.

(iv) *Personal verification of members' accounts and examination of their pass books* - 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.

Sub Section 2 of section 64of 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 the Rule 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 for each item.

3.8*Auditor's duties and responsibilities:* Section64(1) 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 concernedand such other audit matters, as may be prescribed.

Therefore, the auditor should:

(i) Verify the cash balance on the date of his first 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 auditor shouldverify the bylaws of the society and ascertain as to whether the cash balance is actually kept by the person authorized 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 verificationup 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 realize 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 differences, 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 the 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;

(x) 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

(xi) 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 example 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 the conditions of Co-operative finance. He has also to examine the repayments in order to aSscertain 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.

3.9. Powers of Auditor-The powers given to the auditor under subsection (2) a, b, c of section 64of the Kerala Co-operative Societies Act 1969 are the following:-

"The Director of Co-operative Audit or the person authorized by him under sub-section 2(a) and (b) shall at all reasonable times have access to all the books, accounts, documents, papers, and all other relevant records , securities, cash and other properties belonging to, or in the custody or of the society and may summon any person in possession of, or responsible for the custody of any such books, accounts, documents, papers, other records securities, cash or other properties, to produce the same at any place at the headquarters of the society or any branch thereof or where there is no working office for a society, at the office of the Director of Co-operative Audit or at the office of any of his subordinate officers as may be specified by him.

“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 societywho is in possession of any information and records in regard to the transactions and working of the society shall furnish such information in regard to the transactions and working of the society as the Director or the person authorizedby Government under subsection 3of section 63 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 64 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 DirectorJoint Director/Assistant Directorwith evidence of the Service of summons. An offence under section 64 is punishable under section 94 of the Act. As soon as a case of such offence is reported to the Director/ Joint Director/Assistant Director, he should take appropriate action to prosecute the delinquents concerned.

Auditing cannot 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-operativeinstitutions 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 awareness 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.

*3.10Liability of Auditor:-(i) Criminal liability*Under section147(5)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. 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 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 Kingston 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 -IV

TYPES OF CO-OPERATIVEAUDIT

The special feature of Co-operative Audit is that the auditor verifies not only the financial transactions of the institution but also the Administrative aspects too. As per Sub section 10 of Section 63 of Kerala Cooperative Societies Act, the financial accounts of all apex societies shall be audited by auditing firms from among the panel approved by the Director of Cooperative Audit and the administrative matters and related accounts of assisted apex societies shall be audited by the departmental Auditors from among the Panel approved by the Director of Cooperative Audit as may be prescribed and submit the audit reports to the Director of Cooperative Audit.

As per Sub Section 11 of Section 63, the Audit report of the accounts of an apex cooperative society which includes the report on administrative matters, shall be laid by the Government before the Legislative Assembly in the manner prescribed, from the above it is very clear that, two types of Audit i.e. Financial Audit and Administrative Audit is to be performed in the manner prescribed by the Director of Cooperative Audit.

4.1 Financial Audit

The primary purpose of financial audit is to verify whether the accounts of the audited entity are properly prepared, are complete in all respects and are presented with adequate disclosures. Financial audit thus verifies:

(i) Books of accounts and the financial statements for their compliance with the applicable laws, rules and regulations and accounting principles, policies and acceptable standards including conformity with the form of accounts prescribed by Government.

(ii) Completeness of the books of accounts and the financial statements.
(iii) Accuracy of the books of accounts and the financial statements.
(iv) Timeliness of the books of accounts and the financial statements.
(v) Adequacy of disclosures.

Financial audit aims at ensuring the accuracy of accounts recorded in the Books of the Co-operative Institution. It consists of vouching receipts and payments in the Day Book 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 directly from the Day Book. When all the ledgers have been checked with the Day Book a list of outstandings 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.

4.1.1 Verification of 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.Now as the transactions of Co-operatives have multiplied mani fold it is essential to maintain cash books in every co-operative Societies.

4.1.2 Verification of 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/challans. 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/challans. 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 counterfoils. 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 entries 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.

4.1.3 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 authorized 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. 5000/- and representing any kind of payment to non-members should bear revenue stamp worth One Rupee. Vouchers for disbursement of pay and allowances (including T. A.) and acquittanceof 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. 5000/- also stamp is required. A cash memo (cash bill) exceeding Rs. 5000 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.

4.1.4Receipt 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.

4.1.5. Day Book:-The Day Book should be written as per order of head of account in the balance sheet. 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 authorized 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.

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

4.1.7. *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 of the receipts. The auditor should scrutinize each and reconcile the differences. In the case of fixed deposits ,and so on, 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.

4.1.8. *Register of investments:-* 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 thereupon is worked out and collected periodically. The auditor should check the investments with reference to the share certificates/bonds/other documents related to such investments.

4.1.9. *General Ledger:-*The auditor should see that every entry/total of each head, in the Day Book is posted in 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.

4.1.10. *Reconciliation of Bank Accounts:*

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.

4.1.11. *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 get them 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 and 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 bas 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.

4.2 Administrative Audit

Cooperative Auditor is supposed to be the friend, philosopher and guide of every cooperative institution. As the cooperatives of modern age have stretched their sphere of activities to a wider spectrum, the auditor is expected to rise to that high level and advise them in their needs. Administrative Audit is a 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 certificate 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, try to see that the errors of commission and omission are rectified before the audit of the society is finalized. 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.

Co-operative Audit involves, apart from the financial audit, the verification of administrative aspects also ie; he has to ascertain the propriety of the business, he has to verify the management efficiency and its decision making, he has to evaluate the performance of the institution, through the performance evaluation of the management, employees etc. He has to ensure the cost effectiveness and cost control too.

In the changed environment the financial audit of Apex Co-operatives is entrusted to Chartered Accountants and the Administrative Audit of the Assisted Apex Co-operatives is to be carried out by the department Auditors. Hence the departmental Auditors has to verify the management policies, decision making, budgeting, staffing, performance of employees, financial management, cash management, cash flow, cash planning and budgeting, human resource planning, human resource management, staff performance training and skill development, efficiency in each factors through various kind of ratio analysis, costing techniques etc in a detailed manner. Hence the Administrative audit involves the comprehensive examination and analysis of the institutions functional aspects. The Administrative audit report should be a torch bearer and guiding force for the apex institution.

As per sub section 10 of Section63 of KCS Act, the Administrative Audit of Assisted Apex cooperatives shall be done by departmental Auditors and the financial Accounts of all Apex Societies shall be audited by auditing firms from among the Panel approved by Director of Co-operative Audit. The significance of administrative audit has been increased by the provision that the Audit report of an apex society shall be laid by the Government before the Legislative Assembly.

Modern management thought and management principles has brought about a change in the concept of audit and widened its scope. 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., (a) Propriety audit (b) Management audit (c) Efficiency audit (d) Performance audit and (e) Cost audit

They are briefly explained below:-

4.2(a)Propriety audit:-The auditor should examine 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. The management team should uphold the principles of honesty integrity, objectivity and openness while dealing with the public money. The Cooperatives are being built up with the continuous selfless efforts of its members. Hence, each rupee should be spent economically and efficiently. The rate of return should be maximized. The auditor should be conscious of the legality and accountability of the business transactions. He should verify the minutes in detail with a view to assess the propriety concerns.

4.2.(b)Management audit:- With respect to the steady progress of the Cooperative intuition, a well built management system is necessary. If the management is not having sound business policy and efficient implementation system, the institution could not grow. The management should be able to forecast a prospective target based on sound business policies. The procedures of the institution shall be such that they may be able to yield possible results. The auditor should examine the management policies, objectives and targets, actions and procedures and the performance of the management should be evaluated scientifically. The auditor should verify whether the management has adopted proper objectives. He should also examine the micro level planning process of the institution. The auditor should be able to provide adequate suggestions with respect to the short comings.

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 noticed, they should be examined in detail whether the management has dwindled the business or made the society to run into loss. Management decisions which resulted in loss for the society should be specifically reported. The polices 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 to be 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.

4.2(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-à-vis the budgeted 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.

The efficiency with respect to the factors employed in the business may be analyzed using the tools or techniques applicable in the field. The efficiency of management system, the efficiency of human resources, the efficiency of money invested in the business, the efficiency of internal control systems etc. should be analyzed and verified by the auditor. The efficiency of management system may be compared with other institutions and suitable parameters may be used for analyzing the efficiency. Training plays a significant role in the maintenance of management efficiency.

4.2(d) Performance audit:-

Performance audit in Cooperative sector is an independent assessment or examination of the extent to which a cooperative organization, program or scheme, operates economically, efficiently and effectively and adhering to Cooperative Principles.

a) Economy: Economy is minimizing the cost of resources used for an activity, having regard to appropriate quality. Economy occurs where equal quality resources are acquired at least cost.

b) Efficiency: Efficiency is the relationship between the output, in terms of goods, services or other results and the resources used to produce them which represent the input.

c) Effectiveness: Effectiveness is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

d) Adherence to Cooperative Principles: The auditor will have to ascertain in general, how far the objectives, for which the Cooperative organization is set up, have been achieved in the course of its working. The assessment is not necessarily in terms of profit, but in terms of extending of benefits to members who are the owners of the Society. The society should be able to provide its services to the members at a reasonable cost. It should act as a catalyst in the economy by preventing inflation hoarding and black marketing. For the achievement of these objectives, cost accounting methods, store control methods, techniques of standard costing, budgetary control etc may be adopted.

4.2(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 there from for the purpose of 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".

4.2. (f) Functional aspects

The dutyof an auditor on administrative aspects is to examine the overall functional aspects of the institution extending to the verification of the following too.

i)Minutes book

The auditor should see whether periodical meetings are held as per provisions of the byelaws and resolutions are properly recorded in the minutes book and duly attested by the Directors.

ii)Byelaws

The byelaw provisions should be closely verified to ensure that the institution is functioning inaccordance with its byelaws, which is in agreement with the amendments in the Kerala Co-operative Act & Rules.

iii)Subsidiary rules

In order to attain efficiency and productivity, the Societies shall frame specific subsidiary rules for the business activities including office management. The auditor shall verify the subsidiary rules and see whether the sub rules approved and adopted by the Board of Directors are complied with while implementing the schemes (Read Circular. 51/70 dated 03/09/70).

iv)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 omissions duly rectified during his stay in the society. Defects that could not be rectified then and there should be reported to the Asst. Director / Joint Director of Co operative Audit.

v)Property statement

The auditor should verify the assets and liabilities by making independent enquiries, satisfy himself and also compare the maximum credit limit of the institution.

4.3Summary of defects.

Unlawful actions as well as the mistakes of the society should be reported by the auditor after giving an opportunity to the institution to rectify themthe details disclosed in the audit should be brought to the notice of the society as well as to the administrative wing for follow up action. The summary of defects may contain not only the defects of the society but also suggestions for improvement and development in future too, based on ratio analysis and other observations.

4.3.1. Special Report

If any irregularities are detected during the course of audit, the auditor shall submit a special report containing the details of such irregularities as early aspossible to the Director of Co-operative Audit.

4.4Check list of Administrative Audit:

Part I Financial Audit

1. Whether the institution adheres to Co-operative principles, values and ethics Yes/No
2. Whether an independent and impartial audit of financial statements were held Yes/No
3. Whether the institution is in profit for the current year Yes/No
4. Whether the institution is having accumulated lossesYes/No
5. Whether all the overdue debts of the society were listed and included in the financial statements Yes/No
6. Whether all the cash balance of the institution physically verified and is found to be correct Yes/No
7. Whether all the securities were verified and included in financial statements Yes/No
8. Whether all the assets and liabilities were actually, valued and taken to financial statements Yes/No
9. Whether all financial transactions were accounted and brought to financial statements Yes/No
10. Whether all the account totals were listed in Receipt and disbursement Yes/No
11. Whether all the required books of accounts were maintained Yes/No
12. Whether all the required statements and reports were prepared periodically Yes/No
13. Whether the financial statement reveals true and fair view of the society Yes/No
14. Whether the audit extends to the qualitative aspects beyond the financial aspects Yes/No
15. Whether the dues to Government as per Act and rules were included in the accounts
16. Whether any legal action has been taken against defaulters Yes/No

Part II Administrative Audit

1. Whether the institution had complied with the legal provisions such as provisionsof Kerala Co-operative Societies Act & Rules, Banking Regulation Act etc.

   Yes/No
2. Whether the institution had complied with the circular directions of Government/Registrar/RBI/NABARD during the yearYes/No
3. Whether the expenditure incurred on each is with proper propriety and authenticity of the Board of management Yes/No
4. Whether the audit examined the bye laws and sub rules of the society Yes/No
5. Whether the audit verified the board resolutions in relation to activities Yes/No
6. Whether the audit examined the financial morality of each transactions on the basis of the Co-operative principles, values and ethics Yes/No
7. Whether the audit examined the efficiency of the Society in the implementation of policy decisions. Yes/No
8. Whether the audit examined the performance on the basis of the objectives of the Society. Yes/No
9. Whether each of the employees has been assigned duties and responsibilities though an official circular specifying division of labour. Yes/No

10. Whether the audit examined the transactions and board resolutions on the basis of the following aspects Yes/No

    1. Propriety 2. Management 3.Performance 4.Efficiency 5. Cost

1. Propriety Audit:-

1) Whether the economics and reasonableness of all transactions were ascertained. Yes/No

2) Whether the waste of funds and loss of stores and decisions thereof were identified Yes/No

3) Whether all the board resolutions and transactions are assessed in regard to propriety Yes/No

4) Whether legal requirements are complied with in each transaction and decisions Yes/No
5) Whether the activities undertaken are in the interest of the organization Yes/No

2.Management Audit:-

1) Whether the audit verified the objectives, business plan and results thereof Yes/No
2) Whether the strategies and procedures were in conformity with rules and regulationsYes/No

3 Whether any management decisions lead to loss and against the rules Yes/No

4) Whether staff morale is satisfactory and communication system effective Yes/No
5) Whether the staff recruitment, training and capacity development is progressive Yes/No
6) Whether the annual general body was held properly and budget approved Yes/No
7) Whether the Board of Directors are qualified to be members of the Board of Management Yes/No
8) Whether the election to the Board of Management was conducted at the prescribed date without any delay Yes/No
9) Whether the Committee is functioning properly and meeting at regular intervals Yes/No
10) Whether the Committee members show adequate interest in the affairs of the institution Yes/No
11) Whether the employees of the institution are qualified for the posts in which they are appointed Yes/No
12) Whether the employees are promoted in accordance to Rule 185 of Kerala Co-operative Societies Act Yes/No

3. Performance Audit:-

1) Whether the institution maintains economy, efficiency and effectiveness Yes/No
2) Whether the institution achieved the targeted goals and objectives Yes/No
3) Whether efficient control mechanism is adopted for the organization Yes/No
4) Whether the institution ascertained the social impacts of the performance Yes/No

4. Efficiency Audit:-

1) Whether the Society implemented the business plan efficiently Yes/No
2) Whether the expenditure incurred is in conformity with the estimates Yes/No

3) Whether there is an efficient management system, human resources, investment and internal control Yes/No

4) Whether the results were compared through ratio analysis etc Yes/No

5) Whether the working efficiency of the institution is at par with others in the field Yes/No

5. Cost Audit:-

1) Whether the institution follows generally accepted cost accounting methods/techniques Yes/No

2) Whether the cost control, inventory control and profitability ascertained Yes/No

3) Whether the cost effective measures are adequate Yes/No

4) Whether the expenditure incurred is budgeted Yes/No

5) Whether the costing is in conformity with Co-operative principles values and ethics Yes/No

CHAPTER - V

AUDIT COMMENCEMENT

5.1. Preparation for audit and framing of audit programme

Audit begins where accounting ends. The system followed in the accounting decides the auditing strategy. A well-defined system for accounting viz.Generally AcceptedAccounting Principles (GAAP) or an accounting manual is important.

An Accounting system is a collection of process, procedures and controls designed to collect, record, classify and summarize financial data for interpretation and management decision making. At present accounting in co-operative sector is performed in two ways.

1) Manual Accounting 2) Computerized Accounting

(1) Manual Accounting: -It is the traditional system of keeping financial records. This has the chance of inherent limitations of human error. Hence auditors vigilance is required in each step of the accounting process.

(2) Computerized Accounting: - Many of the cooperatives in our state are computerized and are working with different software. Uniform software for similar category of cooperatives is highly needed. Computer assisted auditing tools (CAATs), may be used for the audit of computerized institutions.

5.2 Intimation of audit-

Every auditor, except those attached to the institution itself for continuous 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 AssistantDirector/Joint Director. 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 prior to the date of commencement of audit. 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 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 concurrent audit is being conducted no previous intimation would be necessary as the visits of the auditor are frequent.

5.3. Procedure to deal with complaints

Sometimes, the auditors may receive complaints, alleging mismanagement or serious irregularity 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 points 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 Joint Registrar/Registrar with his observations.

5.4 Checkingof Statements of accounts and information required for audit

Every Co-operative Society shall prepare for each 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/NPA statement 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 expenes, 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.(in caseof Land, survey no. anddetails of possession, should be shown in the statement)

(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

(l) List of matured deposits showing interest payable up to 31st march.

5.5. *Production of records and statements for audit and procedure to be adopted in the event of non-production of records on demands*

As per subsection 2(b) of section 64 of the Kerala Co-operative Societies Act, 1969, summons can be issued by the Director of co- operative Auditor persons authorizedby him forproduction 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,Coiretc

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:

Date:

Asst. Director/Auditor of Co-operative Society

If the society or the person responsible does not produce the records within the time-limit specified in the summons issued, the Assistant Directorof Co-operative Audit will send intimation through the Joint Director of Co-operativeAuditconcerned 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 Society's 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 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 unstated

5.6. ***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 their 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 the office.

5.7. 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 is 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, 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.

In case of Co-operative Societies, whose accounts are fully computerized and the financial statementsand connected statements are system generated, the auditor should not insist on the manual books of accounts. However such books of accounts, financial statements and connected statements should be certified by the chief executive.

5.8. ***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 Kerala Co-operative Societies 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 authorize any person to preparethe accounts at the expense of the society through a person/persons authorized 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).

5.9. ***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.There foretheauditor should verify the recordkeeping and the record room.

The following records shallbe retained till the completion of period indicated below, from the date of audit to accounts contained therein:-

1	Original Certificate of Registration together with the Registered Bye-laws	Permanent
2	Amendments to Bye-laws	Permanent
3	Admission register with the list of shareholders	Permanent
3A.	Register of members eligible to vote	Permanent
4	Day Book	Permanent
5	Ledgers of deposits and other borrowings	Permanent
6	Reserve fund ledger	Permanent
7	Audit Certificate	Permanent
8	Property Statement of members	Permanent
9	Investment account in other institutions	Permanent
10	Act and Rules	Permanent
11	Minutes Books	Permanent
12	Share Withdrawal Register	Permanent
13	Register of immovable property of defaulters	Permanent

	brought in auction	
14	Register of fluid resources	Permanent
15	General ledger	Permanent
16	Investment register	Permanent
17	General information register	Permanent
18	Register of bonus on purchase	Permanent
19	Register of inspection of affiliated Societies	Permanent
20	Register of loan applications from societies	Permanent
21	Register of delegates and delegation fees	Permanent
22	Register of assets and liabilities of affiliated societies	Permanent
23	Stock book of forms and furniture	Permanent
24	Acquittance Roll	10 years
25	Chitty ledger, Chitty day book and minutes book	12 years
26	Receipt Book	10 years
27	Register of monthly receipts and disbursements	5 years
28	Letter file	5 years
29	Voucher file	5 years
30	Price fixation register	5 years
31	Loan ledger	Permanent

32	Liability Register	Permanent
33	Register of closed loans	5 years
34	Store Keepers day book	5 years
35	Purchase book	5 years
36	Goods Ledger	5 years
37	Share application register	3 years
38	Loan application register	3 years
39	Letter book register	3 years
40	Register in joint purchase	3 years
41	Register of joint sales	3 years
42	Register of application for arbitration and execution	3 years
43	Dividend register	7 years
44	General current register	3 years
45	Disposal register	3 years
46	Dispatch register	3 years
47	Incidental charges register	3 years
48	Register of issue to the salesmen	7 years
49	Register of establishment charges	3 years
50	Suppliers personal register	3 years

51	Trade advance register	3 years
52	Register of contingent charges	3 years
53	Suspense Account register	3 years
54	Sales chit	2 years
55	Daily Sales book	2 years
56	Register of purchase made by members	3 years
57	Register of condemned articles	3 years
58	Deficits by drainage and wastage	3 years
59	Bond register	10 years
60	Nomination register	Permanent
61	Rectification register	5 years
62	Register of declaration made under section 36	12 years
63	Register of lands cultivated by member	Permanent
64	Credit limit statement	3 years
65	Any other records for such period as the Registrar my direct.	

5.10. Auditor not to insist onpassing entries in audit without proper understanding –

In the course of audit, the auditor has to get himself satisfied of the genuineness of the transactions recorded in the books of accounts of the society. Before commencement of audit of 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 insist on passing on entry unless, he understands the full implications of the transactions recorded in the books of accounts of the society.

5.11. 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 ofanyone, on the contrary, 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 errors,omissions frauds, etc

5.12. 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 authorized 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 authorized 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, 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 framed and got approved by the competent authority.

(vii) Cash, stocks, fixed assets, furniture and fittings, machineries, tools, equipment, vehicles, raw materials, stores, finished goods and other properties etc. of the society should be adequately insured in time.

5.13. Reconciliation of Bank AccountsBank reconciliation statements have to be prepared at regular intervals by the Cashier or the officer concerned. 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 books 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 and reconciled in the following period. Any abnormal variation in the dates should also be specially taken note of.If forany collection of Cheque/DD a longerperiod isnoticed, written explanation of the CEO/Manager should be obtained and reserve should be created for such an amount.

5.14. Test of percentage/Random checking - During the course of audit, the auditor has to trace a transaction through various stages from its origin to 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 periodfor/percentagerandomshould be made carefully and the examination of the transactions of that period should be sufficiently detailed. Preferably the period to be selected can bea month from each quarter. But where frauds and serious irregularities are suspected or noticed, a more exhaustive checking/verification should be carried out.

5.15. *Preparation of audit programme-*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.

5.16.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 out 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.

5.17. Maintenance of working sheetsWorking 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 the society

(vi) The action taken by the auditor on serious irregularities, status of special report etc.

From the working sheets maintained by the auditor the progress and stage of audit can be easily ascertained. In the event of transfer of auditors before finalizing the audit report these working sheets must be handed over to the Assistant Director concerned and the Assistant Director should hand over it to the newly posted auditor.

5.18 *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 ie., items appearing in reconciliation would have the letter "C" place on the right hand side
(vii)	Contra or transfers	-	On the right hand side

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.

5.19 ***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, when 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.

5.20. ***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 beforethe checking is commenced.

5.21. ***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 related 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.

5.22. 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 the commencement of the work.

1. Theauditorshould be thorough with the provisions of the Co-operative Societies Act and Rules.
2. Theauditor,should be well conversant with the directions issued by the Registrar of Co-operative Societies from time to time.
3. The auditorhas to examine the Byelawsand Sub rules 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 authorized to receive and pay money, rate of interest etc. It has also to be examined whether the byelaws/sub rules, framed and registered are in consonance with the provisions of Kerala Co-operative Societies Act and the Rules.
4. The auditor 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. The auditor 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. The auditor 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.
9. The auditor should study the business activities of the society, so that he can make anassessment/evaluation/business analysis properly and judiciously.

10)Theauditor should examine whether the society has maintained all the sub rules required and got approved from the concerned authorities and they are intact.

11) Those who are entrusted with the audit of co-operative banks which are regulatedby the RBI/NABARD, should have a fair understanding of Banking Laws.

He can then chalk out a programme of work and do the work in a systematic 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 as to complete the audit as prescribed. If there are more than one society in the group, the programme should be such that the auditor could visit all the societies continuously at regular intervals.

5.23Checkingof final Statements

After completion of the financial and administrative audit theCheckingof the consolidated statement of receipts and disbursements should be taken up from the general 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 receipt and disbursements statement the auditor should ensure that the Trading Account and Profit and Loss account and the Balance Sheet are prepared properly. Thereafter the audit memorandum is to be prepared in the prescribed form and submitted to the competent authority for approval.

CHAPTER -VI

VOUCHING

6.A Vouching of Receipts

6.1 (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 depend 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 the money due 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 the money 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 concerned. 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 are necessary and incidental to the business of the society.

(ii) No fraudulent or unauthorized 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.5000are 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 endeavour 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)The 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 authorized 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 money is being paid should be examined by a responsible person.

6.2. 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.

*6.3. Vouching of receipts- Internal control over receipts***:**

Vouching of receipts is always difficult than vouching payments, since in majority of 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 tappals 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 separately and it is likely that unscrupulous employees might write different amounts in them. The practice of acknowledging 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 be renumbered and the accuracy of serial numbers examined before a new receipt book is brought into use. In the case of banks, paying-in-slips with the signature of remitter is recommended.

(ii) Spoiled and cancelled receipts should be pinned to the carbon copy as evidence of what had taken place. Cancellation should be made under the initials 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 initialed by the persons authorized to sign the receipts.

6.4. ***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 provide indirect evidence. But there are different types of documents to be examined for verifying such receipts.

6.5*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 the 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 a 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 of 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. He has also to ensure whether provisions of section 22 of the Kerala co-operative Societies Act are complied with while allotting shares of the society.

6.6. Recovery of shares by installment.-

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 the members. In the case of employees credit societies, monthly subscriptions at rates specified in the byelaws are collected fromthemembers 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.

6.7. 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.

6.8. 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 money received and payments made by them prior to the registration of the society. If the transactions prior to the registration merely relate to the 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 the 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 a 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 itself. 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.

6.9. 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 authorizing 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 the 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 to two credit or housing societies, necessary precaution should be made with regard to the prohibition of dual membership.

(v) Undertakings are 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.

6.10. 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 related to the 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 seen 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 outstanding 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.

6.11. Receipt of Government assistance, Share capital, loans and subsidies

(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 the Government.

(b) Receipt of loan and subsidy:As regards the 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 utilization of the loan/subsidy by the society and indicate in his report, cases of non compliance of conditions, if any. He should also verify the refund of loans installments and if there is any default that should be reported to the authorities.

In case of godown loans to co-operatives, 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 Bank and the amount utilised properly as specified in the sanction order.

Officers sanctioning loans and subsidies have directions to forward to the auditor concerned, a copy of the order sanctioning loan 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 Assistant Registrar to whom a copy of the order has been sent has to communicate the same to the auditor concerned to enable him to note the 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 misuse such assets or not to dispose of or mortgage the assets without the prior permission 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 utilization 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 utilize them for other purposes without prior permission of Government. The utilization of grant should be verified by the auditor with Grant Utilization Register and sanction orders.

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.

6.12. Receipt from financing Agencies:

While vouching the receipt of loans from financing agencies, like the Apex 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.

6.13. 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 Apex 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.

6.14. 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").

6.15. Receipt from debtors

As regards the 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 dispatching 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, statement of accounts may be obtained and the balances got confirmed.

6.16.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 the Board/investment committee for the sale of 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.

6.17. 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 auctioner's report should be made 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 authorized 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 auctioner’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.

6.18. 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 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. The auditor 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 a log book and trip sheet with respect to each vehicle. In the case of machinery and other costly equipment's, proper accounts should be maintained with regard to the hiring of the machinery or equipment. 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 for etc. Hire charges due to the Society shall 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 should 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 should be checked from the counterfoils of the printed receipts issued to them. Calculation of interest will have to be checked while checking the postings in the loan ledger. Also ensure that the rate of interest charged is in accordance with the circular directions of Registrar

(vii) Sale of forms, Newspapers and Periodicals:-

Usually these items can be charged to Establishment and Contingencies under Stationary 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 resale also. In such circumstances the expenditure should be capitalized and shown as other assets in the Balance sheet. The value of stock should be charged to loss account every year and the scale 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 resale to members are not done to make any profit, no separate trading account needs to 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 utilized.

(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 a case, the account and folios to which the amount was deducted and transferred and vice versa should be noted in the General Ledger. The auditor shall call for clarification from the chief executive in respect of long pending items under “Advances due to” and ascertain the realisability of such amounts and shall made specific remarks in his report.

6.19. 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 Rs.100 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 should 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 or daily balance. The paying-in-slips, or chalans, which are filled in by the remitters, should 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 challans which are prepared by the customers, 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.

(v) KYC Norms

The auditor shall verify the application for opening deposit account and ensure that the circular directions of Registrar inrespect of 'KYC' norms are properly compliedwith. (Read Circular No. 30/2013 dated 24/04/2013)

6.20. 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.

6.BVouching of Payments

6.21Propriety of expenditure

(i) After vouching the receipt side of the Day Book, the auditor has tounder take 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 familiarized 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 be addressed to the society itself and not in the personal name of the Secretary, Managing Director, Chairman, or any 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 authorized 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 ₹ 5000 should have been duly stamped.

(f) The vouchers should be 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 be 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 be 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 be 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 be 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.

***6.22. 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 fee 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, if the construction is without proper sanction orvaluation.

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, i.e. the profit and loss account.

6.23Deferred 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

6.24.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 capitalized. Expenditure incurred by newly organized societies, upto the date of commencement of trading may be allowed to be capitalized. 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 capitalized.

6.25. ***Land and Building***

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.While auditing the transactions with respect to land and building, the following points shall be verified.

(i) Whether the purchase of land or Land and building or constructions of building are having the approval of Registrar

(ii) Whether the plan and estimate areapproved/certified by licensed engineer in case of construction ofbuilding

(iii) Whether the society has compliedwiththe legal /tender procedures

(iv) Completion certificate

(v) The valuation certificate, in order to compare the amount and expenditure.

6.26. Plant and Machinery.-

Where plant, machinery, furniture etc. have been newly acquired, invoices and receipts should be verified. Enquiry should be made to ascertain whether there is proper authorization 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 capitalized.

6.26(a)*Expenditure on Electronic items*:- Expenditure on computer hardware and software is usually incurred by the cooperative societies which are computerized. The auditor should ensure that all expenditure on electronic items and computer hardware are taken to capital expenditure and expenditure on software as revenue expenditure. Website creation charges may also be classified as revenue expenditure.

6.27. *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.

6.28. *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.

6.29. *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 possesses 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.

6.30. 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.

6.31.*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 dispatch register. The amounts drawn from the petty cashier by the dispatch clerk should be verified and the balance on hand counted. The auditor should also ensure that someone 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. Auditor shall check the vouchers of payment on courier charge.

6.32. ***Management expenses***

Rule 48 of the Rules authorizes 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.

6.33. ***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.

6.34. ***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.

6.35. ***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.

6.36. ***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.

6.37. 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. The donations made against the above provision should not be admitted by the auditor.

6.38. 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 receipt 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.

6.39Telephone charges

Register of telephone 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 telephonecalls can be checked with the TelephoneCall Register. Charges for private calls should be realized from the parties making the calls.

Mobile Bills or recharge expenses on mobile phones should beverified and any un authorized or private usage should not be admitted.

6.40. 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 quotations and accepting 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.

6.41Payment 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.

6.42. Advertisement charges

Newspaper cutting of the advertisement and the bill received from the press should be 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. The budget allocation for advertisement charges shall be verified and transaction with advertisement agencies should be verified carefully to check unnecessary expenses on this accounts. Also ensure that donation made has not been included under the head advertisement charges.

6.43Vouching 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-imbursement of petty cash. 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.

6.44.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.

6.45. 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.All such advances must be settled before the end of the financial year.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.

6.46.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, irrespective of the class of shares. 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.

6.47Refund 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:For payment of saving deposits withdrawal formsandcheque leavesshould be supplied to the depositors and their signatures obtained thereon, which should be kept as voucher and serially numbered.

The auditor has to see that interest on deposit has been paid by the societies at the rates specified by Registrar of Co-operative Societies from time to time .

6.48Payment 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 30th September and on 31st March 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.

6.49 Payment out of profit:

(a) Dividend:The auditor has to first 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.

(b) 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.

(c) 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.The auditor has to see that separate sub rules are being framed and approved by the Registrar for the utilization of common good fund.

6.50. Refund of Suspense accounts

Amounts credited to the 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 up on.

6.51. 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.

6.52 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 receiptchallan can be checked. Hiring of premises and approval of rent or compensation should be sanctioned by the committee. Deposits and advances paid towards rent or compensation should also be sanctioned by the committee. The auditor should also see the terms and conditions of repayment of those advances.

6.53Miscellaneous-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.

6.54Expenses 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 incurred for publicity, propaganda, 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

(vi) Expenses incurred from owned funds without sanction from the administrative department and exceeding sanctioned limit

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. 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

6.55Checking 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; out standings, 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,dishonor of bills etc

(x) Closing entries i.e. 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 pay due attention while checking these contra entries.

6.56 Repayment of loans to Government

Repayment of Government loans are to be vouched with reference to the receiptchallan 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 challans. While vouching the payment, the auditor should satisfy himself that the Challan 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.

6.57. Expenses out of:-

(a) 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 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.

(b) 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.

6.58 Auditor's duty in regard to the audit of Reserve Funds

(i) He should check that the amount setapart from the net profit is in accordance with the rate prescribed in the Kerala Co-operative Societies Act/Rules/Bye-laws and the appropriation is authentic.

(ii) He should see that an amount not less than 15% of net profit is credited to the reserve fund and 7% of net profit to the agriculture credit stabilization 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	1) Reserve Fund,
	2) Co-operative Education Fund,
	3) Member Relief Fund
	4)Agricultural Credit Stabilization Fund
	5) Professional Education Fund
Balance :	

(Read circular No. 62/2013 dtd. 04/10/2013 of Registrar of Co-operative societies)

(Rule 53, sub clause 3 and 3A of KCS rules)

(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 utilized 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 utilized has been utilized for the purpose for which it is allowed.

6.C. Vouching of Trading Transactions

6.59 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 up-to-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 initialed 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 could 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.

6.60. Purchase returns.-

When the goods are returned to the seller when 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 neutralizing certain fictitious entries for the previous years purchase given and or with a view to manipulating the accounts.

6.61Credit 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.

6.62 Checking of invoices

Invoices are to be checked both by the purchase Department and Accounts Department. The purchase 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 purchase 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 purchase Department.

The invoices should be initialed 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.

6.63Allocation of charges

Allocation of charges and credits to nominal accounts and cost accounts should be done by proper authority. The basis of allocation should be indicated in the invoice of the credit notes itself. With regard to the acquisition of or addition to fixed assets, it should beauthorized 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.

6.64.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 purchase 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 authorized 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.

6.65Organization 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.

6.66Sales

Retail sales are mostly confined to consumers' societies and other societies which deal directly with customerThe 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 dispatched.

(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.

6.67Credit Sales

Employees and other consumer Store/Societies allow credit sales to their members up to 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.

6.68Control 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.

6.69Checking 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 Goods and Service tax is to be collected from the customers, the auditor should see that the rates of 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 societies should be advised to remit the GSTcollected to the Treasury monthly, before the due date and returns of

GSTin respect of the month should also be filed before the GSTauthorities in time.

6.70. 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 each item should be accepted only on terms and conditions acceptable to the society. Where credit sales are allowed to customers, credit limits should be 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 dispatch 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 dispatched 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'.

6.71Consignment 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 the goods 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.

6.72Sales 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.

6.73 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 of sales column in 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.

6.74Packages 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 of 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.

6.75Bills receivable Book

The particulars of all bills and drafts upon which the business is entitled to receive money are entered in this book. This book contains 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 at 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.

6.76 Bills payable Book

All bills accepted by the business in favour 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 by the concerned parties, account should be credited with the amount of the bill plus expenses, if any, incurred by them. The accounts of noting charges should be vouched and receipted accounts forwarded to the concerned creditors.

6.77Bought 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 will be credited. In due course and at different dates two cheques will be 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 will be produced twice or a duplicate receipt will be obtained and produced before the auditor. Such frauds are difficult to be detected and unless there is a perfect system of internal check, and a careful check by the auditor of all the invoices, these kinds of frauds cannot be detected.

6.78 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.

6.79Sales 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 the auditor can get a list of good, bad and doubtful debts, from the management.

After vouching of the entries in the various subsidiary journals has been completed and their postings checked in 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.

6.80 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 dry age 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,

6.81Production Register

This register contains 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 of 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 realized by sale or scrap or wastage should be deducted. The work in progress at 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 the cost of production

(iii) Cost per unit

(v) Cost per unit of the previous period

6.82Inventory Control

Inventory control is a 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 an 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 the 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 is being stocked at any given time.

(2) Fast and slow moving articles and incidental items which are not being sold

(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 unsalable

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-dependent 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 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 find 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 persist ability, storage facilities, price trends, discounts, amount of capital necessary and available, seasonal trend of prices, availability of supplies and so on.

The auditor should ascertain and satisfy whether 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 been out of stock and that a proper inventory control is exercised effectively by the management.

6.C.1. Payment of Wages

6.82(a)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 varies 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 frame necessary Sub Rules regulating the service conditions of employees. The approval of the Registrar should also be obtained for the sub rules. Every employee should have personal cards Service Registersto record details such as appointment, promotions, rates of pay, retirement etc. These personal card Service Registers should be maintained by the Personnel Department. All general increase in pay, deduction from wages, payment of advances against wages etc., should be properly authorised.

(b) Attendance and job recordingIf wages are paid for an 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.

***6.83Method 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 acquittance 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 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 during the time of payment of wages and satisfy himself that the prescribed procedures are being regularly followed.

6.84Payment 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.

6.C2. Loans to Members

6.85. 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 of 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, interlending between societies has been prohibited, Registrar may permit such inter lending’s 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.

6.86Restrictions on lending

Different types of Co-operative Institutions are being set up with a view to provide financial assistance for different purposes. Accordingly agricultural credit societies are organized 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,large and small business concerns and of industrial establishmentsetc. Employees Credit societies are organized to meet the credit requirements of employees of Government departments, long term credit facilities are extended through Land Mortgage Banks/PCARDBs 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 creating a charge in favour of the society on the lands held by him or his interest in the lands cultivated by him as tenant for the dues of the society. (Subject to amendment in Registration Act)

(2) Every salary earning member of a society, while applying for a loan, shall execute an agreement authorizing 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.

6.87Checking of loan operations

The byelaws of most of the Co-operative Banks and credit societies specifically provide 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 utilized 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.

6.88Checking of loan bonds

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 Minutes Book.

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

(iii) Whether the loan was sanctioned on the basis of a proper valuation of security properties mortgaged by competent authorities. Incase of improper valuation, it shall be reported by the auditor immediately without waiting for the finalisation of audit.

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

(v) When the loans are disbursed, amount upto 20000 may be in cash, and above it throughcheque.

(vi) 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.

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

6.89. ***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 installments, 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 honored 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.

6.90 Loans against different kinds of securities

*(*a) *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 favour of the lending Bank/ Society will have to be got registered with the Bank issuing the receipt.

(b) *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 of the payment of the latest premium should be attached to the policy. An undertaking shouldalso be obtained from the borrower agreeing to keep the policy alive.

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

(iv) Loansshould be limited to the surrender value of the policy. If required a certificate should be obtained from the LIC for the surrender value of the policy. It should be ascertained whether the policy is subject to any charge, encumbrance etc.

(c) *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. As the Central Co-op Land Mortgage Bank, now Kerala State Co-operative Agriculture & Rural Development Bank has stopped the floating of debentures from2013-

2014onwards; the outstanding debentures if any may be verified by the auditor.

If the securities have not been purchased by the borrower himself, the auditor should see that the last endorsement is in his name. 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 case of securitiesin physical form. In case of DMAT Accounts, the holding statements from the depositary should be verified with the book of accounts in order to ascertain the outstanding balances. 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 a society to advance loans on the security of the shares issued by itself. In the case of certain bonds and debentures second charges are not recognized and hence it should be seen that prior encumbrances have not been created on such securities. Securities carrying Government guarantee should be preferred.

(d) *Gold and Silver Ornaments*

Every Bank/Society which pay advances against gold and silver ornaments should have appointed a qualified appraiser to test and value the ornaments offered as security. Adequate security should also be 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 should ensure whether the society has strictly complied with the directions of Registrarissued in Circular No. 1/78 dated 6-2-1978 (CRP3-50058/77), regarding custody, insurance etc. of the ornaments pledged.A stock Register of ornaments pledged should be kept in the society which should be verified by the auditor. Also refer to circular of RCS (22/16) and Director of Co- operative Audit (13/13).

(e) *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 thereupon, 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 the competent authorities should be verified. The mortgaged property should be insured for its full value and the policy assigned to the lending Bank.

(f) *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.

(g) *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.

(h) *Consortium lending*:- Large Scale credit needs in first method development such as Roads, Bridges and other extension works are met through consortium lending of Co-operatives. Theauditor should verify the scheme and report on the event of any irregularity or impropriety of Consortium lending.

6.91Discounting 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 unrealized 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 be 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 dishonor of bills or delay in honoring 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 tothe 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 are being received from approved parties to whom hundi limits have been sanctioned.

6.C 3 Investment of Funds

***6.92.Statutory Provisions*:-**

Section 57 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 prescribed 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 their apex institutions 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 theRegional Milk Unions andRegional Unions to Apex Federation – Milma,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 apexfederal societies.Incase of co-operative banks regulated by Banking Regulation Act 1949, the guidelines issued by RBI should also be considered.

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.

6.93Method 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.

6.94 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.

6.95Purchase 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 has 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 made available for checking. If purchases are made through the brokers, "brought notes", bank transfer forms or endorsement will have to be seen. The securities as such 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 scrutinized by the auditor.

6.96.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.

6.97Investment in Treasury Bills

If the societies, particularly Urban banks and other co-operative banks, invest their surplus funds in Treasury bills or other short term investments which are generally sold at discount, the auditor should check the transactions. The difference between the face value and the purchase price represents the return of the amount invested.

6.98Investment 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 should 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 utilization 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.

6.99Investment 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.

6.100Construction of buildings and godowns by Co-operative Societies

Before commencement of the construction, the plan and estimate of the building/ godown as prepared by the 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)Whether the building supervisor, or other employee of the society who supervises the work hasmaintained measurement book properly.

(iv) Whether all running bills have been 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 PWD authorities (not below the rank of an Executive Engineer).

CHAPTER-VII

AUDIT IN COMPUTERISED ENVIRONMENT

7.1 Introduction

The computerization of accounting function has made the lengthy accounting functions of journal entry, ledgerisation, preparation of trial balance and finalization of accounts to a simple and automatic process. Once the data is captured to the computerized system any type of reports can be conveniently generated, modified and interpreted as required by the user. The computerization of accounts has the following advantages:

The lengthy process of manual accounting function is converted to a simple and quick process.

The tedious and time consuming job of preparation of financial statements from manual accounts is simplified to a job of a few key strokes. It can be prepared at any time according to the requirement.The lengthy process of preparation of any type of report is converted to a simple process which can be prepared at any time.

An adhoc query by the manager or any other person can be answered by an accountant in no time while in manual accounting it was a laborious process and almost impossible.

Accounting used to be person centric and the mangers used to wait till the accountants are ready with the report. In computerised system the process has become system driven and anybody who is authorised to access the report can generate any report at any time.

It was very difficult to rectify errors in manual accounting. By computerization of accounts the rectification of errors can be done with ease.

Any new reports can be generated without difficulty. The security and secrecy of accounting data can be maintained by bringing controls in the programs.

If we analyze the above aspects, the computerization of accounts had helped substantially in the decision making process. The availability of various types of reports at the finger tips helps in the managerial decision process. The data captured in the system can be used as a raw material for data analysis and information processing whichsupports the decision making process.

Notwithstanding anything mentioned above, the uncontrolled use of computers can have a widespread impact on the society.Inaccurate information can cause misallocation of resources within a business organization. It can happen even in an economy.

Now the widespread availability of powerful technology devices and the associated packaged software has resulted in the extensive use of computers.

Information Technology has changed business environment. It has enhanced the ability to capture, store, analyze and process large amount of data. It has become a critical component of business process. Even though the control objectives of a business entity like safe guarding the assets, adherence to management policies, prevention and detection of fraud and errorand the other control objectives remain the same, the manner through which those objectives are met has changed in the computerized environment.As there is a drastic increase in the volume of business and it continues to grow day by day, the business objective can be attained only by computerization of the business. So auditing in such an environment has become a necessity. The computerization has affected both evidence collection and evidence evaluation function of an auditor. The computer control technology is often more complex than the manual system control. So every measure has to be taken to conduct the audit in technological environment in an efficient and effective manner.

The audit should be conducted in such a manner that it evaluates the asset safeguarding, data integrity, system effectiveness and system efficiency. This can be achieved only by implementing a sound system of internal control.

Auditing in computerized environment is dealing with complexity. The auditor may factor the whole system to be evaluated into sub-systems and evaluate the reliability of controls over events in the sub-systems, and progressively aggregate the judgements on each subsystem to arrive at a global judgement on the overall reliability of the system.

The audit can be conducted by carrying out the following steps:

1. Planning the audit considering the control aspects.
2. Attain an overall understanding of the internal controls and test whether they are working effectively.
3. Auditor must carry out substantive tests of details of transactions to evaluate whether a material loss or account misstatement loss has occurred or might occur.
4. Carry out substantive test of balances or overall result to gather sufficient evidence to make a judgement regarding the losses, or account misstatement that has occurred or might occur.
5. Based on the evaluation of the evidence collected the auditors shall issue an audit opinion.

There are S two approaches of auditing based on the application of technical knowledge in the process of auditing. The methods are auditing around the computer and auditing through the computer.

Auditing around the computeris a cost effective method where the computer is considered as a black box. The application system's processing is not examined directly. Based on the quality of the application system's input and output, the auditor infer the quality of the application system's processing.The approach is selected in three circumstances:

1. When the system is an extension of the manual system which is simple and batch oriented.
2. Often it is cost effective when the application system uses generalised packages as its software platform.

   The auditor should ensure that (a) the organization has not modified the package ; (b) adequate control exists over source code, object code and documentation to prevent an unauthorised modification; (c) high quality control exists over input and output from the package.
3. The technique is used only when high reliance is placed on user rather than computer controls to safeguard assets, maintain data integrity and attain effectiveness and efficiency objectives.

This is a simple approach and it can be performed by auditors who have little technical knowledge of computers.

Auditing through the computeris the approach adopted whereextensive knowledge and technical competence of the auditor is used while carrying out the audit. He uses the processing logic and controls existing within the system and the records produced by the system.

This approach is suitable where the inherent risk is high and the significant part of internal control system is embodied in the computer system. It is used where the application system processes large volume of input or produces large volume of output.

The primary advantage of auditing though thecomputer is that auditors have increased power to test an application system effectively. They can expand the range and capability of tests they can perform and thus increase their confidence in the reliability of the evidence collection and evaluation. This is often a costly method but it becomes sometimes inevitable.

The auditor should adopt the approach considering the cost effectiveness and necessity of the situation. Irrespective of the approach adopted the auditor should give the best possible opinion.

7.2 Planning and Conduct of Audit

Audit preparation and planning can be discussed under the following heads:

1. Understanding the Business
2. Audit Scope
3. Planning
4. Staffing
5. Audit Schedule
6. Execution of Audit
7. Reporting

7.2.1Understanding the business-

The auditor should understand the business before conducting audit to meet the audit objectives.The auditor should study the nature of business, organisation strategy, the level of IT infrastructure and the computer application systems. The auditor should gain an understanding of the types of system transactions and practices that have significant effect on the organisation’s function, process or data that are the subjects of the audit.

7.2.2 Audit Scope-

There should be a clear mandate for an audit. The scope of the audit should be documented and reviewed periodically. It should contain the aspects of purpose, authority, responsibility and accountability. There shall be a charter which clearly mentions the same.

7.2.3 Audit Plan

An audit plan should contain an outline of the auditor's plans and procedures in conducting an audit. The objective of the audit plan is to assist the auditor in conducting an effective and efficient audit. The audit plan should be documented. It should contain:

1) A brief aspect about the business
2) Potential audit risks
3) How audit resources are allocated
4) Audit procedures to be performed

7.2.4 Audit Staffing

Aligning the audit and technical skill requirements with the skills of the available staff and the development goals of team members require effective management skills. The members of the team should have knowledge in technology, risks and audit techniques unique to the subject. The members should be allocated with scheduled jobs according to their skills and training they have, so that the audit assignment can be completed in a timely manner. The auditor may not have technical knowledge and skills in the business such as engineering knowledge or life science knowledge. Therefore, to examine such aspects, any expert in the field can be consulted by the auditor if he feels that such an expert should be consulted.

7.2.5 Audit Schedule

The audit team should prepare a schedule for their work. There may be start and finish deadline for the audit work. Time available shall be allocated to planning , training, meetings, field review, report writing and post audit follow up. A scheduled audit saves time and resources.

7.2.6 Execution of Audit

The three major aspects which should beconsidered before the auditprocess are:

a. Data gathering

b. Sampling

c. Materiality and evidence gathering.

a) Data gathering

Data gathering is one of the most important and time consuming part of an audit process.

The sources of data are :

iOrganisation website

ii Organisation's annual reports

iii Previous audit reports

ivPrevious audit check lists and working papers

vThe data base of the computerised system

viOther related documents/ materials.

b)Sampling

Sampling is adopted when time and cost precludes total verification of all transactions and events. Sample is the subset of a population which infers the characteristics of a population.

The two methods used by the auditors are attribute sampling and variable sampling. The former is used in compliance testing situation while the latter is generally used in substantive testing situation.The sample should be evaluated from the audit perspective.

c) Materiality and evidence gathering

The auditor should assess the materiality and plan the audit effectively by focussing efforts on high risk areas. Materiality is a matter of judgment which considers the effect on the organisation as a whole, of errors, omissions, irregularities and illegal acts which may ensue as a result of control weaknesses.

Any information used by the auditor to determine whether the entity or data follows the established criteria is said to be the evidence. The audit evidence include the auditor's observations, notes taken on interviews, material extracts from correspondence and internal documentation or the results of audit test procedures. Evidences help the auditor to reach audit conclusions. An independent and objective evidence provided by a competent person is reliable. Gathering of evidence is a key step in the audit process.

Techniques of gathering evidence include the following methods:

aAnalysing the organisation structure

b Analysing the documentation

c Interview of appropriate personnel

d Observing the processes and employee awareness.

7.3 Information System Audit Process

7.3.1 Preparation for audit

iInitially theauditor conducts meetings with management and the personnel to discuss the overall scope of the audit.

ii The auditor should conduct the review of all important documents about the organisation.

iiiManagement policies and guidelines should be reviewed carefully.

iv Procedures and the detailed information about the processes which should also be reviewed.

v Flowchartshelp in understanding the processes and how the transaction flow has dependencies and branches to various directions.

viOrganisations should have control over processes and have to preserve the evidence of the same in the form of system screen shots and system logs which can be accepted as evidence.

7.3.2Interviewing the key personnel

Interview and meetings with key personnel working in the organisation help to understand the processes and get information about policy, procedures and the control aspects. This would give indications of weaknesses and the areas to be concentrated during the course of the audit.

7.3.3 Conducting the walk throughs

Walk throughs are conducted to understand the processes and gain evidence for the compliance and deviations if any. It includes physical rounds around the facility, interacting with the employees, verification of documents, input and output in the processes, etc.

7.3.4Test of controls

It involves applying compliance tests and use of auditing tools. Testing is conducted to see whether the controls are working. It is a scientific process which involves understanding the process and expected results. It ensures design effectiveness and operational effectiveness. It may be compliance testing or substantive testing.

7.3.5Documentation

Proper documentation of the work performed and evidence supporting their findings and conclusions are very much essential. It help to prove the extend of work the auditor has done and facilitate third party reviews. It speak about the preparations, the audit programme, steps performed and the evidence. The observations, conclusion and recommendations and other reports form part of documentation.

7.3.6 Audit Reports

Audit reports are prepared after the completion of the audit. It should be the sum total of the observations and findings.
It includes:

1. Scope
2. Audit methodology
3. Conclusion and road map
4. Detailed findings
5. Observations
6. Policies and procedures to be reviewed
7. Risk areas
8. Recommendations
9. Annexures supporting the observations
10. Personnel interviewed
11. Evidences obtained
12. Disclaimer

7.3.7 Follow up

The audit does not end with a report. The follow up process should be ascertained to monitor and ensure that management actions are effectively implemented or the senior management has accepted the risk of not taking the action. This should be noted and followed up. The auditor should review the auditee responses and corrective action and evaluate them and the follow up findings.

7.4.Auditing IT Controls

7.4.1 General Audit Controls

The auditor shall give attention to the following:

1. Understanding the internal control environment of the organisation and the processes related to financial reporting.
2. Identification of IT systems which are contributing towards processing the financial data.
3. Identify the key controls which address specific financial risks.
4. Understand the design and implementation of internal controls and its effectiveness.
5. Verify the documentation and testing results to their IT controls.
6. Ensure that IT controls are updated and changed to address the necessary and corresponding changes in internal control or financial reporting process.

The IT application controls should ensure that the completeness of transactions have direct impact on financial statements.

7.4.2 Access control

a) Access modes:

1)Read only : User can view, copy and print but cannot alter or modify it.

2)Read and write: User is allowed to view and print as well as add, delete and modify the information.

3)Execute: It is an activity performed by the users in relation to the applications and programs. Usually the program executes the function.

b)User types:-

User types are of two, general user and super user. ***General user*** is restricted to a few activities. A general user enters the data, views it for completeness and correctness and prints it.***Super user*** is an elevated user. A super user is able to change or modify the access rights of the general user, system parameter, settings and access to system data. Super users can authorise the transactions and change the system parameter.

c)Role based access:-

A role is a function or a job assignment. Access rights are defined under the role name. It restricts the access rights to the individuals. An individual may be given more than one role. While defining the roles in the system and assigning them to the different users, segregation of duties should be centralised. Any system will have a better control if role based access control is established.

*d)Password***:-**

Password is the authentication key to login into the system. The system should set best practices followed in the industry about the pass words.

a) System default pass words are to be changed.
b) User awareness is created about not sharing the pass word.
c) Pass words of an elevated user are stored in a sealed envelope.

Password setting guidelines may be followed:-

- Contribution of Alphanumeric characters
- Password length restrictions
- Use of uppercase and special characters
- Password expiry (eg:- 60 days)
- Not to use past 3 passwords
- 5 unsuccessful attempts, the account should get locked.

The auditor should review the User Management policies and procedures to ensure the following:

1. Process of access to a new user.
2. Process of user access to a terminated employee or those on long leave
3. Process of granting access to existing users in case of change of role.
4. Periodic monitoring mechanism of access rights.

7.4.3 Change Management Controls:-

The change management process ensures that all changes to the information system infrastructure are carried out in a planned and authorized manner. The auditor should review the change management process.

7.4.4 Physical and environmental security controls

The auditor should review the process:

1. Procurement, commissioning of equipment in the facility.
2. Periodic monitoring mechanism of all such external parties.
3. Annual maintenance contracts in existence.
4. Periodic maintenance being conducted.
5. Break down calls attended under AMC.
6. Documentation of all the above items.
7. Performance evaluated annually by external party.

7.4.4(a) Physical access controls

1. Employee access- photo ID cards, Electronic IDs, Biometric
2. Visitors access - logging register
3. Access to sensitive areas like server rooms, data centres etc.
4. Monitoring mechanism – security guards, CCTV
5. Periodic review of monitoring mechanisms – Visitors logs, CCTV logs, etc.
6. AMC for all third parties like security instruments, CCTV etc

7.4.(b) Environmental controls

1. Water and smoke detector
2. Fire extinguisher
3. Fire suppression system
4. Humidity/temperature control
5. Electrical power
6. Electrical surge protectors
7. Air conditioning
8. Wiring running through adequate conducts
9. Alternative electric power sources
10. Documented tested emergency building evacuation plan

7.4.5 Application Control

7.4.5(a) General aspects

Application Control Audit ensures that the controls built into the application should provide reasonable assurance that data processed by the system is valid, accurate, reliable, timely and secure.

IT application or program controls are fully automated and designed to ensure the complete and accurate processing of data from inputs through output. It ensures data privacy and security. Application software processes the business transactions. The rules are built in and implemented by the system.

The auditor should see whether the following risks are addressed:

1. System availability risks
2. System security risks
3. System integrity risks
4. System maintenance risks
5. Data risks.

The auditor should ensure that proper application controls are implemented in the system which includes input control, data validation and edit controls, process controls, output controls and data file controls.

7.4.5(b) Software acquisition control

Software acquisition control should cover areas like adherence to business rules in the flow, and accuracy in processing, validation of various data inputs, logical access control and authorisation, exception handling, logging, etc. The audit process may be carried out by the following steps:

1. Study the key function of the software.
2. Run through the menus, features and option to identify processes and option for conformance to business rules and practices.
3. Validate every input to the system against the applicable criteria which eliminate errors.
4. Verify access control in the software by checking the inherent design of the access control module and the nature of access granted to various users.
5. Verify how errors and exceptions are handled and how it is authorised in the software.
6. Evaluation of environment such as operating system and the data base in which the application runs.
7. Check whether the above are documented properly.

7.5 Network Security Audit

Network audit sees whether the networks and associated components are configured, tested and reliable, prior to being placed inter production.To see whether network resources are appropriately monitored,andadequate controls are in place to ensure the security and recoverability of the networks.

The data transmitted over network passes through various media. It could be intercepted if there is an undesirable disclosure. It should also be available to the authorised user. The network provides various access points. These access points should be secure. So proper network security audit should be conducted by the organization in a periodic manner to ensure data privacy, integrity and availability.

There should be proper controls established in the network to protect the information assets from the intruders. Good physical access controls at data centres and offices and physical security over telecommunication equipment can limit the interception through sniffing. Encryption of data is another effective control. Control should be built at the access points.

The auditor should understand the network infrastructure.

The auditor should review physical and logical access controls.

The auditor should study the network design, strategies, segmentation of routers and switches and WAN for configuration and protocols.

The auditor should gather sufficient information about the risk analysis along with the likelihood of occurrence and probable impact of the event.

The auditor should review the polices, and procedures of the network infrastructure management.

Personal interview, documentation analysis and wireless infrastructure testing should be used in gathering, analyzing and interpreting the data.

If third parties are involved, the auditor should review the terms and conditions of the agreement.

7.6. Data Migration Audit

The auditor should study the application process, source of data and destination. The migration may be single-tier migration or multi-tier migration. There may also be continuous policy driven migration. The data mapping and migration plan should be reviewed by the management. The auditor should verify whether the procedures have been followed properly with respect to implementation, readiness of the system, pre-migration sample test and data conversion.

IT migration can be defined as a process of movement of anyone or a group of IT assets from one state of existence to another.The auditor should assess the risks involved in the Data migration process which includes;

- Data corruption
- Data loss
- Application down time
- Performance degradation
- Technical incompatibilities

Data mapping is the process of creating data element mappings between two distinct data models. It is the first step of data transformation. The auditor should assess the adequacy and completeness of the planned data conversion. It includes;

- Migration strategy and key activities
- Data sources and destinations
- Dependencies
- Required equipment and migration tools
- Customer expectations
- Test plan
- Verification procedures
- Risks and contingency plans
- Change control procedures
- Project schedule
- Post implementation activities
- Migration completion criteria

Pre-migration sample test is conducted to ensure that the plan is working properly. Once the data is moved, all clients should also be checked by redirecting them to the destination devices.

7.6.1Types of Migration

1. Application Migration - From one vendor application to another vendor application, from old programming to new one or from legacy application to new application.

2. Operating System (OS) Migration

3. Data base Migration

4. Hardware Migration

5. Data Centre Migration

6. Service provider Migration

The auditor should ensure that the implementation is executed prudently and successfully. A review of the testing of the initial production operations using the new solution should also be completed. The auditor should complete the audit analysis of the results of the implementation and the management actions that have been completed to address any issues observed during the actual implementation.

7.7 Business Continuity Management Audit

The auditor should look into the following aspects:

1. Business continuity management policy and procedure which should be documented, approved, updated and reviewed.
2. Risk assessment should be carried out.
3. Business impact analysis of loss, interruption or disruption of business processes in an organisation.

Business Continuity Management (BCM) refers to the activities required to keep your organization running even during a period of interruption of normal operations.

Business Continuity Planning (BCP) is the practical logical plan of how an organization will recover and restore interrupted critical function within a predetermined time after a disaster or an extended disruption.

Disaster Recovery Plan (DRP) is a document which guides an organization for the process of rebuilding an operation or infrastructure after the disaster has occurred.

The auditor should see whether the Business Continuity Management policy and procedure is being documented, approved, updated and reviewed. He should make risk assessment related to business interruption.

He should conduct the business impact analysis.He should look in to thedevelopment and implementation of BCP and DRP, training conducted for the employees, test drills conducted and offsite procedures like selection of the site, back up, restoration, security etc.

The auditor should also review and update the maintenance of BCP and DRP.

7.8.Data Centre Audit

A data centre is a facility used to leave mission critical computer systems and associated components for companies and organisations. It includes environmental controls, redundant backup power supplies, redundant data communication connections and high security.

1. Data Centre policy and procedure should be documented, approved, updated and reviewed.

2. Data Centre should have adequate physical and logical access controls.
3. Data Centre operations should be documented.
4. Data Centre should have adequate backup and restore of data operations.
5. Adequate environment measures should be implemented in the Data Centre.
6. All aspects of the Data Centre should be properly documented.

7.9 CAATs (Computer Assisted Auditing Techniques)

The auditors use Information System tools to handle large number of transactions. The growth in the data volumes has made it impossible to handle all transactions. The audit software ensures complete scrutiny of the transactions.The process is carried out and indicatory reports delivered in no time, which can be effectively used by the auditor.Use of CAAT makes it simple. It includes many types of tools and techniques such as Generalised Audit software, (GAS) customised queries or scripts, utility software, software tracing and mapping and audit expert systems.The audit should consider the following facts:

1. Computer knowledge, expertise and experience of the auditor
2. Availability of suitable CAATs and IS facilities
3. Efficiency and effectiveness of CAATs
4. Time constraints
5. Integrity of the IS and IT environment
6. Level of audit risk
7. Ease and flexibility of use
8. Training requirements
9. Processing efficiency
10. Compatibility of CAATs with data

7.9.1 Uses of CAAT

CAATs may be used in performing various auditing procedures, including the following:

i. Tests of details of transactions and balances, for example, recalculating interests or extraction of invoices over a certain value from records.
ii. Analytical procedures, for example, identifying inconsistencies.
iii. Test of general controls, for example, testing the setup or configuration of the operating system.
iv. Sampling programs to contract data for audit testing.
v. Reperforming calculations performed by the entity accounting systems.
vi. Tests of application controls, for example testing the functioning of a programmed control.

CAATs may consist of package programs, purpose -written programs, utility programs or system management programs.

7.9.2 Types of CAAT

These are some of the CAATs available:

1. *Generalised Audit Software*

Generalised Audit Software can directly read and access various database platforms and is used typically for the following functions:

a) File Access: It enables the reading of different record format and file structure.
b) File Organisation: It enables an indexing, sorting, merging and linking with another file to get meaningful information.
c) Data Selection:Filteration of data as per the requirements.

d) Statistical Techniques : Sampling, stratification and analysis of data.

e) Data analytics: Using the above functions, the available data is analysed for evidences and inferences.

   The auditor uses the skill, training and experience to use CAAT and come to certain conclusions in the course of an audit.

2. *Stress Testing Tools*

   Tools that can be specially deployed for volume and stress testing of user traffic response through newly implemented application programs.

3. *Integrated Test facility*

   Program that simulates transactions that can be used to test programming logic, computations and controls actually programmed within software applications.

4. *Utility software*

   It provides evidence to the auditors about system control effectiveness. It is generally a subset of software.

7.9.3 Documentation of CAATs

The CAATs processes have to be documented to provide audit evidence. It should list out:

a. CAATs objectives
b. CAATs to be used
c. Control to be exercised
d. Staffing and timing
e. CAATs preparation and testing procedures and controls
f. Details of tests performed by CAATs
g. Details of inputs, testing periods, processing, and outputs
h. Relevant parameters or source code

i. Output produced
j. Audit analysis
k. Audit findings
l. Audit conclusions
m. Audit recommendations

7.9.4 Reports relating to CAATs

The CAATs used should be clearly mentioned in the body of the report where specific findings related to the use of CAATs are being discussed. It may also be mentioned in the objective, scope and methodology section of the report.

7.9.5 Online Audit Approach

One or more of the following automated evaluation techniques are used to improve audit efficiency.

i. *SCARF and EAM*– (System Control Audit Review File and Embedded Audit Module). The application systems are monitored on a selective basis, by using this technique. This involves embedded audit software modules within an application system to provide continuous monitoring of the system's transaction.
ii. *Snap shots* – Analysing the pictures of the processing path that a transaction follows from the input to the output stage. Transactions are tagged by applying identifiers to input data and recording selected information about what occurs for a review.
iii. *Audit hooks* – This technique involves embedding hooks in application systems to function as red flags and the system can take care of it before the event occurs.
iv. *Integrated Test facilities* – Facilities are set up and included in an auditors production files. The system should be allowed to process live transactions or test transactions during the regular processing norms and have these transactions, update the records of the dummy

entity. The operation gives input of the test transactions, simultaneously with the live transactions and is then processed. The output is compared with the data that has been independently calculated to verify the correctness.

v. *Continuous and Intermittent simulation (CIS*) - The computer system, during a process, runs of a transaction, simulates the instruction and execution of the application. The transaction is checked for the predetermined criteria and if so,the audit conducted.

7.10 Major Considerations –Audit in Computerised Environment

1) Is there a documented and approved information system strategy used in the organization?
2) Are there any information system policy and procedures documented and approved by the management?
3) Whether the information system users are made aware of such information system policy and procedures?
4) Is the information system management working according to the laid down policy and procedure?
5) Whether roles and responsibilities of staff defined and documented?
6) Is there any job rotation in place for critical roles?
7) Are there proper humanresources policiesfor recruitment, draining, Development and termination?
8) Is information system asset management procedure documented and approved?
9) Is the physical access control procedure documented and approved?
10) Is the physical access control mechanism working properly and documented?
11) Is the environment control mechanism working as per policy?
12) Is the user access control mechanism working as per policy?

13) Is the granting of access to third party working according to the policy?
14) Are all the access logs documented and proper back up of the whole system happening at regular intervals?
15) Is the change management control policy and procedures documented?
16) Isthe development, test and production environment separated?
17) Is the backup and restoration policy documented and approved?
18) Is the backup and restore activity functioning in regularly and kept in secure location as per the policy?
19) Is the network security policy documented and approved?
20) Is the network security policy implemented and the network management working according to the policy?
21) Is there any policy for the use of mobile devices which is documented and approved?
22) Are the use of mobile devices done as per the policy and documented?
23) Is therean antivirus protection software implemented as per the security policy?
24) If the work is outsourced, is there any policy and is it followed properly?
25) Is the service level agreement documented and worked accordingly?
26) Is there any performance monitoring mechanism functional in the organization?
27) Is the acquisition, development and maintenance policy and procedure documented and approved and functioning accordingly?
28) Is there any approved policy for data migration and do the organizations comply with such a policy?
29) Is the business continuity management policy and procedure documented and approved and functioning accordingly?
30) Is the system working as per information system laws?

7.11 Auditing in Computerized Co-operative Banks

The auditor should evaluate the following factors while conducting the audit of a co-operative Bank:

i The extent to which the computerization is used to record, compile and analyze accounting information.

iiThe system of internal control in existence in the organization with regard to the flow of data, processing of data, analysis and reporting tasks.

iiiThe impact of computer based accounting system on the audit trail.

The nature of audit evidences, and the techniques used to evaluate them haveundergone significant changes. Now they are audited through the computer.

7.11.1Special aspects incomputerized environment

The control concerns of an auditor in computerized environment given by a bank:

1. The use of IT to calculate and record, substantially all of the interest and expense.
2. The use of IT and telecommunication systems to determine various values.
3. The dependence on the records produced by IT as they produce the information on bank' s asset and liability positions such as customer loan and deposit balances.
4. The complex valuation models incorporated in the IT systems.
5. The models used to value assets and data used by those models are often kept in spreadsheets prepared by individuals on PCs not linked to the main system.

6. The use of different IT system resulting in the risk of loss of audit trail and incapability of different systems.
7. The use of multiple channels of delivery of services to a bank's customers such as ATM, EFT, internet banking, card based payment systems, etc.
8. The integrity of financial data moving through data interfaces between several systems.
9. Potential risk of management override of controls through privileged access to information.
10. Potential segregation of duty in multiple systems granted to users.
11. The extreme use of third party vendors.

7.11.2 Roles and responsibilities of Bank

A Co-operative Bank has to share the following information with the auditor:

1. Overall IT policy, structure and environment of the Bank's IT systems and changes if any.
2. Data processing and data interfaces under various systems.
3. Data integrity and data security.
4. Business continuity plans and Disaster Recovery Plans.
5. Accounting manual and critical accounting entries and the processes and involvement of IT systems.
6. Control and recording of various e-banking and internet banking products.
7. Manual processing of transactions, if any .
8. MIS reports generated and its periodicity.
9. Hard copies of any other reports generated.
10. Process of generating information related to various disclosures.
11. Major exception reports and the process of generation thereof.

12. Major IT related issues resolved/unresolved having bearing on preparation and presentation of financial statements.
13. Significant observation of internal auditors, concurrent auditors, system auditors, RBI inspection and internal inspection, etc related to computerized accounting and overall IT systems.
14. Customer complaints related to mistakes in transactions.
15. Cost of key aspects such as accounting codes, mapping use of various account heads, income recognition, expense valuation etc.

7.11.3 Roles and Responsibilities of Auditors:

1. Review the roles and responsibilities of branch auditor and the control auditors.
2. To the extent possible, data analysis tools are used for better and effective audit.
3. Test of auditors and substantive checking of sample transactions are carried out at the branch level and, where considered necessary, the results are shared with the head office auditors.
4. Significant observations having bearing on the true and fair view are reported to the head office auditors by the branch auditor.
5. Any other limitations on audit which are required to be reported to the head office auditor by branch auditor.
6. Based on the work undertaken, identify key issues to be taken up with the Audit Committee and the Board of the Bank.
7. Consider whether the significant adverse observation in the periodic system audit reports needs to be considered while framing the opinion of a true and fair view of the financial statements of the Bank.

7.11.4 Internal Control System

The auditor should reduce the risk to an acceptably low level by the performance of substantive procedures by considering the following:

1. The extensive use of IT and EFT systems.
2. The high volumes of transactions processed by Banks.
3. Geographic nature of branches.
4. Complex nature of transactions.

   The internal control systems established by the management are assessed to know the level of audit site involved to reduce it to the acceptable level.

   The principal objective of the auditor is to evaluate the effectiveness of controls.

   Controls are those policies and procedures which the organisation implements to minimize the events and circumstances whose occurrences could result in a loss.

7.11.5 Security Control Aspects

The key security control aspects that an auditor needs to address when undertaking audit in a computerized Co-operative bank include:

i Ensure that authorized, accurate and complete data is made available for processing.

ii. Ensure that in case of interruption due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records.

iii Ensure that the system prevents unauthorized amendments to the programmes.

ivVerify whether “access controls” assigned to the staff-working match with the responsibilities, as per the manual. It is important for the auditor to ensure that access and authorisation rights given to employees are appropriate.

v.Verify that segregation of duties is ensured while granting system access to users and that user activities are monitored by performing an activities log review.

vi.Verify that changes made in the parameters or user levels are authenticated.

vii. Verify that charges calculated manually for accounts when function is not regulated through parameters are properly accounted for and authorized.

viii Verify that all modules in the software are implemented.

ix. Verify that exceptional transaction reports are being authorized and verified on a daily basis by the concerned officials.

x. Verify that the account master and balance cannot be modified/amended/ altered except by the authorized personnel.

xi. Verify that all the general ledger account codes authorised by the head office are in existence with the system.

xii. verify that balance in the general ledger tallies with the balance in the subsidiary book.

xiii.verify that important passwords like that of database administrator and branch manager’s password are kept in sealed covers with branch manager, so that in case of emergency and in the absence of any of them, the passwords could be used to run the system properly.

xiv. verify that the bank takes daily and monthly backups. The backup media should be duly labelled and indexed properly and should be maintained under joint custody.

xv. Ideally, daily backup should be taken in 6 sets, one for each weekday and 12 sets for each month end.Verify that backup register is maintained and updated.

xvi. Verify that the backup media is stored in a fireproof cabinet secured with a lock and key and also that the off-site backups are preserved for an emergency.

xvii. Verify that the anti-virus software of latest version is installed in servers/PCs of branches to prevent data corruption, and is being regularly updated for new viruses.

xviii. Verify that security patches are applied to systems as and when they are released by the vendors / developers.

xix. Verify that access to the computer room is restricted to authorised persons only.

7.11.6.Outsourcing of Financial Services

Regular audits either by the internal auditors or external auditors of the co-operative bank should assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the bank's compliance with its risk management framework and other requirements. The auditor should accordingly undertake procedures necessary to meet these requirements.

7.11.7 Electronic Payment Transactions

Electronic Payments effected through alternate products/channels are becoming popular among the customers, with more and more banks providing such facilities to their customers. One such initiative by RBI, is mandating additional factor of authentication for all Card Not Present (CNP) transactions. Banks have also to put in place mechanisms and validation checks for facilitating on-line funds transfer, such as: (i) enrolling customer for internet/mobile banking; (ii) addition of beneficiary by the customer; (iii) velocity checks on transactions, etc.

With cyber-attacks becoming more unpredictable and electronic payment systems becoming vulnerable to new types of misuse, it is imperative that the co-operative banks introduce certain minimum checks and balances to minimise the impact of such attacks and to arrest/minimize the damage.

7.11.8 Opening and Operation of Accounts

The use of electronic/online payment modes for payments to merchants for goods and services like bill payments, online shopping etc., has been gaining popularity in the country. The increased facilitation by co-operative banks and prepaid payment instrument issuers, has accelerated the use of electronic modes by customers for payments to merchants which generally involves the use of intermediaries like aggregators and payment gateway service providers. Further, Electronic Commerce and Mobile Commerce (e-commerce and m-commerce) service providers have also been acting as intermediaries by providing platforms for facilitating such payments. In most existing arrangements involving such intermediaries, the payments made by customers for settlement of e-commerce/m-commerce/bill payment transactions), are credited to the accounts of these intermediaries, before the funds are transferred to the accounts of the merchants in the final settlement of the obligations of the paying customers. Any delay in the transfer of the funds by the intermediaries to the merchant"s account will not only entail risks to the customers and the merchants but also impact the payment system. There should be proper guidelines to safeguard the interests of the customers and to ensure that the payments made by them are duly accounted for by the intermediaries receiving such payments and remitted to the accounts of the merchants who have supplied the goods and services without undue delay.

7.11.9 E-Banking

E-banking may be defined as the automated delivery of new and traditional banking products and services directly to the customers through electronic, interactive communication channels. E-banking includes the systems that enable financial institution customers, individuals or businesses, to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the internet. Customers access e-banking services using an intelligent electronic device, such as, a personal computer (PC), personal digital assistant (PDA), smart phones, automated teller machine (ATM), kiosk, etc.

7.11.10Mobile Banking

Mobile banking involves undertaking banking transactions using mobile phones by bank customers that involve credit/debit to their accounts. It also covers accessing the bank accounts by customers for non-monetary transactions like, balance enquiry, 'stop payment' instruction of cheques, transactions enquiry, location of the nearest ATM/branch, etc.

In carrying out an audit of mobile banking transactions, the auditor is primarily concerned about aspects such as authentication procedures, understanding the information security framework, compliances with regulatory requirements, etc.

7.11.11 Authentication procedures for mobile banking transactions

All transactions affecting an account including those which lead to an account being debited or credited should be allowed only after authentication of the mobile number and the MPIN associated with it. Further, the accounts allowed to be transacted through mobile banking should be correctly linked with the mobile phones so as to safeguard against spoofing of the phone numbers. The auditor needs to ensure that the bank has put in place a system of document based registration with relevant details and with mandatory physical presence of the customers, before commencing mobile banking services.

The auditor needs to ensure that the bank has proper infrastructure and information security policy put in place since information security is of paramount importance and critical to the business of mobile banking services and its underlying operations. Therefore, technology used for mobile banking should be secure and should be able to ensure confidentiality, integrity, availability and authenticity. Proper level of encryption should be implemented for communicating between the customer, mobile service provider and the bank. The bank needs to ensure that proper security checks have been made to ascertain the security levels of the service providers. The payment authorisation message from the user’s mobile phone should be securely encrypted and checked for tampering by the service provider or the bank. It should not be possible for any interceptor to change the contents of the message. The statutory auditor should, accordingly, undertake procedures necessary to evaluate the bank's compliance with these requirements.

7.11.12 Compliance with Regulatory Guidelines

Banks need to ensure that the guidelines on KYC norms, anti money laundering, risks and controls in computers and telecommunications, etc., issued by the RBI which apply to mobile banking are also adhered to. The auditor also needs to examine whether the transaction limit, as stipulated by the RBI, is adhered to and imposed on mobile banking transactions.

7.11.13 Basic Approach and Methodology

1. Have you understood the overall IT Policy, IT organization structure, IT Governance framework and control environment of the bank and the relation thereof to the preparation and presentation of financial statements?
2. Have you obtained sufficient appropriate information about the total IT systems in use and the area covered therein?
3. Have you obtained flow charts of activities in relation to data entry, recording, processing, storage and interface in each of the systems? Obtain a list of unprocessed transactions as at the year end.

4. Have you gathered information about the critical IT and manual controls in relation to data processing and data interface, in general, and accounting and preparation and presentation of financial statements in particular?
5. Have you reviewed the process documents for all the critical processes having bearing on recording of transactions and preparation and presentation of financial statements? In case the processes are not documented, have you ensured that written representation explaining the whole process has been taken on record?
6. Have you reviewed the work done by other agencies, such as, internal auditors, concurrent auditors, internal inspectors and system auditors in relation to IT processes and systems? Have you documented significant observations, if any, made by any of the above agencies?
7. Have you enquired about the major breakdowns/corruption in system/data during the year having bearing on the preparation and presentation of financial statements and how the same were resolved? Obtain details of unresolved issues, if any, as at the year end.
8. Have you identified the samples for test of controls and substantive checking? Have you documented the process of sampling and the details of sample selected? Have you taken screen shots of the relevant accounts/data used in sampling?
9. Have you compared the outcome of testing with the financial records? Are you satisfied with the results of test of controls and substantive checking? If not, have you taken some more samples for further testing?
10. If you are not satisfied with the results, has this been escalated to concerned officials and those issues have been resolved?
11. Are there any unresolved issues and have you noted the same for final reporting?
12. Have you documented the entire audit process and significant observation at all stages?

7.11.14 System of Accounting and Record keeping- HO

1. Have you understood the process of creating head of accounts? Are there adequate controls on creating new heads of accounts and closing unused heads of account? Obtain a list of accounts heads created and closed during the year?
2. Have you understood the process of recording transactions in all the heads of accounts including routing/intermediary accounts? Obtain a list of all the routing accounts and purpose and usage thereof? Review the balances held and the ageing of these accounts as at the year end.
3. Have you verified Out of the Book Entries passed at the yearend for the purpose of financial closure and subsequent accounting/reversal thereof?
4. Have you ensured that the balances in the general ledger are tallied with the balances as per the sub-systems used for recording primary transactions? In case of significant differences, ensure that the same is reported in the audit report?

7.11.15 Certain specific aspects – branches

1. In case of deposits have you understood the process of compliance with KYC? Please carry out test check of certain cases and document the test results.
2. In case of deposits, have you understood various types of deposits and carried out test check to ensure the correctness of the interest accrual, application, year endprovisions, TDS calculations, Please document the process and test results.
3. In case of advances, have you understood the different types of facilities offered, the process of monitoring the limits and interest

accrual and application (including yearend provisions) in accounts under various types of facilities? Please document the process and test results.

4. In case of advances, have you understood the process of identifying non-performing assets (NPA) under various types of facilities (cash credit, overdraft, term loan, packing credit, bill purchase and discounting) and segments (wholesale and retail) as well as borrower wise?
5. In case of foreign currency assets and liabilities, have you understood the process of revaluation (as per Accounting Standard /FEDAI guidelines) periodically and at the year end, as the case may be? Please document the process and results.
6. In case of sundry assets and liabilities, have you understood the usage, process of clearance of outstanding items, periodic ageing and reporting and provisioning of old items. Please document the process and test results.
7. In case of day to day operating expenses, have you understood the process of accounting, payments, TDS calculation and year end provisioning.Special care needs to be taken for the provision of expenses as at the year end. Please document the process and test results.
8. In case of fixed assets have you understood the process of the entire process of purchasing fixed assets and the capitalization and amortization thereof? Please document the process and test results.
9. Have you understood the process of maturity-wise classification of assets and liabilities of the bank? Please document the process and test results.
10. In case of data migration from one platform to another platform have you verified that the same was error free and there were no pending

issues having bearing on the preparation and presentation of financial statements?

11. In case of errors spotted during the audit, have you enquired about the primary reason/s and specific pattern/s, if any for the errors? (In computerized accounting, due to automated data processing, it is quite likely that there are some primary reasons and some patterns behind the errors which, if not detected, could lead to serious misstatement in the financial statements.) Please document the process and test results.

7.11.16 Check list for an audit in computerised environment

Auditors need to verify the system software and version being operated at the branch. It is advised to obtain the licensed copy of the software along with the documentation provided by the vendor and compare the same with the software running in the live environment. To carry out verification the auditor may look into the following:

a) The software register to check whether all the softwares in use are entered and maintained desktop-wise.
b) Note the Name and Version of the software currently in use.
c) Whether it is the latest version of the software authorised by the Central Office of the Bank to be used.
d) Installation of the Software is in accordance with the directions issued by the Central Office.
e) All the modules of the software are properly installed and are working. If any module is not in use presently,the reason has to be ascertained and documented.
f) Physical verification of the copies of the softwares, documentation and manuals were carried out by internal / concurrent / statutory auditors.
g) The existence of Annual Maintenance Contract is in operation and is duly renewed on the expiry date.

Purchases

Computerisation is a constant process of development and improvement of the previous technology. In this process Banks also upgrade their hardware and software installed to improve the efficiency and provide better service to the customers. There has been a phase of such improvements, where branches operating on Automatic Ledger Posting Machines (ALPM) where upgraded to semi-computerised branches and then to fully computerised branches. The fully computerised branches are now in the process of being upgraded to fully networked branches. The phase is not over and there are still ALPM branches, which are in the process of upgradation. Auditors, in many branches might come across the purchases made for new software during the concerned financial year. To achieve the desired level of satisfaction that the purchase process was in accordance with the guidelines of the Central Office and installation was carried out under the supervision of the appropriate person,the auditor may verify the following:

a) Software register is duly updated with new purchases.
b) Purchase Order was duly filed and purchase was properly authorised and software was obtained from an authorised vendor only.
c) The license of the software, and warranty is obtained and registration with the manufacturer completed.
d) Installation was inspected and completed in the prescribed order.
e) Purchase was atreasonable value.

Logical Access Controls

To ascertain that assets are safeguarded and data integrity is maintained by the computer system, auditors may verify the following:

a) Does security policy address specific capabilities of operating systems and require that the available security features be implemented?
b) Is there a security officer appointed in writing?
c) Does the security officer ensure that the available features have been implemented?
d) Is there a process in place for granting access levels?
e) Do users have only the minimum access level needed to do their job?
f) Are the users' access restricted to specific applications, menus within applications, files, and servers?
g) Is file maintenance a separate access privilege?
h) Is maintenance restricted to a minimum number of persons and is it properly approved and reviewed?
i) Is the password file encrypted?
j) Are methods in place to detect security violations?
k) Can security restrictions be overridden?
l) Are access levels periodically reviewed by the internal auditor?
m) Are procedures implemented to limit the access to workstations after normal working hours?
n) Is modem access protected by a secure system, such as call back?
o) Are the modem numbers changed periodically?

Password Controls

There are few fundamental problems in maintaining the integrity of thePassword, they are:

i. Users for their convenience write down the password, as they are hard to remember.
ii. Users to reduce the burden of remembering cumbersome passwords, opt for easy to use passwords, which are also easy to guess.

iii. Users in routine do not change their passwords at regular intervals.
iv. Users fail to appreciate the importance of having apassword and consequences of it being compromised.
v. Passwords in Banks change hands very fast for the convenience of work.
vi. Certain Access Control Mechanism requires users to enter multiple passwords.
vii. Certain System Software does not store password in the encrypted form.
viii. Passwords are not changed / deleted on the transfer / retirement of the operator / officer in the Master Record of the System Software.
ix. Passwords are transmitted in clear test form, especially in Wide Area Network (WAN).

The auditors are required to take extra caution in verifying the integrity of passwords in the branches. Following issues should be looked into to establish the integrity:

a) Password Register for updating the changes.
b) Passwords secrecy is to be maintained by the following officers of the Bank:
    i. Branch Manager
    ii. System Administrator
    iii. Users
    iv. Authorized Persons
c) The critical passwords, for accepting sensitive jobs are known only to Branch Manager or System Administrator. Sensitive jobs include:
    i. To enter operating systems.
    ii. To take back-ups.
    iii. To monitor disk space.
    iv. To create/edit Master Records.

d) The Operating System Password is kept under dual control of branch Manager and System Administrator. The password should be protected in a sealed cover and opened in the presence of at least two persons. It should be changed at once on being opened.

Day Start-up Activities

Following areas require the attention of the auditor:

(a) Verify that the day start-up activities of a computer system are carried out either by the Branch Manager or System Administrator. It should be properly documented and signed in the register maintained.

(b) Verify the time of commencement of day-start-up activities. It should not be carried out prior to the banking hours.

(c) Verify that all the security checks are performed as per the prescribed guidelines from the Head Office of the Bank.

(d) Verify that Banking date is verified daily and check sum facility is used regularly.

Transaction Controls

Following are the areas the auditor may verify along with going through the manuals in relation to data base management:

a. Date is authorized either by the Branch Manager or System Administrator.

   The control exists in the software to ascertain that the entries pertaining to the current date should only be accepted. There should not be any provision to feed back, dated or future dated entries.

b. In the case of non-usage of terminals, terminals are logged-off.

c. Register for recording problems in the software and suitable actions taken.

d. For only physically present users of the computer system, the requisite terminal/user account is enabled, else the account remains disabled.

e. Special batch reports are printed, checked, authenticated and duly filed.

Personnel Controls

To discourage misuse of funds and such practices, it is important to implement Personnel Controls.The auditor may verify the following to establish that efficient and effective personnel management practices are being followed:

a. The technical competence of the employees of the bank, operating the computer system.
b. Whether adequate training was imparted to the employees in connection with the operations of the software, presently being used in the bank.
c. Whether there is segregation of duties among the bank employees and the process of monitoring the performance of each employee.
d. Whether authorization for amounts entered by the operators are clearly defined and documented.
e. Whether job rotation is carried out at regular intervals.

Day End Activities

Keeping in view, the serious effects on the system software,the auditor may scrutinize the entries on and around the various closing dates of the bank. This verification can be conducted by going through the exceptional report or supplementary generated by the system software. Besides this, auditor should also verify that the following activities are carried out regularly and documented:

a. Day end activities are carried out by either the Branch Manager or System Administrator and are properly documented.
b. Supplementary are checked and special users are deleted.
c. The following functions are completed at the day end:
    i. Minimum balances calculated.
    ii. Products calculated for Current Account (Debit balances)
    iii. Mandatory reports generated.

iv. Fall back procedures activated.
v. Day end back up taken.
vi. Recording of entries in back-up register.
vii. Recording in Log Books.
viii. Filing of reports.
ix. Shutting down of the entire computer system.

d. The data back-ups taken are in safe custody and properly documented.
e. Server room is properly locked and the keys are kept only with an authorised person.
f. The generation of following documents:
   i. Access log
   ii. Supplementary
   iii. Audit Trail
   iv. Transaction number given for each transaction entered.
g. After the business hours of the bank the computer operators perform the following functions:
   i. Supplementary report is printed either bythe Branch Manager or System Administrator and filed.
   ii. Cash Denomination Report is printed and filed.
   iii. Vouchers are tallied and signed either by the Branch Manager or System Administrator.

Parameter/ Master File

Parameters/ Master is a quantity constant but could vary for different cases. In banks, we come across various types of accounts with different guidelines to operate them. In a Parameter/ Master File, all the relevant information related to that particular account isbeing fed and stored. The information would relate to the Rate of Interest to be applied, Penal Interest to be charged, Commission Rates, Operation Limits in case of loans, Nature of operation of account, single / jointly etc. This exercise is carried out at the first stage of implementation of computerisation of the branch. Thereafter, the system software behaves according to the parameters enforced currently or as per the latest circulars. It is important to check that Parameter/ Master File if accessible to the operators should only be in read-only format, else it would invite undesirable modifications, which would lead to revenue leakage and misuse of funds. Whenever any alterations are to be made in the Parameter/ Master File, printouts of the file prior to the changes and after the changes should be taken and documented in the safe custody of Branch Manager.The auditor should verify the following:

a. The authorized personnel has marked all the bank holidays in the software at the beginning of the financial year.
b. Operation limits and authorization levels are defined clearly for the operators and supervisors.
c. The parameters for interest and bank charges are defined in accordance with the relevant rates and guidelines. The file is updated as and when changes are announced.
d. Printouts of the parameter file are taken out before and after the changes are given effect and documented.
e. The safe custody of the printouts arewiththe Branch Manager and alterations entered inthe“Parameter Register".

e-Banking/Internet Banking Procedures

1. Identify the bank’s current and planned e-Banking activities and review the bank's public internet websites. Consider whether the bank provides the following types of services:
    a. Telephone banking
    b. Retail internet banking services
    c. Corporate/ wholesale internet banking services

   d. Internet Services Provider (ISP)
   e. Brokerage services over the internet
   f. Insurance service over the internet
   g. Trust services over the internet
   h. Account aggregation
   i. Electronic bill payment
   j. Other activities (e.g. Web portals, financial calculators, cross-marketing arrangements and alliances, unique services, etc.)
2. Review prior audit reports related to e-Banking, including compliance, information technology and other examination areas that may be relevant.
3. Determine if material changes have been made to e-Banking products, services, or operations since the last examination and if any significant changes are planned in the near future.
4. Determine if the bank operates the Web site(s), e-Banking system(s) or core data processing system(s) internally and whether any activities are outsourced to a vendor. Identify the location of the following operations:
   a. Design and maintenance of the bank's public web site or home page.
   b. Computer/ server for the bank's public web site.
   c. Development and maintenance of the bank's electronic banking system(s).
   d. Computer/ server for the bank's e-Banking system(s).
   e. Customer service (e.g., call center) for electronic banking services.
   f. Electronic bill payment processing or other ancillary services.
5. If the bank operates the e-Banking system or core data processing system in-house, review the topology (schematic diagram) of the systems and networks, and determine whether there is a direct, on-line

connection between the bank's core processing systems and the electronic banking system.

6. If the bank operates the e-Banking system or core data processing system in-house, review the transaction process flow between the e-Banking system and the bank's core processing systems and identify key control points. Determine whether information is exchanged in a real-time, batch (overnight), or hybrid processing mode.
7. Determine the adequacy of risk management for e-Banking activities. Given the level of risk of the institution the following procedures are to be evaluated:
   a. Adequacy of policies and procedures governing e-Banking activities.
   b. Adequacy of internal controls and security for e-Banking activities.
   c. Adequacy of audit coverage for e-Banking activities.
   d. Adequacy of monitoring and compliance efforts.
   e. Adequacy of vendor and outsourcing management.
8. Determine the impact of any deficiencies on the financial condition of the organization.
9. Determine the extent of supervisory attention needed to ensure that any weaknesses are addressed and that associated risk is adequately managed.

Adequacy of Internal Controls:

1. Are updates and changes to the bank's public website(s) made only by authorised staff and subject to dual verification?
2. Are website information and links to other websites regularly verified and reviewed by the bank for:
   a. Accuracy and functionality
   b. Potential reputational, compliance, and legal risk
   c. Appropriate disclaimers
3. whether operating policies and procedures include:

a. Procedures for, and controls, over opening new customer accounts submitted via electronic channels to verify potential customer identity and financial condition.

b. Procedures for administering access to the electronic banking system (eg: customer passwords, PINs, account numbers).

c. Requirements for review of or controls over wire transfers or other large transfers initiated through the electronic banking system for potentially suspicious activity.

d. Appropriate authorizations for electronic debits initiated against accounts of other institutions, if such transfers are allowed.

e. Depending on the type of account, dollar limits on transactions over a given time period initiated through the electronic banking service: f. Reconcilement and accounting controls over transactions initiated through the electronic banking system, including electronic bill payment processing.

4. Do written information security policies and procedures address electronic banking products and services?

5. Are business recovery procedures adequate? Consider whether the procedures address:

   (a) Events that could affect the availability of the electronic banking system, such as system outages, natural disasters, or other disruptions.

   (b) Planned recovery times that are consistent with the degree of importance of the electronic banking activities to the institution.

   (c) Whether the management has established an incident response plan to handle potential system security breaches, website disruptions, malicious tampering with the web site, or other problem situations.

6. Has the bank or service provider implemented a firewall to protect the bank’s web site

7. Are ongoing monitoring and maintenance arrangements for the firewall in place to ensure the firewall is properly maintained and configured?
8. If the bank uses a turnkey e-Banking software package or outsources to a service provider:
    a. Are the bank staff familiar with key controls detailed by the vendor's security and operating manuals and training materials?
    b. Are workstations that interface with the service provider's system for administrative procedures or transfer of files and data kept in a secure location with appropriate password or other access control, dual verification procedures, and other controls?
9. Does the bank's administration of access to the e-Banking system by bank staff and customers include:
    a. Procedures to ensure that only appropriate staff is authorised to access e-Banking systems and data, including access to any workstations connected to a remote system located at a service provider?
    b. The length and composition of passwords and PIN ?
    c. Encryption of passwords and PINs in transit and storage?
    d. The number of unsuccessful logon attempts before the password is suspended?
    e. Procedures for resetting customer passwords and PINs?
    f. Automatic logoff controls for user inactivity?
10. Have security vulnerability assessments and penetration tests of e-Banking systems been conducted and results reviewed by the bank?
11. Has the bank or its service provider established:
    a. An intrusion detection system for e-Banking applications?
    b. Procedures to detect changes in e-Banking files and software?
    c. Measures to protect the e-Banking system from computer viruses?

d. Procedures for ensuring an ongoing basis that e-Banking applications, operating systems, and related security infrastructure incorporate “patches” and upgrades that are issued to address known security vulnerabilities in these systems?

12. If e-mail is used to communicate with the customers, are communications encrypted or does the bank advise customers not to send confidential information via e-mail?
13. whether adequate summary-level reports are made available to the management to allow the monitoring of:
    a. Web-site usage
    b. Transaction volume
    c. System problem logs
    d. Exception
    e. Unreconciled transactions
    f. Other customer or operational issues
14. Has the management established adequate procedures for monitoring and addressing customer problems regarding e-Banking products and services?
15. Does the management accurately report its primary public web-site address on the Report of Condition?
16. Have the required Suspicious Activity Reports involving e-Banking, including any computer intrusions, been filed?
17. Areeachand every significant vendor, service provider, consultant, or contractor relationship involved inthe development and maintenance of the e-Banking services covered by a written, signed contract? Depending on the nature and criticality of the services, dothe contracts specify:
    a. Minimum service levels and remedies or penalties for non-performance.

b. Liability for failed, delayed, or erroneous transactions processed by the service provider and other transactions where losses may be incurred (e.g. insufficient funds).

c. Contingency plans, recovery times in the event of a disruption, and responsibility for back-up of programs and data.

d. Data ownership, data usage, and compliance with the bank's information security policies.

e. Access by the bank to the service provider's financial information and results of audits and security reviews.

f. Insurance to be maintained by the service provider.

18. Has the legal counsel reviewed the contracts ensure that they are legally enforceable and that they reasonably protect the bank from risk?

19. Has the bank ensured whether any service provider responsible for hosting or maintaining the bank's web-site has implemented:

    a. Controls to protect the bank's web site from unauthorized alteration and malicious attacks?

    b. Procedures to notify the bank in the event of such incidents?

    c. Regular back-up of the bank's web-site information?

20. Depending on the nature and criticality of the services, does the bank conduct initial and periodic due diligence reviews of service providers, including:

    a. Reviewing the service provider's standards, policies and procedures related to internal controls, security, and business contingency to ensure they meet the bank's minimum standards?

    a. Monitoring performance relative to service level agreements and communicating any deficiencies to the service provider and to bank management?

    b. Reviewing reports provided by the service provider related to response times, availability/ downtime, exception reports, and capacity reports and communicating any concerns to bank management and the vendor?

c. Periodically reviewing the financial condition of the service provider and determining whether back-up arrangements are warranted as a result?
d. Conducting on-site audits of the service provider if appropriate based on the level of risk?
e. Ensuring the bank staff receives adequate training and documentation from the vendor or service provider?

21. If the bank operates a turnkey e-banking software package:
    a. Is the software held under an escrow agreement?
    b. Has the bank established procedures to ensure that relevant program files and documentation held under the software escrow agreements are kept current and complete?
22. If a vendor maintains the bank's electronic banking system, does the bank monitor on-site or remote access of the bank's systems by the vendor, through activity logs or other measures?

Evaluation of Operation System

1. Obtain or prepare logical and physical diagrams of the operating system and attach local and wide area networks.
2. Document the operating system domain(s), identifying the Primary Domain Controller (PDC), Backup Domain Controller, and any other operating system servers or significant operating system workstations participating in the domain.
3. Using the information obtained in the prior steps, document the server and directory location of the significant application programs and data within the network; document the flow of transactions between systems and nodes in the network.

4. Using the Server Manager utility, review all trusted domains assigned to the audit domain and include these trusted domains within the audit scope.
5. Assess whether the trusted domains are under the same physical and administrative control and are logically located within the same sub network.
6. Determine whether router filtering is being used to prevent external network nodes from spoofing the IP address of a trusted domain.

User Security

Determine whether the user log in identification and authentication process is orderly configured and that users are assigned to operating system groups which are consistent with their job requirements for system access.

Obtain the documented security policies and procedures for the operating system server environment. Use the User Manager utility to display the global log in accounts security parameters and review and assess the following settings:

a. Forcibly disconnect remote users (forces users to log off the system after a predetermined limit of time)
b. Minimum password age in days
c. Maximum password age in days
d. Minimum password length
e. Password uniqueness (number of past passwords disallowed for future use)
f. Account lockout after X number of bad log on attempts

g. Account lockout—reset the bad log on count after X number of minutes
h. Account lockout duration—require administrator to unlock or automatically unlock after X number of minutes.
i. User must log on to change password (may allow or restrict users with expired passwords from logging on and changing the password themselves or requiring an administrator to change the password for them)

Determine whether the Administrator (super user) and Guest accounts havepasswords assigned to them (by attempting to log on without providing a password). Also ascertain that the Administrator account password is well controlled and used/ known by only the system administrator and one backup person.

Using the User Manager utility, review the following account properties settings active in every user's individual profile, which may override the global account policy:

a. Full name (should be used to facilitate ID management)
b. Description (job, department, etc.)
c. Change password at next log in (should be used for new users' initial log in)
d. User cannot change password (forces administrator to manage the password: may be used for vendor and other third-party accounts)
e. Password never expires (may be used to override the global restriction in the Accounts Policy)

f. Account disabled

g. Account locked out

h. Groups (cross-reference to group's audit procedures)

i. Profile (each user should have a home directory, path statement, and log in script)

j. Hours (log in time restrictions)

k. Log on to (restricts workstations from which the user may log in from)

l. Account (specifies local or global and may specify an expiration date)

4. Using the User Manager utility, review and assess User Rights assigned to groups and individual users.

5. Use the User Manager utility to view and assess membership in the sensitive built-in groups: Administrators, Domain Administrators, and Account Operators. Assess the appropriateness of users assigned to these groups.

6. Using the User manager utility, document the user memberships in groups which are used to grant access to resources with audit significance (application program and data directories and files), cross-reference to review file system security audit steps, and assess appropriateness of every user’s membership in groups.

File System Security

To ensure that significant system and application program and data resources are protected from unauthorized access and modifications.

1. Review the file system directory trees to ensure that only operating system file systems are being used on servers within the audit scope (since any other file system type, DOS or other, cannot be controlled by operating system security with the exception of operating system share security).
2. Using the File Manager directory, tree directory, tree utility, list out the Security Permissions for all system directories and significant application programs and ensure whether directories perform the following:
   a. Determine whether the owner of all operating system directories is the Administrator account.
   b. Determine whether application program and data directories are owned by a restricted application owner account of the operating system Administrator account.
   c. Review and assess permissions assigned to groups and individual accounts, noting that Full Control (all permissions) and Change (Read, Write, Execute, and Delete) permissions are restricted to authorized users (cross-reference groups to earlier step, identifying users with the groups they belong to).
   d. Determine whether Change permissions and Take Ownership permissions are restricted to Administrative accounts and groups.
   e. Using the File Manager directory, identify all shared directories (directories made available to users the network). Review and assess Share permissions assigned to these directories on a group or user basis.

Operating System Audit and Logging

To determine whether adequate detective controls have been configured and that the information generated by these controls is being reviewed and followed upon:

1. Using the User Manager utility, review the Audit Policy options in effect for the domain (and server, if applicable). Normally, all failure conditions should be audited.
2. Using the Event Viewer utility, review the audit log for suspicious events and follow up on these events with the security administrator.

Operating System Services

To ensure that only necessary, secure services are active in the operating system environment:

1. From the control panel, click on the services option and review all active or dormant services. Identify the purpose and necessity of each. Unnecessary services should be disabled.
2. Ensure that each service, logs on to his own account other than the system account unless the service requires the system account. Audit the permissions granted to each service account.
3. Determine that each service account has the advanced user right, called logon as a service.

Operating System Networking

To determine whether the network and network services are protected against unauthorized access and use:

1. Identify all necessary NetBIOS (Net Binary Input Output System) services offered on each server. Access the propriety of each and ascertain if it is running as a non-privileged service account, unless the service requires the system account.
2. Review router configurations for routers that connect the operating system network to external networks. Ensure that the specific TCP/UDP ports are blocked or altered to restrict Net BIOS traffic coming into and going out of the network.
3. Identify all active, native, and third-party TCP/IP network services active on the operating system server. Audit the security of each service.

The Operating System Registry

To review the security over system and program control parameters in the operating system registry:

1. Review the operating system directory and file permissions over system and program control parameters in the operating system registry.
2. View the registry permission for the major system and program keys and sub keys to ensure the following:

a. Whether the administrators' local group owns each key

b. Whether the owner group and system global group have full access permissions.

c. Whether the global group called everyone, has restricted special access permissions.

Automated Teller Machine

It houses one of the primary assets of the Bank - cash which is to be recognized by the auditor in his scope of work. While verification of cash in the ATM is one aspect, the operational efficacy should be responsive to the policy of the Bank and the standard operating procedures including the directives of the Reserve Bank of India.

Few ATM frauds are reported till date but these have no implications on their occurrence. Banking business deals with money and ATM is one part of its service. The auditor needs to view thisservice with the same critical eye as any manual cash management. Following aspects of internal control in relation to ATMs may be ascertained and evaluated by the auditor.

Pre-installation Stage

1. Board's sanction of ATM installation service.
2. ATM installation complies with the strategic information technology plan of the Bank.
3. Purchase of ATMs need to be driven through the same formality as the purchase of asset of the bank like floatation of tenders, etc.
4. Location of the ATMs both attached in branches as well as independent locations should be finalized to achieve the aim of bank’s investment in this service.
5. All requisite permissions and licenses should be obtained by the Bank including communication to the Reserve Bank of India.
6. Environmental preparations should be made considering legal, security and operational issues. Environmental policy should also be set in writing to permit standard environment with sufficient provision to permit customization necessitated by location peculiarities.

7. The estate department of the Bank or an independent architect should certify to the Estate department about the quality and appropriateness of translation of set policy at each of the ATM location.
8. Cash replenishment policy needs to be finalized before operating any of the ATMs. This can be a set policy or a contingent policy determined by the number of ATM units set up by the Bank. Cash replenishment can either be managed by the Bank itself or it can be outsourced. With the Bank itself it can either be done by a Central or Regional office or a nodal equivalent branch in which case, the ATM cash balance is reflected in the books of this Branch. The various alternatives should be evaluated and selected.
9. If the cash management of ATMs is to be outsourced, similar procedure should be adopted by invitation of either open tenders or inviting tenders.
10. Insurance of cash in ATMs should be negotiated with insurance companies and if the number of ATM is numerous, select insurance companies may be invited to bid.
11. Application software should be able to communicate with the ATM software and this delicate requirement should be specifically mentioned in the agreement with the ATM vendor and application vendor since their cooperation is essential at this stage.
12. ATM software, its operation and reflection in the main application should be software tested either internally or through a professional firm before operations commence.

13. Cash replenishment policy should be set ensuring that the maximum limit set per ATM is not exceeded.

Operational stage

1. Is the security manual in place describing the security measures to ensure at the time of replenishing cash in the ATMs?
2. Are all the staff involved in cash transfers screened thoroughly and their photos and prints taken? In case of a contract, does the service vendor follow similar formalities? This should be periodically checked by the Bank and this point needs to be have been specifically made in the agreement with him.
3. Is the process of allocation of ATM cards secure?
   a. Are the Personal Identification numbers (PIN) generated randomly?
   b. Are the PIN cards printed in a manner that no staff is able to read them without tearing open the seal?
   c. Are the cards and PIN numbers sent separately? Popular delivery mode is delivery of card only through a courier agency. The PIN number is physically delivered through the branch. In case the PIN number is also to be delivered, it should be given on a later date and that too through another courier agency.
   d. Courier agency should be under separate contract to fulfill the extra formality of identification confirmation of the person accepting the card with the strict instruction to hand over the card only to the person to whom the card is allotted.

e. Bin filling exercise should be done in the presence of at least two persons who should not only supervise each other to ensure that the correct denominations are inserted in the correct bins.

f. User report if available on the 'special service ATM card' should be obtained and filed for future reference. This should ideally record the time and date of opening the ATM machine presumably to replenish it. Along with this, the cash balance after replenishment should also be printed.

g. Cash shortages should be thoroughly investigated with full reference to the server report and compared with the ATM's log available on site of ATM.

h. All cards should be changed after a period say 2 years to allot cards only to regular users thus diminishing the risk of the cards of non users.

4. Whether surprise checks are carried out by the vendor or the Bank's departmental officer to ensure that the amount and time of currency replenished as reflected in the register is accurately recorded.

5. Whether schedules of currency replenishment are not static and are changed on each occasion randomly to ensure that there is no definitive pattern.

6. Whether ATMs providing additional service like refilling phone cards or e- transfers etc. are system audited periodically.

7. Whether the bank has a system to thoroughly report and investigate complaints regarding non-performance of services.

8. Whether Cash in ATM and Cash in transit insurance is kept alive at all times.

   (Refer Circular No. 27/2017and 29/2017 of Registrar of Co-operative Societies)

CASH DEPOSIT MACHINE (CDM)

The account holder need not visit the branch to deposit the cash if CDM is available at nearby places.It is an ATM like machine,which allows the customers to deposit cash in their account using the ATM cum debit card.The depositor shall get a receipt showing details of deposits as well as the balance outstanding in the account.The important features of cash deposit machine are:

(i)Instant credit of cash deposit in to one's accounts
(ii)Quick and convenient
(iii)Saves the time on account of visit to the branch
(iv) Paper less
(v)Limits the transaction,ieRs 49900 for card less deposit and Rs 2 lacs through debit card having PAN number
(vi)CDM accepts denominations of Rs.100,500 and 2000/- as of now.
(vii)Up to 200 currency notes can be deposited in a single transaction.

Banks often charges on more number of transactions.Upto three transactions no charges shall be made.If it is more than three,Rs.50+GST shall be charged (SBI rate subject to change from time to time)

The auditor shall verify the following:

(i)Whether the details of cash receipts from CDM is incorporated in the Day book, General Ledger and personal Ledger.
(ii)Whether the amount of cash receipts through CDM is reconciled with deposit statement on a daily basis.
(iii) Whether the institution has taken sufficient insurance policies in order to safeguard the risk involved.
(iv)Verify whether sufficient security mechanism such as CCTV and securityguard is provided in the CDMroom.
(v)Check whether the institution has created reserves /provisions for anykind of loss of cashfromCDM.

CHAPTER-VIII
DEPRECIATION AND RESERVES

8.1. 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 the "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, i.e. 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 objectives 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 the replacement of a wasting asset. Unless depreciation is provided periodically and annually and the amount is 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 as per Registrar's Circular No. 26/72 in file ADL(1) 21274/72 dated 5-6-1972 and 5/2003 dated 23-01-2003 (depreciation of computers).

8.2. 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.

8.3. 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 should be added to the value of asset, and rate of depreciation to be written off should 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 installment 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 for 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) *Fixedinstallment 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 should 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 installment or diminishing balance method :*This system is adopted with a view that every year the profit and loss account should 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.

8.4. How to charge depreciation

(i)*Building*-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, may be constructing 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 that 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. 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.*(ReadCircular No. 26/72, 101/75 of Registrar)*

(ii) *Furniture and equipment's* : The value of furniture and equipment, 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 the 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 the 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) Computer Hardware

The depreciation in respect of computers is to be charged in accordance withthe circularno:5/2003dated.23.01.2003of Registrar of Co-operative Societies. As per the circular, the depreciation tobe charged is as follows:

1st Year – 34%

2nd Year - 33%

3rd Year - 33%

Thus the value of computers purchased by the Co-operative Societies will be wiped off within 3 years.

(v) Depreciation for Software:

Generally software is classified into two categories, System software and Application software. System software is the software which makes the hardware functional. This type of software is amortized over the useful life of the hardware to which it is attached. The percentage of depreciation is same as that of the hardware.

Application software is independently depreciated over the useful life of the software. The anticipated useful life shall not be greater than three years. Renewal charges or AMC charges are written off in the year of use/payment itself on the basis of accounting principles practiced in the country.

(vi) WebSitedevelopment :

The treatment of charges for website development depends on the contract with the website developer and materiality of the amount spend for such website development.

Website development charges shall be written off in the year in which it is developed, if not so material. The updationcharges for the website shall be charged as expense during the year in which website is updated.

(vii) *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.

8.5. 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.

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 pecific 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 realizing 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 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 and 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.

7. *Revaluation Reserve*

The land purchased years back will depict only the book value paid at the time of purchase, but the assetvalue would have increased many times. Hence, the value of immovable properties will show only areduced rate. As per circular no RBI /2008-2009/490 from RBI,Banks can appreciate the value ofland through revaluation procedure and revaluation reserve shouldbe created. (RPCD. Co.RF.BC.No.112/07.03.02/2008-2009 dated 3rd June 2009)

II. *Statutory Reserves*

(a)*Reserve Fund*:Reserves in co-operative institutions are being created with a view to strengthen 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 Section 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 Kerala Cooperative Societies Rules.

(b)*Co-operative Education Fund*:Sub clause (b) of clause (1) 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 percent (5%), as may be prescribed, to the Co-operative Education Fund referred to in clause (xix) of subsection (2) of Section 109". As per sub rule 2(a) Rule 53 of Kerala Cooperative Societies Rules, the Cooperative education fund is appropriated from net profit subject to a minimum of Rs. 2000/- and maximum of Rs. 60000/- per annum.

The constitution, maintenance and administration of Co-operative Education Fund has been specified in Rule 53 of the Kerala Cooperative Societies Rules.

(c)*Member Relief Fund*: The Sub clause (1) (c) of section 56 lays down that " A society shall out of its net profits in any year transfer an amount of ten percent (10%) of the net p rofitsubject to a maximum of one lakh Rupees to be credited to the member relief fund. (Read Circular No. 25/2015 of Registrar of Co-operative Societies)

8.6. ***Other Reserves:-***

(a)*Agricultural creditstabilisation fund*

The subclause (c) of Subsection (2) of Section 56 lays down that a society may outof its net profits, in any year, credit 7(seven) percent of the net profit to agricultural credit stabilization fund . Sub Rule (3) of Rule 53 of KCS Rules provides the manner in which the Agricultural credit stabilisation fund is to be constituted and utilized. The auditor should verify the constitution as well as the utilization of the fund with reference to the scheme approved by the Government.

(b)*Professional Education Fund*

Professional Education Fund is maintained by the Registrar, which is accumulated by means of the contribution of co-operative Societies at a rate of 5% from their net profits.The Government have approved a scheme for the utilization of the fund. (Read Circular no.62/2013 of Registrar of Co-operative Societies).

(c)*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 byelaws, may set apart an amount not exceeding ten percent (10%) 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.

(d)*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.

(e)*Building Fund*: The allocation to this fund is not mandatory if not provided in the byelaws. 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.

(f)*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 by credit societies but also by non-credit societies, which have provision in their bye-laws for credit sales.

(g)*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.

(h)*Wages Equalisation Fund*: Allocation to this fund is permissible but not mandatory unless provided in the bye-laws. 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.

(i)*Reserve for depreciation of investments*: This kind of reserve is provided mainly for 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 outstanding) 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.

(j)*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 utilization of this reserve. Hence the auditor should ascertain whether administrative sanction has been obtained by the society for its utilisation.

(k)*Provision for gratuity*:Circular No. 85/75-ADL (I)-49283/75 of the Registrar of Co-operative Societies explains in detail the guidelines to be followed by the auditors for creating provision for payment of gratuity to the employees. The auditors may strictly follow those guidelines in this regard.

(l)*Land recoupment Fund*:- The amount spent for the purchase of land out of general funds is to be recouped in the forth coming period. Usually the sanction for purchase of land may be on condition that the amount shall be recouped within a specifiedperiod, the auditor shall verify the sanction order and ensure that the amount spent is recouped.

(m)*Building recoupment Fund*:- Building fund is created through appropriation of net profit or through contributions from members for building proposes. If general fund is utilised for building construction that is to be recouped.The sanction order shall be conditional that the amount should be recouped within a specified period and the general fund is released.

8.7. Non-statutory Reserves:

(i) *Reserve for deficit stock :*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 of, 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 caused book value less depreciation of the sale price and 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 realizable 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 , the 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 the 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 sections of the community.

Loans issued for agricultural production alone are 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*:-Incometax liability for a particular financial year/ accounting year is assessed on the profits earned during the preceding accounting year. So the auditor has to make provision for incometax, 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 incometax for a particular year is debited to the profit and loss account of the same year. If, on the last day of the year, the tax is pending, payment is to be shown as liability in terms of the order of assessment of the incometax 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 of 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, GST, 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 of the affairs of the institution.

No. ADL (2) 12314/75 Office of the Registrar of Co-operative Societies,
Trivandrum, dated.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 has 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 the 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 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 are applicable for other assets acquired, utilizing the General Funds which are to be recouped in subsequent years.

CHAPTER -IX

VERIFICATION AND VALUATION OF ASSETS

9.1(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. Interest received and receivable shall be compared with the amount of investment or loans disbursed and outstanding and see that the rate of interest is in compliance with the rate fixed by the regulators.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. Cash balance kept at ATM and CDM should also be included in the closing balance at the end of the year, and should be verified and certified by the auditor with proper reconciliation.

(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 a 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 followed in the valuation of these typeof assets is to show it in the balance sheet at its original cost and provision made for depreciation.

9.2. 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. 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 the 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) *Electronic items*

Most of the cooperatives now-a-days have some stock of electronic equipment, especially computer hardware which should be assessed and valued by the auditor and should ensure that they are properly classified in the appropriate heads of accounts. The stock register should also be verified by the auditor in order to ensure that they are properly accounted and documented.

(vii) (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. In case of revaluation the appreciated amount should be shown separately in the Balance Sheet.

The building should appear in the balance sheet at original cost. Depreciation reserve created should be shown on 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 tenant'sagreement 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.

(viii) *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 a 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.

(ix) *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 equipment should be obtained and the total agreed with the amount appearing against the item in the balance sheet.

(x) *Library books*: Purchase of costly books especially reference books 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.

(xi) *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.

9.3. *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 case of DMAT accounts, the auditor should verify the confirmation statements obtained from the Depositary.

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.

9.4. 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 custodian of stock,manager/ Secretary / andPresident/Vice president andDirectors of the co-op society. 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 Dispatched 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, ie., 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 subjected 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*:-These arise due to inefficiency, negligence, mischief or such losses that 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 the 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) ie., indirect or over head 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 totaling 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 deducted 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, i. e, 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 the President, Chief Executive and theBoard of Directors.

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. *In the case of Deficit Stock* : The auditor after valuing and verifying the closing stock should make an assessment of the trading transactions which should be capable of exposing the true picture of trading activities. If any deficit is noticed he should make a specific report on it and send a special report to the Audit Director or to the officers concerned clearly specifying the persons responsible for deficit.

(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 byproducts. 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.

9.5. *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 i.e, 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, i.e, 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 expenseetc. The auditor should be careful to see that any balance of stock of consignment inwards is not included in the stock list.

9.6. 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 has been taken place.

(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. The auditor should be cautious about pending advances that heshould verify the reason for the payment of advances as well as the frequency & period of advances.

(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.

9.7. 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 installments 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. The auditor shall verify the loan manual or sub rules and ensure that the terms conditions are complied properly by the society.

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 reliability. 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 S 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 installments he should examine whether all the previous installments 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 installment 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 importantworkof the auditor. Outstanding loans and advances in banks and credit societies consist of current dues and over dues. An overdue account is one in which the principal outstanding or any portion thereof or any installment 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 installments, new goods being supplied for cash.

[the payment of an old balance by installment 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 scrutinized with reference to the security available and the age of the overdues. After careful examination of all overdue 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. In the case of Co-operative Banks regulated through BR(Act) classification of debts should be based on the norms prescribed by RBI/NABARD and NPA Statement should be obtained andverified by the Auditor, in accordance to the circular directions of RBI/NABARD.

(ix) *Procedure for writing off of bad debts statutory provisions:*Rule 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 G311491/75 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 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 must be instituted against persons found to be negligent.

The following additional conditions are also to be fulfilled for writing off bad debts:

(i)Prior sanction of the General Body must be obtained.

(ii) Prior approval of the Registrar and the financing bank to which the society is indebted must be 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.

9.8. 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.

9.9.Verification of cash balance

i Cash on hand

This is the first item of work to be attended to by the auditor while checking 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 andsatisfy 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. “Incomplete Cash book” is not an excuse for postponing the cash balance verification. 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 Society or in the premises of ……………………….

Given under …………… ……………………my hand and seal this……………………day of ……………………… 20…….

Signat.ure………………………..

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 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 on the 31st March… …..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 certificate of all the accounts of the Society with 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 of the reasons for the payment of advance to the members of staff and directors. It should be seen that advances made are genuine and for the 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 -X

VERIFICATION AND VALUATION OF LIABILITIES

10.1. 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.

10.2. 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.

10.3. 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).

10.4. 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.

10.5. 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.

10.6. 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.

10.7. 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.

10.8. 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 the interest receivable has been included in the profits it is necessary that, that portion of interest receivable which is overdue should 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.

10.9. 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.

10.10. Taxation on income of co-operatives

In India the Co-operative Societies have always enjoyed concessional treatment for the purpose of Income Tax. However, each Co-operative Society like any other assessee has to compute income under different Heads of Income and then take permissible deduction.

A Co-operative society under the Income Tax Act is treated as an association of person which is included under the definition of 'persons' under the Income Tax Act 1961. But a Co-operativeSociety is taxed at a rate which is different from those applicable to an AOP. A Co-operative Society is chargeable to tax as per the rates prescribed under paragraph B of Part1 of the First Schedule to the annual Financial Act. The tax amount is increased by surcharge as prescribed in each of the Finance Act. The rate prescribed for the Financial Year 2016-17 is given below:

Upto Rs.10,000	10%
Rs.10,000 to Rs.20,000	20%
Rs.20,000 and above	30%

Computation

Compute the total income under the different heads of income such as

income from home property	******
Profit and gain from business or profession	******
Capital Gain and	******

Income from other sources	******
Gross Total Income	******

Exempted Income U/s 10 is not included in the gross total income as obtained above.

Deduction under Section 80G, 80JJA and 80P are made and net income is arrived. To the net income so arrived at, the rate of tax as per the Finance Act for the respective year is applied. There may be surcharge on tax to be added on the tax to the Co-operative Society if applicable. The tax together with cess/surcharge has to be paid as per the schedule of advance tax applicable for the particular assessment year.

Specified Deductions
Deduction -100% such as of profits
Applicability

A. *A Co-operative Society engaged in :*

a) Business of banking or providing credit facilities to its members
b) Cottage industry
c) Marketing of agricultural produce grown by its members
d) Purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for supplying them to its members
e) Proceeding of the agricultural produce of its members without the aid of power
f) Collective disposal of the labour of its members
g) Fishing or allied activities

Note:-

In case of points(f) and (g) , the Rules and Bye-laws of the society restrict the voting rights to the following members only:

- Individuals who contribute their labour or carry on fishing and allied activities

- Co-operative credit societies providing financial assistance
- State Government

B. *A Co-operative Society being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to:*

- Federal co-operative society
- Government or Local authority
- Government company or corporation established by a Central or State Act

➢ **Deduction of 100% is available for the above two categories**

C. A Co-operative Society engaged in activities other than above two (either independently or in addition to any or all activities so specified)

- In case of consumer co-operative society, such profit and gains do not exceed Rs.1,00,000.

- In other cases, such profit and gains do not exceed Rs.50,000/-.

➢ **Deduction -100% of such profits shall not exceed the limit specified.**

Income –specified deductions

Deduction -100% provided that the GTI does not exceed Rs.20,000

i. Interest on securities or income from house property
ii. Earned by co-operative society, other than:
   - Housing Society
   - Urban Consumers' Society
   - Society engaged in transport business
   - Society engaged in manufacturing operations with the aid of power.

<u>Deduction – 100% of such income</u>

i. Interest or dividends derived from another co-operative society

ii. Income from letting of godowns or ware houses for storage, processing or marketing commodities.

The Finance Act 2006 introduced Section 80P(4) which says that this deduction shall not apply in relation to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

10-11 Goods and Services Tax (GST)

I. Introduction

Goods and Service Tax (GST) is a destination based tax levied on consumption of goods and services. It is levied at all stages (from manufacturer to the consumer) on the value addition of goods and services, with the elimination of multiple taxes leading to seamless flow of credit.

The GST was introduced to simplify tax regime, broaden tax base, eliminate tax cascades, enhance export competitiveness and improve transparency. It intends to transform the country into a single market and making Indian products competitive in the domestic and international market.

A bird's eye view of the GST law is given here as on the month of September, 2019. Since there are changes happening very frequently the latest law may be followed.

II. Concepts and Definitions

1. Meaning of Goods and Service Tax

As per Article 366(12A) of the Constitution of India,**Goods and Services Tax** means any tax on supply of Goods or Sevices or both except on the supply of alcoholic liquor for human consumption.

Goods means every kind of movable property other than money or securities but include actionable claim, growing crops , grass and things attached to or forming part of the land which have been agreed to be severed before supply or under a contract of supply.

Services means anything other than goods, money and securities but includeS activities relating to the use of moneyor its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

2. The ACTs involved in GST

The GST Law consists of the following legislations administered by the Central and State / UT Governments and applicable throughout India:

1. The Central Goods and Services Act, 2017 read with Rules,
2. The Integrated Goods and Services Act,2017 read with Rules,
3. The Union Territory Goods and Services Act, 2017 read with Rules,
4. The State Goods and Services Acts and Rules with respect to each State,
5. Goods and Service (Compensation to states) Act, 2017 read with Rules.

3. Components of Goods and Services Tax

CGST, SGST/UTGST, IGST are the components of GST.

GST in India comprises of Central Goods and Services tax (CGST) – levied and collected by Central Government, State Goods and Services tax

(SGST) – levied and collected by State Government/Union Territories with State Legislatures and Union Territory Goods and Services tax (UTGST) – levied and collected by Union Territories without State Legislatures, on intra state supplies of taxable goods and/or services.Inter-State supplies of taxable goods and/or services are subject to Integrated Goods and Services tax (IGST). IGST is approximately the sum total of CGST and SGST/UTGST and is levied by Centre on all inter-state supplies.

4. *GST Council*

A new constitutional body named GST Council has been created by Government of India for smooth functioning of GST in our country. The council is vested with powers to administer taxation of Goods and Services. The responsibilities include:

a) The administration of GST Laws
b) Specifies the taxes to be levied and collected by Central, State and U T under GST regime
c) Specifies Goods and Services to be exempted under GST regime
d) Specifies the tax rate
e) Specify the threshold limits for registration and payment of taxes
f) Apportionment of IGST between Centre and State
g) Approval of compensation to be paid to the States
h) Levy special rates for a specified period to raise additional resources
i) Resolution of disputes arising out of its recommendations.
j) Imposition of additional taxes in times of calamities and disasters.

5. *Levy of GST*

GST is attracted when the following aspects are involved:

i.There should be goods or services involved

ii.Goods or Services should be supplied

iii.Supply should be between persons

iv. Supply should be in the course of furtherance of business

v. Supply should be for a consideration and

vi. Activities specified in the schedule

Under CGST Act, 2017, items have to be distinguished as goods or services separately. Time of supply or place of supply provisions are prescribed for goods or services separately. More over the rate applicable for supply of goods and services are different.

6. Supply

Supply as per the Section 7(1)of CGST Act, states that, the expression "Supply" includes:

a) All forms of supply of goods or services or both such as sale, transfer, barter exchange, license, rental, lease or disposal made or agreed to be made for a consideration by person in the course or furtherance of business.
b) Importation of services for consideration whether or not in the course or furtherance of business.
c) the activities specified in Schedule I, made or agreed to be made without a consideration and
d) The activities to be treated as supply of goods or supply of services as referred to in Schedule II.

7. Time of Supply (TOS)

The liability of a person to pay GST depends on the time of supply. The tax rates, exemptions and abatements keep changing from time to time.

Thus it is required to know the precise date and time when the charging event takes place.

a. Time of Supply of Goods

Time of supply of goods by a person who is liable to pay GST on the supply shall be the earlier of the following two dates:

The date of issue of invoice or the last date on which the invoice ought to have been issued under section 31 orDate of receipt of payment (the date on which payment is recorded in the books of account of the supplier or the date on which the payment is credited in the supplier's bank account whichever is earlier) , to the extend payment covers the goods.

A composition supplier has to pay, in lieu of tax payable by him, an amount calculated at the prescribed rate applied on his turnover for a quarter.

b.Time of Supply of Services

Invoice issued within the prescribed time period:

Earliest of the following:
Date of issue of invoice by the supplieror
Date of receipt of payment (the date on which payment is recorded in the books of account of the supplier or the date on which the payment is credited in the supplier's bank account whichever is earlier).

Invoice not issued within the prescribed time period:

Earliest of the following:
Date of provision of serviceor
Date of receipt of payment (entering the payment in the books of accounts of the supplier or crediting the payment in bank account) whichever is earlier.

When the above events are unascertainable

Date on which the recipient shows the receipt of services in his books of account

c. Time of supply where tax is payable under Reverse Charge

Time of supply of goods

Earliest of the following:

i. Date of receipt of good, or

ii. Date of payment as entered in the books of accounts of the recipient or the date on which the payment is debited to his bank account, whichever is earlier or

iii. 31st day from the date of issue of invoice.

Time of supply of Services

i. Date of payment as entered in the books of accounts of the recipient or the date on which the payment is debited to his bank account, whichever is earlier or

ii. 61st day from the date of issue of invoice.

8. The liability to pay tax

A registered dealer has to pay tax if:

a.Any advance for Goods/Services are received or

b.Invoice for supply for Goods/Services are raised or

c.Delivery of Goods/Services are made, and if

d. The total GST output taxes are more than total GST input taxes for the month.

9. Place of supply

GST is primarily a destination-based consumption tax which means that the tax collected on supply of goods or services should accrue to the State in which those goods or services are consumed. While for goods, determination of place of supply is relatively easier, it is difficult for services considering the intangible nature of services. Place of supply provisions provide the place where the goods or services are said to be consumed.

10. Interstate sale

Where the selling party and the buying party are situated in different States and the sale has occasioned the movement of goods from one State to another.

11. Presumptive Tax

An eligible registered person can opt payment of tax under presumptive tax (Composition Levy) if the aggregate turnover in the previous year does not exceed Rupees one crore or any such amount as may be recommended by the council.

Such person may pay:

(1) One percent of the turnover in the State or UT in case of a manufacturer.
(2) Two and a half percent of the turnover in State or UT in case the person makes supply under Schedule II 6 (b)
(3) Half percent of the turnover in State or UT in case of other supplies.

The registered person shall be eligible to opt for this only if he satisfies the following conditions:

1. He is not engaged in the supply of services other than that referred to in Schedule II 6 (b).
2. He is not engaged in the supply of goods which are not leviable for tax under the Act.
3. He is not engaged in making any interstate outward supply of goods.

4. He is not engaged in the supply of goods through e-commerce operator.
5. He is not a manufacturer of goods as may be notified by the Government.

Other conditions:

aThe option shall lapse if the turnover exceeds the specified limit.

b The taxable person availing such an option shall not collect any tax under GST and shall not be entitled for any tax credit.

c If a person avails this option even when he is not eligible, the tax shall be levied by a proper officer under Section 73 and 74.

III. Input Tax Credit

Input credit means at the time of paying tax on output, you can reduce the tax you have already paid on inputs and pay the balance amount.

When you buy a product/service from a registered dealer you pay taxes on the purchase. On selling, you collect the tax. You adjust the taxes paid at the time of purchase with the amount of output tax (tax on sales) and balance liability of tax (tax on sales minus tax on purchase) has to be paid to the government. This mechanism is called utilization of input tax credit.

1. *Eligibility for taking ITC*

Everyregisteredpersonshallbe entitledtoITCofGSTchargedoninwardsupplyofgoodsand/orservices.Thisissubjecttotheprovisionsrelatingtouseof ITCundersection49andtheconditionsand restrictionsin therules.

ITC of GST will be available on goods and/or services which are used in the course or furtherance of the business. Thus, tax paid on goods and or/services which are used or intended to be used for non-business purposes cannot be availed as credit. ITC will be credited in electronic credit ledger.

2. Conditions for availing ITC

The registered person will be entitled to ITC on a supply only if ALL the following four conditions are fulfilled:

1. Possession of tax paying document

ITC can be availed on the basis of any of the following documents:

i) Invoice issued by the supplier of goods and/or services

ii) Invoice issued by the recipient receiving goods and/or services from unregistered supplier along with proof of payment of tax, in case of reverse charge

iii) Debit note issued by the supplier

iv) Bill of entry or similar document prescribed under the Customs Act

v) Revised invoice

vi) Document issued by input service distributor

2. Receipt of the goods and / or services

The registered person taking the ITC must have received the goods and/or services. Goods delivered to another person on the direction of the registered person by way of transfer of documents of title or otherwise, either before or during the movement, are deemed to have been received by such registered person. So, ITC will be available to the registered person, on whose order the goods are delivered to a third person.Similarly, services may also be provided to a third party by the service provider (supplier) on the direction of the service recipient (registered person). In this case also, though the service recipient (registered person) does not receive the service, by virtue of explanation to section 16(2)(b) it is deemed that the registered person (service recipient) has received the service. In other words, service provided to any person on the direction of and on account of the registered person, is deemed to have been received by such registered person. So, ITC will be available to the registered person, on whose direction the services are provided to a third person.

3. Tax leviable on supply actually paid to Government

Tax should actually have been paid, by cash or through utilization of ITC, on the goods and / or services for which ITC is being taken. Section 41 allows taking ITC in electronic credit ledger on self-assessment basis.

4. Filing of return

The registered person taking the ITC must have filed his return under section 39.

5. ITC in case of goods received in lots

In case the goods covered under an invoice are not received in a single consignment but are received in lots / instalments, ITC can be taken only upon receipt of the last lot / instalment.

6. Payment for the invoice to be made within 180 days

The registered person must pay to the supplier, the value of the goods and/or services along with the tax within 180 days from the date of issue of invoice. In the event of failure to do so, the corresponding credits availed by the registered person would be added to his output tax liability, with interest. Interest will bepaid @ 18% from the date of availing credit till the date when the amount added to the output tax liability is paid.

However, once the recipient makes the payment of value of goods and/or services along with tax, he will be entitled to avail the credit again without any time limit .In case part-payment has been made, proportionate credit would be allowed.

This condition of payment of value of supply plus tax within 180 days does not apply in the following situations:

a. Supplies on which tax is payable under reverse charge

b. Deemed supplies without consideration

c. Additions made to the value of supplies on account of supplier's liability, in relation to such supplies, being incurred by the recipient of the supply.

7. *If depreciation claimed on tax component, ITC is not allowed.*

6. *Time limit for availing ITC*

Due date of filing of return for the month of September of succeeding financial year or date of filing of annual return, whichever is earlier is the time limit for availing ITC.

ITC is restricted in proportion of the use of the goods and/or services (i) in the taxable and / or zero-rated part of the supply (ii) for business purposes.

Claiming ITC

All regular taxpayers must report the amount of input tax credit(ITC) in their monthly GST returns of Form GSTR-3B. The taxpayer requires to providethe summary figure of eligible ITC, Ineligible ITC and ITC reversed during the tax period.

A taxpayer can claim ITC on a provisional basis in the GSTR-3B to an extent of 20% of the eligible ITC reported by suppliers in the auto-generated GSTR-2A return. Hence, a taxpayer should cross-check the GSTR-2A figure before proceeding to file GSTR-3B. A taxpayer could have claimed any amount of provisional ITC until 9 October 2019. But, the CBIC has notified that from 9 October 2019, a taxpayer can only claim not more than 20% of the eligible ITC available in the GSTR-2A as provisional ITC. This means that the amount of ITC reported in the GSTR-3B from 9 October 2019 will be the total of the actual ITC in GSTR-2A and the provisional ITC being 20% of the actual eligible ITC in the GSTR-2A. Hence, matching of the purchase register or expense ledger with the GSTR-2A becomes crucial.

Reversal of Input Tax Credit

ITC can be availed only on goods and services for business purposes. If they are used for non-business (personal) purposes, or for making exempt supplies ITC cannot be claimed. Apart from these, there are certain other situations where ITC will be reversed.

ITC will be reversed in the following cases:

1) Non-payment of invoices in 180 days

2) Credit note issued to Input Service Distributer by seller

3) Inputs partly for business purpose and partly for exempted supplies or for personal use – This is for businesses which use inputs for both business and non-business (personal) purpose. ITC used in the portion of input goods/services used for the personal purpose must be reversed proportionately.

4) Capital goods partly for business and partly for exempted supplies or for personal use.

5) ITC reversed is less than required- This is calculated after the annual return is furnished. If total ITC on inputs of exempted/non-business purpose is more than the ITC actually reversed during the year then the difference amount will be added to output liability. Interest will be applicable.

The details of reversal of ITC will be furnished in GSTR-3B.

Reconciliation of ITC

ITC claimed by the person has to match with the details specified by his supplier in his GST return. In case of any mismatch, the supplier and recipient would be communicated regarding discrepancies after the filling of GSTR-3B.

ITC for Capital Goods

ITC is available for capital goods under GST.However, ITC is not available for-

i. Capital Goods used exclusively for making exempted goods
ii. Capital Goods used exclusively for non-business (personal) purposes

No ITC will be allowed if depreciation has been claimed on tax component of capital goods.

ITC on Job Work

A principal manufacturer may send goods for further processing to a job worker. In such a situation the principal manufacturer will be allowed to take credit of tax paid on the purchase of such goods sent on job work.

ITC will be allowed when goods are sent to job worker in both the cases:

1. From principal's place of business
2. Directly from the place of supply of the supplier of such goods

Utilisation of Input tax .

i. Credit of IGST is adjusted for payment of IGST , CGST and SGST in that order.

ii. Credit of CGST is adjusted for payment of CGST and balance for IGST.

iii. Input on CGST shall not be utilized for payment of SGST.

iv. Credit of SGST first for SGST and the balance for IGST. Input tax on account of SGST shall not be utilized towards payment of CGST.

Sequence of discharge of Tax and dues by a taxable person in the following order:

i. Self assessed tax and other dues related to returns of previous tax periods.

ii. Self assessed tax and other dues related to return of current tax period.
iii. Any other amount payable under the Act.

IV.Registration

An entity shall register under GST within 30 days from the day when it is liable to take registration.

Section 22 (1) envisages that an entity which **supply goods**,attains an aggregate annual turnover of Rs.40 Lakhs has to register in a State or an UT(in the case of special category state - Rs.20 Lakhs)under GST Act. In the case of an entity which provides **supply of services**, the threshold limit for registration is an aggregate annual turnover of Rs. 20 lakhs (in the case of special category state - Rs.10 Lakhs).

Section 24(vii) envisages that a person making a taxable supply of goods or services or both on behalf of any other taxable persons whether as an agent or otherwise is required to be registered, irrespectiveof the turn over criteria.

If a business carried on by a registered person is transferred to another person by succession or otherwise, the transferee shall be registered irrespective of the turnover.

In the case of an amalgamation or demerger of Companies by the Court of Law, the transferee company shall get registered irrespective of the turnover.

Registration is required only for a place of business from where taxable supply takes place.

Compulsory Registration in certain cases

The following persons have to register even though the threshold limit of turn over is not attained.

1. Person making any inter-state taxable supply (subject to the threshold limit).
2. Casual Taxable Person (CTP) making taxable supply.

3. Person who are required to pay tax under reverse charge. However, persons engaged exclusively in making supplies, tax on which is liable to be paid on reverse charge basis are exempt from registration.
4. Non-resident taxable person making taxable supply
5. Every Electronic Commerce Operator (ECO) who is required to collect tax at source or persons who supply goods or services other than supplies specified under Section 9(5), through such ECO.

   The threshold limit is applicable in case of suppliers supplying services through ECO.
6. Persons who are required to deduct tax under section 51,whether or not separately registered under this Act.
7. Input Service Distributor, whether or not separately registered under this Act.
8. Every person supplying online information and data base access or retrieval (OIDAR) services from a place outside India to a person in India, other than a registered person.
9. Such other person or class of persons as may be notified by the Government on the recommendations of the Council.

Person not liable for Registration

1. Person engaged exclusively in the business of supplying goods/ services not liable to tax ,ie; wholly exempt from tax.
2. An agriculturist, to the extent of supply of produce out of cultivation.
3. Person making inter-state taxable supplies of notified handicraft goods upto Rs.20,00,000/-
4. Casual Taxable Persons making inter-state taxable supplies of notified handicraft goods upto the threshold limit.

V. Documents Involved in GST

1. *Tax Invoice*

A tax invoice shall be issued by a registered person supplying taxable goods or taxable services or both. The time for issuing an invoice would depend on the nature of supply, whether it is a supply of goods or supply of services.

Time limit for issuance of invoice for supply of goods

- The invoice needs to be issued either **before** or **at the time** of removal (where supply involves movement of goods) of goods/ delivery of goods/making goods available to recipient.
- In case of continuous supply of goods, the invoice should be issued **before** or **at the time** of issuance of periodical statement /receipt of periodical payment.
- In case of goods sent or taken on approval for sale or return, invoice should be issued before or at the time of supply or 6 months from the date of removal, whichever is earlier.

Time limit for issuance of invoice for supply of services

- **Before or after the** provision of service but within 30 days (45 days in case of insurance companies/banking and financial institutions including NBFCs) from the date of supply of services.

Revised Tax Invoice

Every registered person who has been granted registration with effect from a date earlier than the date of issuance of certificate of registration to him, may issue Revised Tax Invoices. Suchinvoices shall beissued against theinvoices already issued during said period.Revised Tax Invoices shall be issued within 1 month from the date of issuance of certificate of registration. The words "Revised Invoice" shall be indicated prominently on such invoices.This provision is necessary, as a person who becomes liable for registration has to apply for registration within 30 days of becoming liable for registration. When such an application is made within the stipulated time period and registration is granted, the effective date ofregistration is the date on which the person became liable for registration.Thus, there would be a time lag between the date of grant of certificate of registration and the effective date of registration. For supplies made by such person during this intervening period, the law enables the issuance of a revised invoice, so that ITC can be availed by the recipient on such supplies.

Consolidated Tax Invoice

A registered person may not issue a Tax Invoice if:

1. Value of the goods/services/both supplied is less than Rs.200,
2. The recipient is unregistered; and
3. The recipient does not require such invoice.

Instead such registered person shall issue a '**Consolidated Tax Invoice'**for such supplies at the close of each day in respect of all such supplies.

Thus, small taxpayers, like small retailers, doing a large number of small transactions for upto a value of Rs. 200 per transaction to unregistered customers need not issue invoice for every such transaction. They can issue one consolidated invoice at the end of each day for all transactions done during the day. However, they need to issue an invoice when the customer demands.

2. *Bill of Supply*

A registered person supplying exempted goods or services or both or a registered person paying tax under composition levy, shall issue a bill of supply instead of a tax invoice. These provisions have also been made applicableto a person paying tax at concessional rate under Notification No. 2/2019 CT (R) dated 07.03.2019.

Person opting for composition levy shall mention the words "Composition Taxable person, not eligible to collect tax on supplies" at the top of the Bill of supply issued by him. Similarly, a person opting for paying tax at concessional rate under Notification No. 2/2019 CT (R) will have the following words at its top - 'Taxable person paying tax in terms of Notification No. 2/2019 CT (R) dated 07.03.2019, not eligible to collect tax on supplies'.

Receipt Voucher

A registered person shall, on receipt of advance payment with respect to any supply of goods or services or both, issue a Receipt Voucher evidencing receipt of such payment.

If at the time of receipt of advance, the rateoftax is not determinable, taxshallbepaid at therateof 18% and if the natureof supply is not determinable, the same shallbetreatedasinter-state supply.

3. *Refund Voucher*

When at the time of receipt of advance payment with respect to any supply of goods or services or both the registered person issues a Receipt Voucher, but subsequently no supply is made and no tax invoice is issued in pursuance thereof, the said registered person may issue to the person who had made the payment, a Refund Voucheragainst such payment.

4. *Invoice and Payment Voucher*

The recipient is liable to pay tax on reverse charge basis where he receives supply of such goods/services/both which are notified for reverse charge purposes. Such supplies can be received from a registered or an unregistered supplier.

Further, a builder/promoter is required to pay GST on reverse charge basis under section 9(4) in one or more of the following cases:

(i) A builder/promoter must purchase 80% of inputs and input services used in supplying the service from registered persons. In case of shortfall, he's required to pay tax under reverse charge on all such inward supplies (to the extent short of 80% of the inward supplies from registered supplier).

(ii) Where cement is received from an unregistered person, promoter/builder has to pay tax on supply of such cement on reverse charge basis and

(iii) GST on capital goods is payable by the promoter on reverse charge basis.

A registered person who is liable to pay tax under reverse charge shall issue an Invoicein respect of goods or services or both received by him from the supplier who is not registered on the date of receipt of goods or services or both. Thus, a recipient liable to pay tax has to issue invoice only when supplies have been received from an unregistered supplier.Besides, a registered person who is liable to pay tax under reverse charge shall issue a Payment Voucherat the time of making payment to the supplier.

5. Delivery Challan

Following are the cases where at the time of removal of goods, goods may be removed on delivery challan and invoice may be issued after delivery:

(1) Supplyofliquid gaswherethequantity at the time of removal from the place of business of the supplier is not known,

(2) Transportation of goods for job work,

(3) Transportation of goods for reasons other than by way of supply, or

(4) Such other suppliesasmaybenotified by the Board.

Delivery challan shall be prepared in TRIPLICATE (Original copy to Consignee, duplicate copy to Transporter and triplicate copy to Consignor).

6. Credit Note

Once the credit note has been issued, the tax liability of the supplier will reduce.The credit note is a convenient and legal method by which the value of the goods or services in the original tax invoice can be amended or revised. The issuance of the credit note easily allows the supplier to decrease his tax liability in his returns without requiring him to undertake any tedious process of refunds.

Any registered person who issues a credit note in relation to a supply of goods or services or both shall declare the details of such credit note in the return for the month during which such credit note has been issued but not later than:

i. September following the end of the financial year in which such supply was made, or
ii. the date of furnishing of the relevant annual return, whichever is earlier.

The tax liability shall be adjusted in such manner as may be prescribed. However, no reduction in output tax liability of the supplier shall be permitted, if the incidence of tax and interest on such supply has been passed on to any other person.

7. *Debit Note*

The debit note/supplementary invoice is a convenient and legal method by which the value of the goods and/or services in the original tax invoice can be enhanced. The issuance of the debit note allows the supplier to pay his enhanced tax liability in his returns without requiring him to undertake any other tedious process.

Any registered person who issues a debit note in relation to a supply of goods or services or both shall declare the details of such debit note in the return for the month during which such debit note has been issued. The tax liability shall be adjusted in such manner as may be prescribed.

8. *E-way bill*

E-way bill is an electronic document generated on the GST E-Way Bill System (https://ewaybillgst.gov.in) evidencing movement of goods.

Section 68 mandates that the Government may require the person in charge of a conveyance carrying any consignment of goods of value exceeding such amount as may be specified to carry with him such documents and such devices as may be prescribed. Rule 138 of CGST Rules, 2017 prescribes e-way bill as the document to be carried for the consignment of goods in certain prescribed cases.

E-way Bill is mandatory in case of movement of goods of consignment value exceeding Rs.50,000in motorized conveyance.
Movement should be:

i. In relation to a supply; or
ii. For reasons other than supply; or
iii. Due to inward supply from an unregistered person,
(iv)Registered GST Taxpayers can register in the e-Way Bill Portal using GSTIN.
(v). Unregistered Persons/ Transporters can enroll in the e-Way Bill System by providing their PAN and Aadhaar.
(vi). Supplier/ Recipient/ Transporter can generate the e-Way Bill.
(vii). Vehicle number can be entered/updated in PART-B of Form EWB-01 by those who have generated the e-Way Bill or by the Transporter.
(viii). QR code is provided in the e-Way Bill to facilitate quick verification.
(ix). Certain goods have been exempted from e-Way Bill and the list is available as Annexure to Rule 138 of CGST Rules. e-Way Bill is not required for transport through non-motorized conveyance.

Mode of Generation of E-way bill

- Various Modes of Generating e-Way Bill
  a) Web (Online)
  b) Android App - The IMEI of the phone and the registered mobile number has to be given.
  c) SMS based (through registered Mobile Number).
  d) Excel based upload is provided for bulk generation.
- If the e-Way Bill is generated with wrong information it can be cancelled and new e-Way Bill can be generated.
- The Recipient can reject the e-Way Bill within 72 hours of generation.

- Alert messages are also issued to the Users through Online and SMS

Registered person causing movement of goods shall furnish the information relating to the said goods in Part A of Form GST EWB-01before commencement of such movement.

Contents of PART - A of the Form EWB - 01 can't be edited or modified once generated. PART - B can be updated with Vehicle details/ RR/Airway Bill etc.

Consolidated e-Way Bill can be generated for vehicle carrying multiple consignments.

Validity of E-way bill

The Validity of e-Way Bill is fixed as one day for every 100 Kms or part thereof. The validity can be extended online before the expiry.Exceptions are granted to minimum consignment value of Rs.50,000/-.Inter-state transfer of goods by principal to job- worker. Inter-State transfer of handicraft goods by a person exempted from obtaining registration.

Movement of goods

If supplier is registered and undertakes to transport the goods, movement of goodsis caused by the supplier. If recipient arranges transport, movement would be caused by him.If goods are supplied by an unregistered supplier to a registered known recipient, movement shall be caused by such recipient.

Information to be furnished in e-way bill

Part A: to be furnished by the registered personwho is causing movement of goods.Part B: to be furnished by the person who is transporting the goods.

Generation of E-way bill

E-way bill is to be generated by the registered consignor or consignee(if the transportation is being done in own/hired conveyance or by railways by air or by vessel) or the transporter(if the goods are handed over to a transporter for transportation by road). Where neither the consignor nor consignee generates the e- way billand the value of goods is more than Rs.50,000/- it shall be the responsibility of the transporterto generate it. Goods transported by railways shall be delivered only on production of e-way bill.E-way bill can be generated even if consignment value is less than Rs.50,000/-.

Details of conveyance may not be furnished in Part- BIn case of intra-State movement of goods upto 50 km distance:

i. from place of business (PoB) of consignor to PoB of transporter for further transportation or
ii. from PoB of transporter finally to PoB of the consignee.

Transfer of goods to another conveyance

In such cases, the transporter or generator of the e-way bill shall update the new vehicle number in Part B of the EWB before such transfer and further movement of goods.

Cancellation of e- way bill

E-way bill can be cancelled if either goods are not transported or are not transported as per the details furnished in the e-way bill. The e-way bill can be cancelled within 24 hours from the time of generation.

VI. Returns under GST Law

Returns are documents containing details of income which a taxpayer is required to file with the tax authorities which transfers information to the tax authorities. Every registered taxable person is required to file his returns.

All the returns under GST laws are to be filed electronically.Taxpayers can file the statements and returns by various modes. Firstly, they can file their statement and returns directly on the GST common portal online. However, this may be tedious and time consuming for taxpayers with large number of invoices. For such taxpayers, offline utilities have been provided by GSTN that can be used for preparing the statements offline after downloading the auto populated details and uploading them on the common portal. GSTN has also developed an ecosystem of GST Suvidha Providers (GSP) that will integrate with the common portal.

Types of Returns

GSTR 3B Monthly Summary return by all regular tax payers
GSTR 1 Monthly Outwards Supply Return by all regular tax payers
GSTR 4 Quarterly Composition Return
GSTR 5 Non Residents Return
GSTR 6 Input Service Distributor Return
GSTR 7 TDS Return by Deductor
GSTR-9Annual return

Due Dates

Return Type	**Due Date**
GSTR-3B	Form GSTR-3B is a simplified summary return and the purpose of the return is for taxpayers to declare their summary GST liabilities for a particular tax period and discharge these liabilities.All Registered person have to file GSTR-3B by 20th of next month.
GSTR-1	GSTR-1 is a monthly Statement of Outward Supplies to be furnished by all normal and casual registered taxpayers making outward supplies of goods and

services or both and contains details of outward supplies of goods and services.

Quarterly GSTR-1 Return (if annual turnover is up to Rs 1.5 crore, one can opt for quarterly filing).

Quarter	**Due Dates**
Apr-Jun 2020	31^{st} July 2020
Jul-Sep 2020	31^{th}Oct 2020
Oct-Dec 2020	31^{st}Jan 2021
Jan-Mar 2020	30^{th} Apr 2021

Monthly GSTR-1 Return (if Annual Turnover of more than Rs 1.5 crore must file monthly)

Due date is 11^{th} of the next month.

Example:

Period	**Due Dates**
June 2020	11^{th} July 2020
July 2020	11^{th} August 2020
August 2020	11^{th} September2020

CMP-08

Taxpayers who are registered under composition scheme.CMP-08 has to be filed by 18^{th} of next quarter

GSTR-5

Monthly return by Non-resident tax payers on 20th of the next month or within 7 days after expiry ofregistration, whicheveris earlier

GSTR-6

The input service distributors have to file GSTR-6 by 13^{th} of next month.

GSTR-7

Form GSTR-7 is a return which is required to be filed by the persons who deduct tax at the time of making/crediting payment to suppliers towards the

	inward supplies received.The due date for filing Form GSTR-7 is 10th day of the succeeding month.
GSTR-8	Form GSTR-8 is a Statement of TCS (Tax Collected at Source) to be filed by E Commerce Operators. The due date for filing GSTR-8 is 10th day of the succeeding month.
GSTR-9	Form GSTR-9 is an annual return to be filed once for each financial year, by the registered taxpayers who were regular taxpayers, including SEZ units and SEZ developers. The due date for filing Form GSTR-9 for a particular financial year is 31st December of subsequent financial year
GSTR-9A	Form GSTR-9A is an annual return to be filed once, for each financial year, by taxpayers who have opted for composition scheme, for any period during the said financial year.The due date for filing Form GSTR-9A for a particular financial year is 31st December of subsequent financial year.
GSTR-9C	Form GSTR-9C is a reconciliation statement, duly verified and digitally signed by Chartered Accountant/ Cost Accountant. This form is required to be furnished along with filing of annual return in Form GSTR-9, by the taxpayer whose aggregate turnover is above a specified limit, during a financial year.The due date for filing Form GSTR-9C for a particular financial year is 31st December of subsequent financial year.
GSTR-10	A taxable person whose GST registration is cancelled or surrendered has to file a return in Form GSTR-10 called as Final Return. GSTR-10 is required to be

	filed within 3 months from the date of effective date of cancellation or date of cancellation order, whichever is later.
GSTR-11	Form GSTR-11 is to be filed by persons who have been assigned a Unique Identity Number (UIN). There is no due date for Filing of Form GSTR-11. UIN holder can file Form GSTR-11 any time after end of the relevant Quarter.

Revision of returns

There is no mechanism of filing revised returns for any correction of errors/omissions. The rectificationof errors/omissions is allowed inthe subsequent returns.However, no rectification is allowed after the due date for furnishing the return for the month of September following the end of the financial year to which such details pertain orfurnishing of the relevant annual return, whichever is earlier.

Late fee for delay in filing of returns

Any registered person who fails to furnish statements, returns u/s 39 and final return by the due datesis liable to pay alate fee of Rs.50 per day. Any registered person whofails to furnish the annual retun by the due dateshall beliable to pay a late fee of Rs.20 per day,subject to amaximum of 0.25% of his turnover in the State/Union Territory, under the CGST Act.

Interest on late payment of GST

Interest is applicable on Late Payment of GST Due. Interest has to be paid by every taxpayer who:

- Makes a delayed GST payment i.e. pays GST after the due date.
- Claims excess Input Tax Credit

- Reduces excess Output Tax Liability

Currently, GST has to be paid at the time of filing GSTR-3B and GSTR-4.If GST is not paid within the due dates of filing return Interest at the rate of 18% has to be paid. If Excess ITC Claimed or excess reduction in Output Tax, Interest at the rate of 24% has to be paid.

VII. Rates of Tax

a)Regular Scheme:

I) 5%

II) 12%

III) 18%

IV) 28%

b) Composition Levy Scheme:

I) Trade – 1%

II) Manufacturer -1%

III) Hotelier -5%

c) Diamond -0.25%

d) Jewellery -3%

GST Compensation Cess:

The Cess is levied under GST is levied to compensate stateswho may suffer any loss of revenue due to the implementation of GST, as per the provisions of the GSTCompensationCess Act. Cess is calculated based on the value of the product without GSTor on the base tax liability of the tax payer. GST compensation cess rates for different supplies that are traded inter state or intra state by GST registered business that do not fall under the compensation scheme for the goods like Pan Masala, Aerated waters, Tobacco and Tobacco products. Compensation cess is to be recomputed asif the same was available in the respective months in which the refund of unutilized credit of CGST/SGST/UTGST/IGST was claimed on account of exports made under LUT/bond. The input tax credit of this cess can be only used to pay compensation cessandnot the other taxes like CGST, SGST or IGST. The compensation cess is levied only for 5 years,ie; only until July 1^{st}, 2020.

Kerala Flood Cess

Kerala flood cess (KFC) is levied to raise the fund required for reconstruction of State after the devastating flood occurred in the month of August, 2018.

The Kerala Flood cess is levied on intra state supplies of goods or services or both made by a taxable person to unregistered person but not on composition levy under Section 10 or exempted supply under Section 11 of KGST Act. Goods leviable @ 0.125% under KGST (ie; diamonds) and goods leviable @ 2.5% are not chargeable to Kerala Flood Cess. Thus we can also infer that KFC is not leviable on inter state supply as well as on supplies made between registered dealers. GST is calculated on the value inclusive of Kerala Flood Cess.ie; Basic price plus KFC.

VIII. Tax Deduction at Source

As per Central GST Law (CGST) Act, the notified entities are required to collect TDS at the rate of 2 percent (CGST 1% and SGST 1%) on payments to goods or services suppliers in excess of 2.5 lakh. E commerce companies will now be required to collect upto 1 percent TCS while making payment to suppliers under the GOODS and Services Tax. The recipients of Goods and services are responsible to deduct tax. They are Government department, Local authority, govt. agencies and such other person notified by the Govt. For the purpose of calculation of TDS the following amount is to be eliminated CGST, SGST, UTGST, IGST and Cess. The Deducted amount is to be deposited to the Government before the 10^{th} of the next month in GSTR 7. TDS is certificate is to be issued in form GSTR7A with in 5 days of depositing the TDS. TDS deducted is visible to the supplier in Form GSTR 2A and the supplier can include abd avail the same in GSTR2.

E-Commerce aggregators are responsible under the GST Law for collecting and depositing tax at the rate of 1% from each transaction.

IX. Accounts and Other Records:

A registered person shall keep and maintain, at his principal place of business and at any other places of business mentioned in the certificate of registration, a true and correct account of :

1. Production or manufacture of goods
2. Inward and outward suppy of goods or services or both
3. Stock of goods
4. Input tax credit availed
5. Output tax payable and paid and
6. Such other particulars if he has maintained records in electronic format.

Rule 56 of CGST Rules says that:

1. Every registered person shall maintain the following additional details:

A true and correct account of the goods or services imported orexportedorof supplies attracting payment of tax on reverse charge along with the relevant documentsincludinginvoices,bills of supply,deliverychallans,creditnotes,debitnotes,receiptvouchers,payment vouchers and refund vouchers.

2. Every registered person, other than a person paying tax u/s 10 shall:

Maintain accounts of stock in respect of goods received and supplied by him and such accounts shall contain particulars of opening balance, receipt, supply, goods lost, stolen, destroyed, written off or disposed off, by way of gift or free sample and the balance of stock including raw materials, finished goods, scrap and wastage there of.

3. Every registered person shallkeep and maintain separate account of advances received, paid and adjustments made there to.

4. Every registered person, other than a person paying tax under section 10, shall keep and maintain an account containing the details of taxpayable (including tax payable in accordance with the provisions of sub-section (3) and sub-section (4) of section 9, tax collected and paid, input tax, input tax credit claimed, together with a register of tax invoice, credit notes, debit notes, delivery challan issued or received during any tax period.

5. Every registered person shall keep the particulars of :

a.Names and complete addresses of suppliers from whom he has received the goods or services chargeable to tax under the Act;

b.Names and complete addresses of the persons to whom he has supplied goods or services, where required under the provisions of this Chapter;

c. The complete address of the premises where goods are stored by him, including goods stored during transit along with the particulars of the stock stored therein.

6. Any entry in the registers, accounts and documents shall not be erased, effaced or overwritten and all incorrect entries, otherwise than those of clerical nature, shall be scored out under attestation and thereafter the correct entry shall be recorded and where the registers and other documents are maintained electronically, a log of every entry edited or deleted shall be maintained.

7. Each volume of books of accounts maintained manually by the registered person shall be serially numbered.

8. Every agent shall maintain :

a) The particulars of authorization received by him from each principal to receive or supply goods or services on behalf of such principal separately.
b) The particulars including description, value and quantity of goods or services received on behalf of the principal.
c) The particulars including description, value and quantity of goods or services supplied on behalf of the principal.
d) Details of accounts furnished to every principal.
e) Tax paid on receipts or on supply of goods or services effected on behalf of every principal.

9. Every registered person manufacturing goods shallmaintain monthly production accounts showing quantitative details of raw materials or services used in the manufacture and quantitative details of goods so manufactured including waste and by products there of.

10. Every registered person supplying services shall keep separate accounts showing quantitative details of the goods used in the provision of services used, details of input services utilized and services supplied.

11.Every registered person executing workcontract shall keep separate accounts for work contract showing :

a) The names and addresses of person on whose behalf the work contract is executed.
b) Description, quantity and value of goods and services received for the execution of thecontract .
c) Description, quantity and value of goods and services utilized in the execution of thecontract .
d) The details of payments received in respect of each work contract and
e) The name and addresses of suppliers from whom he received goods or services.

12.The records maintained in electronic form should be authenticated by means of digital signature.

13.Accounts maintained by the registered person and the required documents shall be preserved for a period of 72 months from the due date of furnishing of annual return for the year pertaining to such accounts and records. Effectively for the financial year, the books of accounts have to be maintained for 81 months from the end of such year.

14.Any person having custody over the goods in the capacity of a carrier or a clearing and forwarding agent for delivery or dispatch there of to a recipient on behalf of any registered person shall maintain a true and correct record in respect of such goods handled by him.

15. Every registered person shall produce the books of accounts on demand as and when required by any law for the time being in force.

The important books to be maintained are :

1. Sales register
2. Purchase register
3. Cash book/ Day book
4. Bank Book
5. Stock register

A registered personshould maintain accounts and records at principal place of business or an additional place of business.

Electronic Cash Ledger

A taxable person may remit any amount towards tax, interest, penalty, fee, cess or any other amount by internet banking, credit or debit cards, NEFT, RTGS or any other amount as prescribed. The payment shall be credited to the electronic cash ledger of such person and maintained in form PMT-05.

Electronic Credit Ledger

Input tax credit as self-assessed in the return of a taxable person shall be credited to his electronic credit ledger. It is maintained in form GST PMT – 02.

A UIN (Unique Identification Number) shall be generated at a common portal for each debit or credit to the electronic cash or credit ledger as the case may be. The discharge of a liability shall be indicated as a corresponding entry in the electronic tax liability register.

Any payment shall be made through a challan in form GST – 06 on the common portal. The payment can be done through internet banking, credit or debit card, NEFT, RTGS or OTC. Over The Counter (OTC) payment shall be made through authorised bank for deposits up to Rupees Ten Thousand only.

If payment is made by way of NEFT or RTGS mode from the bank, the mandate form shall be generated along with the challan on the common portal and the same shall be submitted to the bank .

On successful credit of the amount to the Government account, a Challan Identification Number (CIN) shall be generated by the collecting branch. If CIN is not generated on payment of the amount the fact shall be communicated to the common portal through GST PMT 07.

TDS deducted and TCS collected and claimed in form GSTR-02 by a taxable person shall be credited to his electronic cash ledger.

If any refund is claimed such amount shall be debited to the electronic cash ledger.

X. Accounting Entries under GST

Under GST all these taxes (excise, VAT, service tax) are subsumed into one account.

The trader has to then maintain the following accounts (apart from accounts like purchase, sales, stock) :

1. Input CGST A/c
2. Output CGST A/c
3. Input SGST A/c
4. Output SGST A/c
5. Input IGST A/c
6. Output IGST A/c
7. Electronic Cash Ledger (to be maintained on Government GST portal to pay GST)

Example 1: Intra-state

1. XYZ Co-op Society purchased goods Rs. 1,00,000 locally (intrastate)
2. They sold them for Rs. 1,50,000 in the same state
3. They paid legal consultation fees Rs. 5,000
4. They purchased furniture for his office for Rs. 12,000

Assuming CGST @8% and SGST@8%
The entries will be-

1	Purchase A/c	Dr.	1,00,000
	Input CGST A/c	Dr.	8,000
	Input SGST A/c	Dr.	8,000
	To Creditors A/c		1,16,000
2	Debtors A/c	Dr.	1,74,000
	To Sales A/c		1,50,000
	To Output CGST A/c		12,000
	To Output SGST A/c		12,000
3	Legal fees A/c	Dr.	5,000

	Input CGST A/c	Dr.	400
	Input SGST A/c	Dr.	400
	To Bank A/c		5,800
4	Furniture A/c	Dr.	12,000
	Input CGST A/c	Dr.	960
	Input SGST A/c	Dr.	960
	To ABC Furniture Shop A/c		13,920

Total Input CGST=8,000+400+960= Rs. 9,360
Total Input SGST=8,000+400+960= Rs. 9,360
Total output CGST=12,000
Total output SGST=12,000
Therefore Net CGST payable=12,000-9,360=2,640
Net SGST payable=12,000-9,360=2,640

5	Output CGST A/c	Dr.	12,000
	Output SGST A/c	Dr.	12,000
	To Input CGST A/c		9,360
	To Input SGST A/c		9,360
	To Electronic Cash Ledger A/c		5,280

If there had been any input tax credit left it would have been carried forward to the next year.

Example 2: Inter-state

1. XYZ Co-op Society purchased goods Rs. 1,50,000 from outside the State
2. They sold Rs. 1,50,000 locally
3. They sold Rs.1,00,000 outside the state
4. They paid telephone bill Rs. 5,000
5. They purchased an air cooler for his office for Rs. 12,000 (locally) Assuming CGST @8% and SGST@8%

1	Purchase A/c	Dr.	1,50,000
	Input IGST A/c	Dr.	24,000

	To Creditors A/c		1,74,000	
2	Debtors A/c	Dr.	1,74,000	
	To Sales A/c		1,50,000	
	To Output CGST A/c		12,000	
	To Output SGST A/c		12,000	
3	Debtors A/c	Dr.	1,16,000	
	To Sales A/c		1,00,000	
	To Output IGST A/c		16,000	
4	Telephone Expenses A/c	Dr.	5,000	
	Input CGST A/c	Dr.	400	
	Input SGST A/c	Dr.	400	
	To Bank A/c		5,800	
5	Office Equipment A/c	Dr.	12,000	
	Input CGST A/c	Dr.	960	
	Input SGST A/c	Dr.	960	
	To ABC Furniture Shop A/c			13,920

Total CGST input =400+960=1,360
Total CGST output =12,000
Total SGST input =400+960=1,360
Total SGST output =12,000
Total IGST input =24,000
Total IGST output =16,000

Particulars	CGST	SGST	IGST
Output liability	12,000	12,000	16,000
Less: <u>Input tax credit</u>			
IGST	8,000		16,000
CGST	1,360		
SGST	1,360		

Amount payable	2,640	10,640	NIL

Any IGST credit will first be applied to set off IGST and then CGST. Balance if any will be applied to setoff SGST.So out of total input IGST of Rs. 24,000, firstly it will be completely setoff against IGST. Then balance Rs.8,000 against CGST.From the total Rs.40,000, only Rs. 13,280 is payable.

So the setoff entries will be:

3. Set off against CGST output

Output CGST	Dr.	9,360
To Input CGST A/c	1,360	
To Input IGST A/c		8,000

2 Setoff against SGST output

Output SGST	Dr.	1,360
To Input SGST A/c		1,360

3 Setoff against IGST output

Output IGST	Dr.	16,000
To Input IGST A/c		16,000

4 Final payment

Output CGST A/c	Dr.	2,640
Output SGST A/c	Dr.	10,640
To Electronic Cash Ledger A/c		13,280

XI. Audit under GST Act

1. Audit by GST authorities

Audit can be done by GST authorities under Section 65 of the CGST Act. It is conducted by the Commissioner or any officer authorised by him.

A special audit is conducted by a Chartered Accountant or a Cost Accountant as per provisions of Section 66 if the officer is of the opinion that value has not been correctly declared or credit availed isnot with in the normal limits.

2. Audit by a Chartered Accountant / Cost Accountant

The audit as per CGST Act, 2017 says that (a) Audit is an examination of records, returns and documents (b) Those records and documents may be maintained or furnished under GST Law or any other law (c) The examination is to verify the correctness of : (i) Turn over declared (ii) Taxes paid (iii) Refund claimed(iv) Input tax credited / availed. (d) Compliance with the provisions of GST Act and Rules.

The Audit Report under GST is provided under GST Act in form no.GSTR 9C.

XII.Practical Approach to the Audit of Co-operative Societies

1. The auditor of a Co-operative Society has to check whether the unit is registered under the Act. If not registered, the auditor has to comment on the applicability of the GST law.
2. The auditor may see whether the registration number is displayed in proper places as per the Law.
3. The required places of business are to be declared in the application for registration or subsequently. See if all the places of business are declared in the registration certificate.
4. See the registration number is mentioned in all the invoices issued on supply of goods or services as well as other GST documents
5. All the invoices and other GST documents issued by the supplier should have the registration number of the entity to which such invoices/ documents are issued. Whenever the GST authorities check the documentary evidence of the transactions they refer the GST number of the parties, so the auditor has to verify the same. It is a documentary evidence to avail the input tax credit.

6. See that proper HSN code/ SAC code is referred to for each product and rates decided accordingly.
7. Verify the invoices and other documents and ensure that goods are charged to tax at eligible rates under the Law.
8. The auditor has to verify the invoices and see that they are in agreement with the books of accounts.
9. The auditor has to see that all the entries in the books of accounts relating to GST are in agreement with the supporting documents.
10. Verify the purchase order to the supplier or the agreement between the parties and see terms of agreement regarding the GST. See that it is according to such agreement.
11. Check if all the books of accounts and registers required under the Act and Rules are maintained properly.
12. The books of accounts are maintained in the proper format as required under the Rules.
13. See that the monthly/ quarterly returns are in agreement with the books of accounts.
14. See that the entity has calculated and paid GST as per the law on monthly basis or any other manner as required and has paid before the due date.
15. See that the tax paid as per books are supported by challans and are mentioned in the returns at the appropriate places.
16. See that the entity has availed eligible Input Tax Credit under GST law.
17. Verify that the annual returns are in agreement with the books of accounts and properly reconciled.
18. See the stock records are in agreement with the books of accounts and apply the required ratios to verify the correctness of the records.
19. A quantitative analysis of the inflow and outflow of stock is to be carried out and report if there is any discrepancy.

20. See that all the returns are filed on or before the due dates and if delayed the reasons there for. Frequent filing of belated returns and payment of penal charges has to be reported accordingly.
21. Check whether the annual financial statements are in agreement with GST returns and the books of accounts.
22. See whether proper person with proper authority has signed the returns and documents under GST Law.
23. Check whether the Turnover and other balances as per Financial Statements and that as per the Income Tax records are in agreement with GST records and the reasons ,if there is a difference, is to be looked into.
24. Verify all the audit reports conducted and reported during theperiod ,has reported any negative facts relating to GST.
25. Check whether any demand under GST is pending or any dispute under GST is pending.
26. Scrutinise the notices and orders issued by the GST authorities and see that theappeals if any, are filed in orderand in time.
27. Check whether any penalties are imposed by GST authorities and the officer/s responsible for such incidence of penalty may be reported with reasons.
28. Report whether there is a proper internal control system of maintaining records and filing of returns under GST law.
29. See whether all the documents relating GST law is filed properly and available for easy reference.
30. Scrutinise the audit report by a Chartered Accounatnat / Cost Accountant under GST Lawif any is conducted and the compliance requirement and their comments if any pending rectification.

10.12. 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.

10.13. 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.

*10.14. Others*s

Any other item which is not covered by the above should be verified and valued according to the circumstances of each case.

CHAPTER -XI

VERIFICATION AND SCRUTINY OF FINAL ACCOUNTS

11.1Final Accounts - statutory provision

The preparation of final accounts of the Cooperative is a statutory obligation of the Chief Executive. As per Sub Section (4) of Section 64 of the Kerala Cooperative Societies Act, the financial statements and other statutory statements as required by auditors shall be prepared by the Chief Executive of the society within one month from the date of close of the financial year and submit it before the managing committee and the fact shall be reported to the Director of Co-operative Audit or to the persons authorized byphim in this behalf. It shall be the duty of the Managing Committee of every society to ensure the accuracy of financial and other statutory statements. It is the responsibility of the committee to submit the above statements for audit within one month from the date of receipt of the above statements before the auditor, as laid down in Sub Section (4A) of Section 64.

11.2 What is a Trial Balance ?

The fundamental principle of Double Entry System is that for every debit there must be a corresponding credit .It is but natural that the total of all the debit balance should agree with or equal the sum total of all credit balances. Although by the use of subsidiary journals, the work of posting the entries into the ledger is reduced by half, the above basic principle of double entry is fully maintained in as much as the debits and credits are equalized in the aggregate. Trial Balance may be defined as a statement of debit and credit balances extracted from the ledger with a view to test the arithmetical accuracy of the books. It thus forms a connecting link between the ledger accounts final accounts.

11.3 Difference between Trial Balance and the Receipt and Disbursement Account

Trial Balance tabulates the debit and credit balances separately in a statement to see whether the total of debit balances agrees with the total of credit balances. This ensures that all entries from the original records into the ledger are correctly transferred.

The Receipt and Disbursement statement is a summary of actual cash receipts payments extracted from the cash book covering a particular period. All cash received andpaid during the period whether on account of capital or revenue should be included in this statement .Receipts are entered on the debit side and the payments on the credit side. The account commences with the opening balance of cash and closing balance at the end of the period .It is a mere summary of cash transactions and it does not include any income or expense outstanding and naturally fails to reveal the actual income or expenditure of the period covered.

The auditor should be very careful in the verification of Trial Balance, Receipt and Disbursement Accounts, Trading Account, Profit and Loss Account and Balance Sheet, as they are the most significant part of the Audit Report.

After checking the postings in the Day Book, General Ledger and Subsidiary Ledgers, the auditor should concentrate on the verification of Trial Balance or Receipt and Disbursement statement. The statement which contains a classified summary or list of all closing balances shown in the General Ledger is known as Trial Balance. An important point to be borne in mind in the preparation of Trial Balance is to include the cash balance as well as the bank balances. In certain societies instead of Trial balance, Receipt and disbursement statement is prepared.

Receipt and Disbursement Statementis a statement of total debits and credits of each head of account for a financial year. The auditor should ensure that an agreed trial balance or Receipt and Disbursement Statementis available before starting his verification of the final accounts and financial statements. Due to the following reasons the Receipt and Disbursement statement may not tally.

(a) Wrong posting, totalling, balancing and carry forward in the cash book and general ledger.

(b) Mistaken cash balance or excluded cash balance

The shortage of cash balance may be treated seriously and the amount should be put under the head Suspense Asset with a narration of "Cash balance shortage recoverable from …………..". The person responsible for the shortage should be clearly specified and legal action initiated against him/ her. The excess cash if any should be shown under the head "Sundry creditors" or Suspense Liability.

11.4 Verificationof Manufacturing, Trading and Profit and Loss Account

i). *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, have 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 is 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.

ii. *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 the 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 to 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 accounts in the Personal Ledgers will however have to be carried over from the previous years ledgers.

iii. *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.

iv. *Adjustment and closing of nominal accounts*: Allnominal 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 auditorwillhave to trace back the issue of dispatch of goods to the relative invoices or sales memos. Similarly in the case of securities and other investments, the auditor should ascertain whether all interests accrued during the period have been received and all dividends declared duly credited.

v. *Items coming under:*

(a) 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 are as follows:

(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.

(b) *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.

(c) *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

(vi)*Other items*:

(a) *Outstanding expenses*: All nominal accounts in the 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 Marchmay 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 such expenditure is fully justified.

(vii). *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.

(viii). *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 connection 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.

(ix). *Profit and Loss Account:*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.

(x). *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.

(xi) *Principles governing the preparation of profit and loss account:*

(1) Only such items of income and expenditure as properly belonging 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 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.

11.5 Balance Sheet

1. *Balance Sheet*: De Paula defines balance sheet as:

"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 being 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 asse 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 satisfyhimself that the balance sheet is properly prepared according to the correct and consistent accounting principles.

11.5.1. *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, i.e, therealisable value.

(ii) Value may mean the amount that is estimated to replace the asset,i.e, the replacement value.

(iii) The amount that an asset costs, when purchased or acquired, less the provisions made for depreciation since its acquisition i.e, the written down value or going concern value.

(iv) The balance of revenue expenditure which is being written off over a period of years, i.e, 'Deferred revenue expenditure' or 'prepaid expenses'.

11.5.2. *Going concern value*: Even though all the above basis for valuation may be used in connection with different classes of assets, usually only the written down or going concern value is taken into consideration. Where the asset, in which part of the capital invested is of 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.

11.5.3. *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 i.e, cash and bank balances, which are mostly 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 as 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.

CHAPTER – XII

RATIO ANALYSIS AS A TOOL

12.1 Introduction

The increasing modern businesses have necessitated the dynamic role of management accounting, which helps the management to direct, co-ordinate, control and motivate the designers of business in order to attain better results in the given circumstances.

The accounts of the co-operative institutions should be maintained in such a way that they should exhibita true and fair financial results of the institution.

Its main aim is to highlight the utility of accounting as a tool of management, which includes all techniques and controls such as financial control, budgetary control, cost volume profit analysis etc. It also includes planning for future variances between the actual standards, reporting to top management, formulation of policy etc. Accounting information should be presented in such a way as to assist the management to conduct day to day business most efficiently. The management should be able to think in terms of corrective measures such as cost reduction, extension of business services etc. If the cooperative institutions have a good accounting system it will definitely guide the management to take proper decisions in a time bound manner effectively. Thus the management will be able to know the strength and weaknesses of their institutions that also enable them to analyse the financial results, working performance etc within a short period of time.

Management accounting is concerned with forecasting, which helps in planning for the future. Techniques such as budgeting control, standard costing etc are based on forecasting. Any deviations in budgetary control and standards are to be reported and reviewed, which will increase the responsibility of the auditor.

While dealing with management accounting the auditor should have a thorough understanding of the scope of management accounting which is listed below.

1. General Accounting
2. Cost Accounting
3. Budgeting and forecasting
4. Cost control procedure
5. Taxation
6. Methods and Procedure
7. Audit
8. Office services
9. Legal provisions
10. Statistical information

The auditor should be aware of the management accounting tools also, which are much significant in the process of decision making by the management.

a) Analysis of financial statements
b) Ratio analysis
c) Cash flow and fund flow analysis

d) Statistical and Graphical techniques
e) Costing techniques
f) Standard costing and variance analysis
g) Budgetary control
h) Inventory management
i) Financial planning and Control
j) Evaluation of capital projects and returns on investment
k) Communications and Reporting
l) Total and Marginal cost analysis including breakeven chart and cost volume profit analysis.

12.2 Ratio Analysis

Ratio analysis is a useful management technique to measure the business performance scientifically. Analysis of different ratios will reveal the financial position of the institution which will be a useful tool and aid to the members, creditors and management as well. The principles that are implied in the process are profitability, solvency trend and financial strength of the institution. The ratio can be explained as "the indicated quotient of two mathematical expressions".

Ratio analysis is useful for management control and monitoring which can play a significant role in budgetary control, cost control, financial control as well as auditing.

Ratio analysis is very useful for the general public to understand the financial position and strength of the co-operative institutions. It will enable to have an impression of the performance of the institution past as well as present, facilitating a comparison. Identification of financial responsibility is another key advantage of Ratio analysis.

The auditor should be well versed in the different steps of Ratio analysis viz, collection of data, computation of ratios, comparison of ratios and finally, analysis and interpretation of ratios. Depending on the characteristics of various industries, the ratios of different products may vary. The auditor shall bear in mind the scope of such variations and shall consider the ratios accordingly.

The different classification of ratios such as Balance Sheet Ratios, Profit and Loss account Ratios and Composite Ratios will also be significant in Ratio Analysis.

12.3 Balance Sheet Ratios

12.3.iCurrent Ratio also known as Working Capital Ratio, expresses the relationship between current Assets and Current Liabilities. Current Assets include cash, stock, bills of exchange or investments which are easily convertible into cash. Current liabilities include bills payable, sundry creditors, outstanding expenses etc.

Current ratio is obtained by dividing the total current assets by total current liabilities

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current Ratio measures the institution's ability to meet its short term financial obligations.

1:1 ratio is considered desirable as high ratio may be due to poor or defective investment policies, excessive stock etc. Low ratio(0.5:1) may be because of shortage of the working capital.

12.3.iiQuick Ratio or Liquid Ratio or Acid Test

Quick Ratio is also termed as "Liquid Ratio" or "Acid Test Ratio" or "Near Money Ratio". It is the relationship between quick assets and quick liabilities. Quick ratio of 1:1 is considered desirable. Liquid ratio or quick ratio is helpful to know the immediate cash position of the institution. It places more emphasis on immediate conversion of assets into cash, giving a clear picture about the institution's ability to meet its short term liabilities out of short term assets.

Liquid assets = Current assets other than stock and prepaid expenses

Liquid liabilities= Current liabilities other than bank overdraft

Liquid ratio is obtained by dividing the total liquid Assets by total liquid liabilities

$$\text{Liquid Ratio} = \frac{\text{Liquid assets.}}{\text{Liquid liabilities.}}$$

12.3.iiiProprietary Ratio or Capital Ratio or Equity ratio or *Worth Debt Ratio* indicates how much of the total assets is owned by the proprietor. It indicates the ratio of the amount invested by the owner to the amount invest**e**d by the creditors. This ratio exhibits the ratio between owned capital and borrowed capital, which is calculated as follows

$$\frac{\text{Proprietors fund}}{\text{Total assets}}$$

This ratio helps to test the soundness of capital structure. The main purpose of this ratio is to identify the long term futuristic solvency condition of the institution.

12.3.ivDebt equity Ratio

This ratio assumes much significance while the cooperative institutions indulge on large scale borrowings for meeting their demand for working funds. This ratio relates to all recorded creditor's claims on assets to the owner. It is also known as internal-external equity ratio. It measures the institution's obligations to the creditors in relation to the fund provided by the owners.

It is calculated as $\frac{\text{Debt}}{\text{Equity}}$

12.4 Profitability Ratios/P & L account Ratios

(i)*Gross profit Ratio:*This ratio will reveal the extent to which the business is managed profitably. This also serves as an effective check on stock control. The efficiency of the trading business can be measured through this ratio, which can be compared with previous year's ratios.

$$\text{Gross Profit ratio} = \frac{\text{Gross Profit}}{\text{Net sales}} \times 100$$

(ii)*NetProfit Ratio*: It is the ratio of operating profit to net sales. Higher the net profit ratio, the betteris for the institution. It can be calculated by dividing net profit by net sales multiplied with hundred.

$$\frac{\text{Net profits}}{\text{Net sales}} \times 100$$

The profitability of the business can be ascertained by calculating this ratio, which can be utilized for business promotion purposes as well as sales planning.

(iii)*Expenses Ratio*

It is useful to examine each of the individual expense items as a percentage of sales. The auditor can verify each area of improvement or decline. Establishment and administrative expenses, selling expenses etc can be compared in relation to the turnover.

a) $\frac{\text{Material consumed}}{\text{Sales}} \times 100$

b) $\frac{\text{Selling expenses}}{\text{Sales}} \times 100$

c) $\frac{\text{Administrative expenses}}{\text{Sales}} \times 100$

d) $\frac{\text{Non-operating expenses}}{\text{Sales}} \times 100$

(iv) *Operating Ratio*:

This ratio is calculated by comparing the cost of goods sold and other operating expenses with net sales

$$\frac{\text{Cost of goods sold} + \text{Operating Expenses} \times 100}{\text{Net sales}}$$

A rise in the operating ratio indicates a decline in the efficiency.

Net Profit Ratio+ Operating Ratio = 100

(v)*Operating Profit Ratio*

Operating profit is compared with net sales. The ratio is calculated as

$$\frac{\text{Operating Profit}}{\text{Net sales}} \times 100$$

Operating Profit = Net profit + Non operating expenses- Non operating income.

(vi)StockTurnover Ratio

It is the relationship between inventory and cost of goods sold. The ratio is computed by dividing the cost of goods sold by the average inventory.

$$\text{Stock turn overratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

Cost of goods sold = Opening stock + Purchases - Closing stock

$$\text{Average inventory} = \frac{\text{Opening stock + Closing stock}}{2}$$

12.5 Composite Ratios

(i) *Return on Proprietors Fund*

It is the ratio of net profit to proprietors equity. It indicates the profitability of the business usually expressed as a percentage measuring the business success and managerial efficiency.

(ii)*Return on Total Assets*

It also known as return on gross capital employed. This ratio measures profitability of total capital committed to the business. It helps the management to find out its success in enhancing the income of the share holders through the use of borrowed fund.

$$\frac{\text{Net profit before preference dividend and interest expenses}}{\text{Total Assets}} \times 100$$

(iii)*Turn over of Fixed Assets*

It shows whether fixed assets are fully utilized. This ratio shows any excess investment in fixed assets and the ratio of the cost of goods manufactured to fixed assets. A high ratio indicates better use of fixed assets and vice versa.

$$\frac{\text{Cost of goods sold}}{\text{Fixed Assets}} \quad \text{or} \quad \frac{\text{Net sales}}{\text{Fixed Assets}}$$

(iv)Turn over of Total assets

Total assets turnover ratio is calculated by dividing the net sales by total assets. The standard of this ratio is two times. A high ratio indicates utilization over trading of fixed assets, where as a low ratio indicates excessive investments. ie, a symptom of idle capacity.

$$\frac{\text{Cost of goods sold}}{\text{Total assets}} \quad \text{or} \quad \frac{\text{Net sales}}{\text{Total assets}}$$

(v) *Working Capital Turnover Ratio* is calculated by dividing the net working capital by net sales. Whether working capital is used effectively or not will be shown by the working capital turnover ratio.

It is calculated as

$$\frac{\text{Net Working Capital}}{\text{Net sales}}$$

It helps to ascertain the efficiency of working capital utilization. A high ratio shows higher efficiency and low ratio indicates inefficiency.

(vi) *Turn over of Debtors*:It indicates the rate at which the money is being collected on account of credit sales. This is calculated as

$$\frac{\text{Debtors+ Bills receivable}}{\text{Credit sales}} \times 365$$

This is mainly prepared to know the periodicity of credit outstanding.

(vii) *Earnings Per Share (EPS)*

This is calculated by dividing the Profit by the number of equity shares.

(viii)*Price Earning Ratio (POR)*

$$\text{POR} = \frac{\text{Market Price per equity share}}{\text{Earnings per share}}$$

(ix)*Pay out Ratio/Dividend payout ratio*

$$\text{POR} = \frac{\text{Dividend per share}}{\text{Earning per share}}$$

(x)*Dividend Yield Ratio*

This ratio indicates the effective return on investment, which is calculated as follows:

$$\frac{\text{Dividend per share}}{\text{Market price of equity share}} \times 100$$

Apart from the above ratios, the auditors of Co-operative banks may consider the following ratios also, as they are very significant with respect to Co-operatives doing credit activities and deposit collection.

(xi). *Operating cost to working funds*

$$\frac{\text{Salary + Contingencies}}{\text{Working Funds}} \times 100$$ - In order to ascertain the staff productivity

The ideal position is 2 to 2.5 %

(xii). *Miscellaneous income to working fund*

$$\frac{\text{Non interest Misc. income}}{\text{Average working funds.}} \times 100$$ - not less than 0.75 %

(xiii). *Own fund Working Funds*

$$\frac{\text{Own fund}}{\text{Average work fund}} \times 100$$

This ratio shows the share of own fund to working fund, it indicates the financial health of the institution.

(xiv). *Cost of deposits*

$$\frac{\text{Interest expense on deposits}}{\text{Average deposit of the year}} \times 100$$

Deposit cost has to be contained within the average of interest rates. Cost effectiveness is the motive, hence it shall be 4% less than the average yield on loans.

(xv). *Cost of Borrowings*

$$\frac{\text{Interest expense on deposits}}{\text{Average Borrowings of the year}} \times 100$$

Should be within the average cost of deposits.

(xvi).*Yield loans*

$$\frac{\text{Interest Income from loans}}{\text{Average loan outstanding}} \times 100$$

This ratio is helpful to know whether any change in the loan portfolio is needed.Minimum 4% more than the average cost of deposits.

(xvii). *Interest expense to interest income*

$$\frac{\text{Interest expense}}{\text{Interest income}} \times 100$$

The ratio indicates the interest income utilized for meeting the interest expenses. It also indicates the spread available to meet the cost of management. Ideal position shall be 65 to 70%.

(xviii).*Cost of Management to total income*.

$$\frac{\text{Salary + Contingencies}}{\text{Interest income + Misc. income}} \times 100$$

This ratio indicates the total income utilized to meet the cost of management. Ideal position shall be 15 – 20%

(xix). *Capital to Risk weightedAssets Ratio (CRAR)*

$$\frac{\text{Capital Funds}}{\text{Risk weighted assets and off balance sheet items.}} \times 100$$

This ratio is considered to be an indicator of the institution's financial health. Higher the capital adequacy ratio, higher will be the capacity to bear the risks. RBI in their circular No. RBI/2007-08/203 RPCD.co.RF.BC40.07.38.03/2007-08 dated 27/12/2007 had given directions to all State Co-operative Banks and District Co-operative Banks to disclose their CRAR every year as "Notes on Accounts" along with the Balance Sheet. The Balance Sheet items and off Balance Sheet items have been assigned weights according to the prescribed risk weights (CircularRBI2007/08/203:RPCD.CO.RF.BC.40/7.38.03/2007-08dated 4.12.2007). The value of each asset shall be multiplied by the relevant weights to arrive at the risk adjusted values of assets off balance sheet items. The capital funds shall consist of Tier I and Tier II capital. As per circular NO, RBI/2013-14/433 RPCD. TCB.BC.73/07-51.012/2013-14 dated 7.1.2014, minimum CRAR was prescribed for State Co-operative Banks and District Co-operative Banks as follows.

31st March 2015 – 7%
31st March 2017 – 9%

The auditor shall verify the calculation of CRAR and also see that the minimum prescribed CRAR is maintained in accordance to the circular directions of RBI.

12.6 Calculation of other Important Ratios

1	Yield on Investments	Interest income from Investment (P&L) x100 / Average investment	Not less than average cost of deposit	To know whether the yield is less than average cost of deposit
2	Average yield on working fund	Total interest income (P&L a/c) x 100 / Working funds	Minimum 3.5% more than average cost of working fund	To know whether any change in the compositions of sset is required or not
3	Average cost of Working fund	Total interest expenses (P&L a/c) x 100 / working funds	Minimum 3.5% less than average yield on working fund	To know whether any change in the compositions of liabilities is required or not
4	Gross financial margin	Average yield on Working fund – Average cost of WF	3.5% and above	Intensive health
5	Net financial Margin	Gross financial margin % + Mis. income Margin % - Operating cost %	1.5%	To know whether the bank has working profit

6	Net Margin	Net financial Margin % - Risk Cost %	1.00%	If it is less than 1% whether it is due to low gross margin or high operating cost and take corrective measures accordingly
7	Credit Deposit Ratio Average CD ratio	Loans outstanding x 100 deposits Average loan outstanding x 100 Average deposit	Not less than 70%	On the basis of the increased proportion of borrowing to working funds the CD Ratio may be even more than 100%
8	Individual Deposits to Total Deposits	Depo. from the individuals and institu. other thanCo-ops x 100 Total Deposits	For DCB's 60% and for KSCB 20%	Lower the proportion of individual deposits ,higher will the volatility.
9	Growth rate of deposits	(Deposits of the year – Deposits of the just previous year) x 100 Deposit of the just previous year	20%	To know whether the increase in operating cost is about 12% per annum
10	Gross NPA to loan outstandi	Amount under NPA Loan accounts x 100 Total loan outstanding	Up to 5%	Quality of loan portfolio/tolerance limit

	ng			
11	Net NPA to Net loan outstanding	Amount Under NPA accounts – Provisions held for NPA x 100 / Total Loan outstanding - Provisions held for NPA	Up to 3%	One of the requisites for operational freedom is low level of NPA
12	Return on Asset	Net Profit x 100 / Average total assets	1.00%	Quality of Earning Assets
13	Net worth	Own funds- Accumulated loss	Positive and above Rs. 1 lakh	Compliance of Section 11(i)of BR Act
14	CRAR	Capital funds x 100 / Risk weighted Assets	9% and above	Compliance of CRAR Norms

As far as possible, depending on the nature of business of the co-operative institution, the auditor shall work out the above ratios, relevant to their working and make an inference based on the available ratios and the Board of management may be advised to adoptstrategies in line with the above inferences, in order to guide the institution into a brighter path.

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