

Audit of Co-operative Societies

Question 1

An auditor of a Cooperative Society governed by Cooperative Societies Act, 1912 is required to attach schedules giving certain information. Please list the information required to be given in the schedules.

Answer

Section 17 of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society. Apart from this, the form in which the auditor has to submit his audit report reveals the nature of his duties. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departures from the provisions of the Act, rules framed thereunder, and the bye-laws of the society. The form of the audit report to be submitted by the auditor, as prescribed in various states, contains a number of matters which the auditor has to state or comment upon. For example, the Rules formed under the Maharashtra State Co-operative Societies Act requires the auditor to make the usual affirmation pertaining to proper maintenance of books of accounts, true and fair nature of financial statements, etc. In addition to the above, the auditor will have to attach schedules to the report regarding the following information:

1. All transactions which appear to be contrary to the provisions of the Act, the rules and bye-laws of the society.
2. All sums, which ought to have been, but have not been brought into account by the society.
3. Any material, or property belonging to society which appears to the auditor to be bad or doubtful of recovery.
4. Any material irregularity or impropriety in expenditure or in the realisation or monies due to society.
5. Any other matters specified by the Registrar in this behalf.

In the case of nil report in any of the above matters, the auditor will have to give a nil report.

Question 2

Mention the duties of Auditor of Co-operative Societies in regard to the following:

- (i) Over-due interest.
- (ii) Compliance with provisions of Co-operative Act and Rules thereunder.
- (iii) Special Report to Registrar of Co-operative Societies.

Answer

- (i) **Overdue interest:** Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.
- (ii) **Compliance with provisions of the Act and Rules:** An auditor of a co-operative society is required to point out the infringement with the provisions of the relevant Co-operative Act Rules and bye-laws. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departure from the provision of the Act, rules framed thereunder and the bye-laws of the society. The financial implications of such infringements should be properly assessed and quantified by the auditor and they should be reported. Some of the State laws contain restrictions on the payment of dividends, which should be noted by the auditor and if dividend is declared in excess of the prescribed percentage, the fact should be reported by the auditor. Auditor should also ensure that various provisions in the Co-operative Societies Act, such as, restriction on borrowings, investment of funds, contribution to education funds, restriction on loans, etc are also complied with.
- (iii) **Special Report to the Registrar** The auditors are required to report on number of matters as prescribed in various states. In addition to the main report, the auditors are also required to submit by way of schedules/audit memorandum information on the working of the company as well. During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:
 - (a) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
 - (b) Detection of fraud relating to expenses, purchases, property and stores of the society.
 - (c) Specific examples of mis-management. Decisions of management against co-operative principles.
 - (d) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

Question 3

State the special features of Co-operative Societies Audit.

Answer

Special features of Co-operative Societies Audit: the special features of co-operative audit, to be borne in mind in general while conducting the audit are as follows:

1. **Examination of overdue debts** - Overdue debts for a period from six months to five years and more than five years will have to be classified and shall have to be reported by an auditor. Overdue debts have far reaching consequences on the working of a credit society. It affects its working capital position. A further analysis of these overdue debts from the viewpoint of chances of recovery will have to be made, and they will have to be classified as good or bad. The auditor will have to ascertain whether proper provisions for doubtful debts are made and whether the same is satisfactory. The percentage of overdue debts to the working capital and loans advanced will have to be compared with last year, so as to see whether the trend is increasing or decreasing whether due and proper actions for recovery are taken, the position regarding cases in co-operative courts, District Courts etc. and the results thereof.
2. **Overdue Interest** - Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.
3. **Certification of Bad Debts** - A peculiar feature regarding the writing off of the bad debts as per Maharashtra State Co-operative Rules, 1961, is very interesting to note. As per Rule No. 49, bad debts can be written off only when they are certified as bad by the auditor. Bad debts and irrecoverable losses before being written off against Bad Debts Funds, Reserve Fund etc. should be certified as bad debts or irrecoverable losses by the auditor where the law so requires. Where no such requirement exists the managing committee of the society must authorise the write-off.
4. **Valuation of Assets and Liabilities** - However, regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted. The auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at cost less adequate provision for depreciation. The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised. If the difference in the original cost of acquisition and the present market price is of far reaching significance, a note regarding the present market value may be appended; so as to have a proper disclosure in the light of present inflatory conditions. The current assets should be valued at cost or market price, whichever is lower. Regarding the liabilities, the auditor should see that all the known liabilities are brought into the account, and the contingent liabilities are stated by way of a note.
5. **Adherence to Co-operative Principles** - The auditor will have to ascertain in general, how far the objects, for which the co-operative organisation is set up, have been

achieved in the course of its working. The assessment is not necessarily in terms of profits, but in terms of extending of benefits to members who have formed the society. Considered from the viewpoint of social benefits it may be looked into that how far the sales could be effected at lower prices. For the achievement of these activities, cost accounting methods, store control methods, techniques of standard costing, budgetary control etc. should be adopted. However, these modern techniques are mostly not in application and as such in practice a wide gap is found in the goals to be achieved and the actual achievements. While auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds. Middlemen commissions are, as far as possible, avoided and the purchases are made by the committee members directly from the wholesalers. The principles of propriety audit should be followed for the purpose.

6. **Observations of the Provisions of the Act and Rules** - An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor. For example, under the Maharashtra State Act, the maximum rate of dividend prescribed is 12% but the dividend distributable in cash should not exceed 6% and the balance of 3% in excess of it should be credited to individual share capital accounts of members.
7. **Verification of Members' Register and examination of their pass books** - Examination of entries in members pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organisation to assure that the entries in the books of accounts are free from manipulation. Specifically in the rural and agricultural credit societies, members are not literate and as such this is a good safeguard on their part. Of course this checking will be resorted to on a test basis, which is a matter of judgement of the auditor.
8. **Special report to the Registrar** - During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:
 - (i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
 - (ii) Detection of fraud relating to expenses, purchases, property and stores of the society.
 - (iii) Specific examples of mis-management like decisions of management against co-operative principles.
 - (iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about

the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

9. **Audit classification of society** - After a judgement of an overall performance of the society, the auditor has to award a class to the society. This judgement is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society.
10. **Discussion of draft audit report with managing committee** - On conclusion of the audit, the auditor should ask the Secretary of the society to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalised without discussion with the managing committee. Minor irregularities may be got settled and rectified. Matters of policy should be discussed in detail.

Question 4

List the special features involved in the audit of a Cooperative Society.

Answer

Following are the special features in the audit of a cooperative society:

- Examination of overdue debts.
- Special treatment of over due interest in the determination of profit.
- Certification of bad debts before write off.
- Valuation of assets and liabilities
- Adherence to co-operative Principles.
- Observations of the Provisions of the Act and Rules
- Verification of members' Register and examination of their pass books
- Special report to the registrar on fraud, mismanagement and personal profiteering.
- Audit classification of society based on the audit findings
- Discussion of draft audit report with the managing committee.

Question 5

Under what circumstances, an auditor is required to submit a special report to the registrar of Co-operative Societies?

Answer

During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take

necessary action against the society. In the following cases, for instance a special report may become necessary:

- (i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
- (ii) Detection of fraud relating to expenses, purchases, property and stores of the society.
- (iii) Specific examples of mis-management. Decisions of management against co-operative principles.
- (iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

Question 6

"Examination of overdue debts, audit classification of society, and reporting the infringement of provisions of the Act are the special features of audit of a co-operative society." Do you agree?

Answer

Special Features of Co-operative Society Audit: The special features of co-operative society audit, to be borne in mind in general while conducting the audit are examination of overdue debts, overdue Interest, certification of bad debts, valuation of assets and liabilities, adherence to co-operative principles, reporting infringement of act and rules, verification of members' register and examination of their pass books, special report to the registrar, audit classification of co-operative society, discussion of draft audit report with managing committee etc.

Besides the other special features mentioned above the Examination of overdue debts, audit classification of society and reporting the infringement of provisions of the Act, are some of special features of audit of a co-operative society which are explained as follows:

- (1) **Examination of overdue debts:** Auditor of a co-operative society has to classify the overdue debts for a period from 6 months to five years and more than 5 years. Further these debts are to be analyzed in 'good' or 'bad' depending on the recoverability of the debts. The bad and doubtful debts require some provision and the auditor has to ascertain whether proper provision for bad & doubtful debts has been made. The current year's amount of overdue debts and its ratio to the working capital and loans outstanding is to be compared with last year to know whether the trend is increasing or decreasing. The status of the court cases for recovery of the overdue debts is also to be mentioned in the audit report. While calculating the profit the interest on the overdue debts is not to be taken into account. The Bad debts portion of the overdue debts is to be certified by the auditor for the purpose of writing off.
- (2) **Audit Classification of Co-operative Society:** It is a unique feature of the Co-operative audit. After completion of the audit the auditor has to evaluate the working of the society

on the basis of various parameters and criteria which are specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society. For good performance having certain marks "A" class is given. The D class is given to the society which shows very poor performance. In the same way B or C class is awarded on the basis of the marks obtained by the society.

- (3) **Reporting infringement of Act and Rules:** The auditor of the co-operative Society is required to report the non compliance of the various provisions of the Co-operative Societies Act, Rules framed under that Act and the by laws of the society. He has to assess the financial implications of such infringements and disclose the same in his report. The infringements of serious nature are to be reported separately and infringements which do not have financial implications and which have no serious effect on the working of the society or rights of the members may be reported separately.

Thus we can say that Examination of overdue debts, audit classification of society and reporting the infringement of provisions of the Act, are only some of special features of audit of a co-operative society.

Question 7

State the requirements regarding the maintenance of books of accounts with respect to a multi-state co-operative society.

Answer

Maintenance of Books of Accounts with respect to a Multi-State Co-Operative Society:
As per the Multi State Co-operative Society Rules, 2002, every multi state co-operative society shall keep books of accounts with respect to

- (i) all sum of money received and expended and the matters in respect of which the receipt and expenditure took place.
- (ii) all sales and purchases of goods.
- (iii) the assets and liabilities of the society.
- (iv) in the case of Multi State Co-operative Society engaged in production, processing and manufacturing particulars relating to utilization of materials or labour or other term of cost as may be specified in the bye laws of such a society.

Comprehensively, the following books of accounts may be maintained:

- **Cash book:** It may be maintained to record particulars regarding cash receipts and expenses under suitable heads, with clear distinction between capital and revenue items of receipts and expenses.
- **Stock register:** It may contain detailed information as regards receipts, issues and balances of stock-in-trade, date-wise. In a producers co-operative society, perpetual inventory records may be maintained based on an appropriate costing method.

- *Register of assets and investments:* It will contain detailed particulars regarding the various immovable and movable assets belonging to the society, such as, types of assets, location, date of acquisition, cost, depreciation provided, and so on.
- *Register of fixed deposits:* In the case of a co-operative credit society, or a co-operative bank, or any other society which is authorised by its laws to accept deposits from members/ non-members, a register of fixed deposits may be maintained giving details as regards the dates of acceptance, maturity, interest accrual, repayment, etc.
- *Register of sureties:* In the case of a co-operative credit society, loans are given against personal security of members as also surety (guarantee) provided by two other members. The Register of Sureties will give particulars about the number of borrowers in respect of which a member has stood surety, and show whether it is within the overall limit of surety-ship that may be given by a member as prescribed by the bye-laws.
- *Register of loan disbursement and recovery:* In the case of a co-operative credit society, this Register will provide particulars regarding loans sanctioned by the society, the dates of disbursement and recovery.

Question 8

Write short notes on - Restrictions on investments of funds of a central co-operative society.

Answer

Restrictions on Investment of funds of a Central Cooperative Society. - Provisions of the Central Act put some restrictions on investments of funds of a Central Cooperative Society. According to Section 32 of the Central Act, a Central Cooperative Society may invest its funds only in any one or more of the following:

- (a) In the Central or State Co-operative Bank.*
- (b) In any of the securities specified in Section 20 of the Indian Trusts Act, 1882.*
- (c) In the shares, securities, bonds or debentures of any other society with limited liability.*
- (d) In any co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.*
- (e) In any other moneys permitted by the Central or State Government.*

The principal provision relating to the investments of funds of a co-operative society, the Central as well as State Acts does not mention anything about the investment of reserve fund outside the business specifically.