

13. Audit of Co-operative Societies

Important Point of this chapter

1.

Introduction

A Co-operative society is a business organization with a special mode of doing business, by pulling together all the means of production co-operatively, elimination of middlemen and exploitation from outside forces.

Co-operative organization are also forging ahead in large scale, industries such as sugar mills, oil mills, paper and pulp industries, spinning and weaving mills and distilleries.

Auditor and Management

1. Qualification of Auditor

Apart from a CA within the meaning of the chartered accountants Act, 1949, some of the state Co-operative acts have permitted persons holding a government diploma in co-operative accounts or in co-operation and accountancy as also a person who has served as an auditor in the co-operative department of a government to act as an auditor.

2. Appointment

An auditor of a co-operative society is appointed by the registrar of co-operative societies and the auditor so appointed conducts the audit on behalf of the registrar and submits the report to him as also to the society. The audit fees are paid by the society on the basis of statutory scales of fees prescribed by the registrar, according to the category of the society audited.

3. Books, Accounts and Other records of Co-operative Societies

The books of account required to be maintained in terms of the instruction of the Registrar are in respect of the following:

- i. All sums of money received and expended by the society and the matters in respect of which receipt and expenditure take place.
- ii. All sales and purchase of goods by the society also an account of stock-in-hand.
- iii. Assets and liabilities of the society. It may be understood that such of the books as are relevant to the nature of the society would be required to be maintained, for example, a credit society cannot be expected to maintain books of account for sale and purchase of goods.

4. Restriction on Share Holding

According to Section 5 of the co-operative societies Act, 1912, in the case of a society where the liability of a member of the society is limited, no member of society other than a registered society can hold such portion of the share capital of the society as would exceed a maximum of 20% of the total number of shares or of the value of shareholding to Rs. 1,000/-.

5. Restrictions on Loans

A registered society shall not make a loan to any person other than a member. With the special sanction of the registrar, a registered society may make a loan to another registered Society. The state government may further put such restriction as it thinks fit on the loaning powers of the society to its members or to other societies in the interest of the society concerned its members.

6. Restriction on Borrowings

A registered society may accept loans and deposits from its members and others subject to the restrictions and limits of the bye-laws of the society.

7. Investment of Funds.

A society may invest its funds in

- a. In the central or state government co-operative bank.
- b. In any of the securities specified in section 20 of the Indian trusts Act, 1882.
- c. In the shares, bonds or debentures of any other societies 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.

8. Appropriation of Profits

According to Section 33 of the Central Act states that 25% of the profits should be transferred to Reserve Fund, before distributing as dividends to members. Generally in case of newly started salary earner's credit societies this may be taken as 10%.

9. Contribution to charitable purpose

According to Section 34, a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose as defined in section 2 of the Charitable Endowments Act, 1880.

10. Investment in Reserve fund outside the business or utilization as working capital

Some of the state acts provide that a society may use the reserve fund:

- a. In the baseness of society, as working capital
- b. May invest as per the provisions of act,
- c. May be used for some public purpose likely to promote the object if the society.

11. Contribution to education fund

Some of the states act provides that every society shall contribute annually towards the education fund of the state federal society, at the appropriate rate as per the class of the society. Contribution to education fund is a charge of profits and not an appropriation.

- According to certain state acts, transfer of dividend Equalization Reserve and Share Capital redemption fund are stated as charges against profits. According to the generally accepted principles of accountancy these items are not charges, but appropriation of profits. The auditor should point out such spots where statutory provision of any law is in contradiction with the generally accepted accounting policies.

Special Features of Co-operative audit

1. **Examination of overdue debts** – overdue debts for a period of six months to five years and more than five years will have to be classified and shall have to be reported by an auditor. 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 result thereof.
2. **Overdue Interest** – overdue interest is interest accrued or accruing in account, 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** – bad debts and irrecoverable losses before being written off against bad debts funds, reserve funds etc. should be certified as bad-debts or irrecoverable losses by the auditor where the law so requires. Where no such requirement exist the managing committee of the society must authorize the write-off.
4. **Valuation of assets and liabilities** – the auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be verified at cost less adequate provision for depreciation. 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 condition.
5. **Adherence to Co-operative principles** – the auditor will have to ascertain in general, how far the objects, for which the co-operative organization 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.
6. **Observation of the provision of the act and rules** – an auditor of a co-operative society is required to point out the infringement with the provision of the co-operative societies act and rules and bye-laws.
7. **Verification of members register and their passbooks** – examination of entries in members pass book regarding the loan given and its repayments and confirmation of loan balances in person is very much important in a co-operative organization to assure that the entries in books of account are free from manipulation.
8. **Special report to the registrar** – case for instance a special report may be necessary are as follows:
 - a. Personal profiteering by member of managing committee in transaction of the society which are ultimately detrimental to the interest of the society.
 - b. Detection of fraud relating to expenses, purchase, property and stores of the society.
 - c. Specific examples of mis-management.
 - d. In case of co-operative banks loan given to member or relative of members, and deliberate negligence about the recovery thereof.

9. Audit classification of society – after a judgment of an overall performance of the society, the auditor has to award a class to the society. The auditor should be very careful, while making a decision about the class of the society.

10. Discussion of draft audit report with committee – the audit report should never be finalized without discussing with the managing committee. Minor irregularities may be got settled and rectified. Matters of policy should be discussed in detail.

Form of Audit report

The auditor will have to attach schedules to the report regarding the following information:

1. All transaction which appear to be contrary to the provision 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 for recovery.
4. Any material irregularity or improperly in expenditure or in the realization of monies due to society.
5. Any other matters specified by the registers in this behalf.
 - In the case of nil report in any of the above matters, the auditor will have to give a nil report.
 - The auditor of co-operative society in the applicable state has to answer two sets of questionnaires called as audit memos. The first set of audit memo is set of general nature and is applicable to all type of societies such as urban banks, consumer's stores, credit societies etc. the second set of memo is specific for a particular type of society. These questionnaires are drafted in detail and serve the practical purpose of audit programme.

Audit, Inquiry and inspection of Multi-state co-operative societies.

The multi-state co-operative Societies act, 2002, which came into force in August, 2002, applies to co-operative societies whose objects are not confined to one state.

➤ **Books of account** – as per the same listed above

➤ **Auditor**

- a. *Qualification* – a person who is a CA with meaning of CA act can only be appointed as auditor of the multi-state co-operative society. However the following are not appointed as the auditor of the society
 - i. A body corporate
 - ii. An officer or employee of the multi-state co-operative society
 - iii. A person who is a member or who is in the employment, of an officer or employee of the society.
 - iv. A person who is indebted or provides a guarantee for amount exceeding Rs. 1000
- b. *Appointment* - first auditor shall be appointed by the board within one month of the date of registration of the society and if they fail then the auditor appointed in general meeting.
- c. *Power and Duties* – every auditor of a MCS shall have a right of access at all times to the books of accounts and vouchers of the MCS, whether kept at the HO or MSC elsewhere, and shall not be entitled to require from the offices or other employees of the MCS such information and explanation as the auditor may think necessary for the performance of his duties.

d. *Content of Audit report:*

Sub section – 3

- In the case of the BS, of the state of the MCS's affairs as at the end of its financial year; and
- In the case of P&L, of the profit and loss of its financial year.

Sub Section – 4

- Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of audit.
- Regarding the satisfaction from co-operation of staff regarding verification of book of account.
- Whether the report on the account of any branch where another person is as auditor has been forwarded his report to him and how he has dealt with the same in preparing the auditor's report.
- Whether the MCS's balance sheet and P&L dealt with by the report in agreement with the books of account and return.

Sub section – 5

- Where any of the matter referred to in above section is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

e. *Power of Central Government to direct audit in special cases* – the case for such situation are as follows:

- i. That the affairs of any MCS are not being managed in accordance with the self-help and mutual aid and co-operative principles or prudent commercial purpose or with sound business policies.
- ii. That any MCS is being managed in a manner likely to cause serious injury or damage to the interest of trade industry or business to which it pertains.
- iii. That the financial position of any MCS is such as to endanger its solvency.

- **Inquiry by central register u/s 78** – the central registrar may, on a request from a federal co-operative to which a MCS is affiliated or a creditor or not less than 1/3rd of the members of the board or not less than 1/5th of the total number of members of a MCS hold an inquiry or direct some person authorized by him by order in writing in his behalf to hold an inquiry into the constitutions, working and financial conditions of a MCS. However for this 15 days notice must be given to MCS.

- **Inspection of MCS u/s 79** – the central register may, on a request from federal co-operative to which a MCS is affiliated or a creditor or not less than 1/3rd of the members or not less than 1/5th of the total numbers of a MCS by general or special order on writing in this behalf or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a MCS.