CHAPTER-16
AUDIT OF CO-OPERATIVE SOCIETIES

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1. AUDIT AS PER SECTION 17 OF CO-OPERATIVE SOCIETY ACT 1912

1) The Registrar shall audit or cause to be audited by some person authorized by him by general
or special order in writing in this behalf the accounts of every registered society once at least in
every year.

2) The audit under sub-section (1) shall include an examination of overdue debts, if any, and a
valuation of the assets and liabilities of the society.

3) The Registrar, the Collector or any person authorized by general or special order in writing in this
behalf by the Registrar shall at all times have access to all the books, accounts, papers and
securities of a society, and every officer of the society shall furnish such information in regard
to the transactions and working of the society as the person making such inspection may
require.

“Registrar” means a person appointed to perform the duties of a Registrar of Co-operative Societies
under this Act.

2. IMPORTANT POINTS RELATED TO “CO-OPERATIVE SOCIETY” WHICH
AUDITOR SHOULD KNOW.

Following points kept audit of a co-operative society:

Related to Auditor
1. Qualifications of Auditors (CAs / Diploma in Co-operative Accounts are also allowed)
2. Appointment of the Auditor (Appointed by Registrar but report is submitted to both Registrar &
Co-operative Society / Fees decided as per various criteria like working capital, Here working
Capital means paid up share capital + Accumulated Profits + Money raised)

Books of Accounts
3. Books, Accounts and other records of Co-operative Societies (State government can frame rules as
per Sec 43(h), In Maharashtra requirements of state law is like companies act, depending on nature of
society other records must be kept)

Balance Sheet
4. Property and Investment Register (It is just like fixed asset registered with all key details of asset &
investment)

5. Investment of funds
   According to Section 32 of the Central Act the modes of investment of funds of a society may be
stated as follows. A society may invest its funds in any one or more of the following:
6. 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 (Section 29). The State Government may further put such restrictions 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 and its members.

7. Surety Register
In case of co-operative credit societies, loans are granted to members as per regulations in that behalf in the bye-laws of the society. These loans are given against the personal security of the debtor, in addition to a surety or guarantee given by two members. In order to keep a watch on the number of borrowers for whom a person has stood surety, this register would be of immense help. The bye-laws prescribe the limit of surety by a person depending on his financial position, shareholding etc.

8. Restrictions on share holdings
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 a society other than a registered society can hold such portion of the share capital of the society as would exceed a maximum of twenty percent of the total number of shares or of the value of shareholding to Rs 1,000/-. The auditor of a co-operative society will be concerned with this provision so as to watch any breach relating to holding of shares. The State Acts may provide limits as to the shareholding, other than that provided in the Central Act.

9. Restrictions 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. The auditor will have to examine the bye-laws in this respect (Section 30).

10. Fixed Deposits Register
(In case of Urban Co-operative Banks and credit societies accepting deposits from members, a fixed deposit register should be maintained showing all the particulars such as date of acceptance, date of maturity, interest due date, repayment etc.)

11. Appropriation of profits Section 33 of the Central Act states that 25% of the profits should be transferred to Reserve Fund, before distribution as dividends or bonus to members. However, having regard to the financial position of the society, the Registrar may reduce the percentage of transfer, but in any case, not less than 10%. Generally, in case of newly started salary earners’ credit societies this liberal view is taken.

12. Contributions to Charitable Purposes
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, 1890.

13. Investment of 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 business of a society, as working capital (subject to the rules made in this behalf). *(Lending, Goods for Farmers, Consumer Goods etc)*

b) May invest as per provisions of the Act.

c) May be used for some public purposes likely to promote the object of the society. *(Importance of Savings, how to do farming, how to save money in goods)*

The auditor should ensure strict compliance with the State Act and Rules in this regard.

14. Contribution to Education Fund

Some of the State Acts provide 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 on profits and not an appropriation.

### 3. SPECIAL FEATURES OF “CO-OPERATIVE AUDIT”

#### SPECIAL FEATURES OF “CO-OPERATIVE AUDIT”

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<th>Most Important</th>
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<tr>
<td>1. Observations of the Provisions of the Act and Rules</td>
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<td>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. <em>(Delhi: - In no co-operative society, the dividend shall exceed 18 percent per annum on paid-up share capital.)</em></td>
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<th>2nd Most Important</th>
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<td>2. Adherence to Co-operative Principles</td>
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<td>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 affected 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.</td>
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<th>Debt Related Points</th>
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<td>3. Verification of Members’ Register and examination of their pass books</td>
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<td>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.</td>
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4. **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.

5. **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.

6. **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.

7. **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 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.

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: (E-MAP)
   i. Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society. *(Allocating contracts to family members, taking decisions beneficial to own business etc)*
   ii. Detection of fraud relating to expenses, purchases, property and stores of the society. *(Excessive payments, personal expenses paid from co-operative society)*
   iii. Specific examples of mis-management. Decisions of management against co-operative principles. *(No proper meetings & decisions, decision to make profits and have luxury office is against co-operative principle)*
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. 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.

10. 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.

4. AUDIT REPORT OF CO-OPERATIVE SOCIETY

On completion of audit, the auditor has to submit his audit report to the society, and copies thereof to the respective authorities such as District Special Auditor, District Deputy Registrar etc. According to the present prescribed form in some of the States, the auditor has to state:
a) Whether in his opinion, proper books of account as required by the Act, the Rules and the bye-laws of the society have been properly maintained.
b) Whether the Balance Sheet and the Profit and Loss Account examined by him are in agreement with the books of account and returns of the society.
c) Whether in his opinion and to the best of his information and according to the explanations given to him, the said accounts give all the information required by the Act.
d) Whether the Balance Sheet drawn up as at the end of the year gives a true and fair view of the state of affairs of the society as on the given date.
e) Whether the Profit and Loss Account of the society gives a true and fair view of the Profit and Loss made by the society.
f) Whether he has obtained all the necessary information and explanations which to the best of his knowledge and belief were necessary for the purpose of audit.

The auditor will have to give qualifying observations, if any of the answers to the above-mentioned matters are negative.

Schedules to Audit Report: - (ME –CS)
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. (Eg Loan to non-member)
2. All sums, which ought to have been, but have not been brought into account by the society. (Eg Donations received not yet accounted because no consensus in which fund to credit)
3. Any material, or property belonging to society which appears to the auditor to be bad or doubtful of recovery. (Eg Obsolete Inventory or Loan given to defunct co-operative society)
4. Any material irregularity or impropriety in expenditure or in the realisation or monies due to society. (Eg Excess payment in celebrating birthday of chairman, political contribution)
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.
Further in addition to the audit certificate in the prescribed form and various schedules stated above, 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 or questionnaire is of general nature and is applicable to all types of societies such as urban banks, consumers’ stores, credit societies etc. The second set of questionnaires is specific for a particular type of society. These questionnaires are drafted in detail and serve the practical purpose of audit programme.

Audit Report in Narrative Form

The audit report in a narrative form is also required to be submitted by the auditor addressed to the Chairman of the society. Generally, the narrative audit report as per convention is divided into two parts styled as part I and part II.

Part I of the report is very important which throws a light on comparative financial position, capital structure, solvency position and the profitability or otherwise of the society. It may contain comments on the working of the society and the suggestions for future improvements. It must be suitably divided into paragraphs.

Part II of the report points out the observations of routine nature, which are the finished products of the routine vouch and post audit such as missing vouchers, loan bonds, inadequacies of documents, mistakes of principles in accounting etc. However, mistakes having an impact on the profitability of society should be pointed out in Part I as it has got a consequential effect on the financial position of society.

5. MULTI STATE CO-OPERATIVE SOCIETY

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. The Act Contains detailed provisions regarding registration, membership and management of such Societies.

Chapter VII of the Act deals with properties and funds of the Multi-State co-operative societies. The funds of a Multi-State co-operative society cannot be utilised for any political purpose. The Act contains detailed provisions regarding the investment of funds and restrictions on loans, borrowings, etc.

(Sec 72) Qualifications and Disqualifications:

1. A person shall not be qualified for appointment as an auditor of a multi-state cooperative society unless he is a chartered accountant within the meaning of the Chartered Accountants Act 1949 (38 of 1949).

2. None of the following persons shall be qualified for appointment as auditor of a multi-state cooperative society:
   a) a body corporate;
   b) an officer or employee of the multi-state cooperative society;
   c) a person who is a member, or who is in the employment, of an officer or employee or the multi-state cooperative society;
   d) a person who is indebted to the multi-state cooperative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the multi-state cooperative society for an amount exceeding one thousand rupees.

3. A person shall also not be qualified for appointment as an auditor of a multi-state cooperative society if he is, by virtue of sub-section (2), disqualified for appointment as an auditor of any other body corporate or multi-state cooperative society or cooperative society.

4. If an auditor becomes subject, after his appointment, to any of the disqualifications specified in subsections (2) and (3), he shall be deemed to have vacated his office as such.
First Auditor

First auditor or auditors of a multi-state cooperative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting:

Provided that-

a) the multi-state cooperative society may, at a general meeting, remove any such auditor or all or any of such auditors and appoint in his or their places any other person or persons who have been nominated for appointment by any member of the multi-state cooperative society and of whose nomination notice has been given to the members of the multi-state cooperative society not less than fourteen days before the date of the meeting; and

b) If the board fails to exercise its powers under this sub-section, the multi-state cooperative society in the general meeting may appoint first auditor

Subsequent Auditor

Every multi-state cooperative society shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting and shall, within seven days of the appointment, give intimation thereof to every auditor so appointed.

Provided that such auditor or auditors may be appointed from a panel of auditors approved by the Central Registrar or from a panel of auditors, if any, prepared by the multi-state cooperative society.

Powers of Auditor

Every auditor of a Multi-State co-operative society shall have a right of access at all times to the books and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi-State cooperative society or elsewhere, and shall be entitled to require from the officers or other employees of the Multi-State co-operative society such information and explanation as the auditor may think necessary for the performance of his duties as an auditor.

Inquiry by Auditor

As per Section 73(2) the auditor shall make following inquiry:

a) Where it is Stated in the books and papers of the Multi-State co-operative society that any shares have been allotted for cash, whether cash has actually, been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet as correct regular and not misleading.

b) Whether loans and advances made by the Multi-State co-operative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State co-operative society or its members,

c) Whether personal expenses have been charged to revenue account, and

d) Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,

Audit Report

a) Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.

b) Whether, in his opinion, proper books of account have been kept by the Multi-State cooperative society so far as appears from his examination of these books and proper returns adequate for the purpose of his audit have been received from branches or offices of the Multi-State co-operative society not visited by him.

c) Whether the report on the accounts of any branch office audited by a person other than the Multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor’s report.
d) Whether the Multi-State co-operative society’s balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.

Special Audit
Power of central Government to direct special audit in certain cases - Under Section 77 where the Central Government is of the opinion:

a) that the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual did and co-operative principles or prudent commercial practices or with sound business principles; or

b) that any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains; or

c) That the financial position of any Multi-State co-operative society is such as to endanger its solvency.

The central Government may at any time by order direct that a special audit of the Multi-State co-operative society’s accounts for such period or periods as may be specified in the order, shall be conducted and appoint either a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 or the Multi-State co-operative society’s auditor himself to conduct the special audit. However, central Government shall order for special audit only if that Government or the State Government either by itself or both hold fifty-one per cent or more of the paid-up share capital in such Multi-State co-operative society.

The special auditor shall have the same powers and duties in relation to the special audit as an auditor of a Multi-State co-operative society has under section 73. However, the special auditor shall instead of making his report to the members of the Multi-State co-operative society make the report to the Central Government. The report of the special auditor shall, include all the matters required to be included in the auditor’s report under section 73 and any other matter as directed by the Central Government.

On receipt of the report of the special auditor the Central Government may take such action on the report as it considers necessary in accordance with the provision of the Act or any law for the time being in force.

Provided that if the Central Government does not take any action on the report within four months from the date of its receipt, that Government shall send to the multi-State cooperative society either a copy of, or relevant extract from, the report with its comments thereon and require the multi-State co-operative society either to circulate that copy or those extracts to the members or to have such copy or extracts read before the multi-State cooperative society at its next general meeting.

The expenses of, and incidental to, any special audit under this section (including the remuneration of the special auditor) shall be determined by the Central Government which determination shall be final and paid by the multi-State co-operative society and in default of such payment, shall be recoverable from the multi-State co-operative society as an arrear of land revenue.