

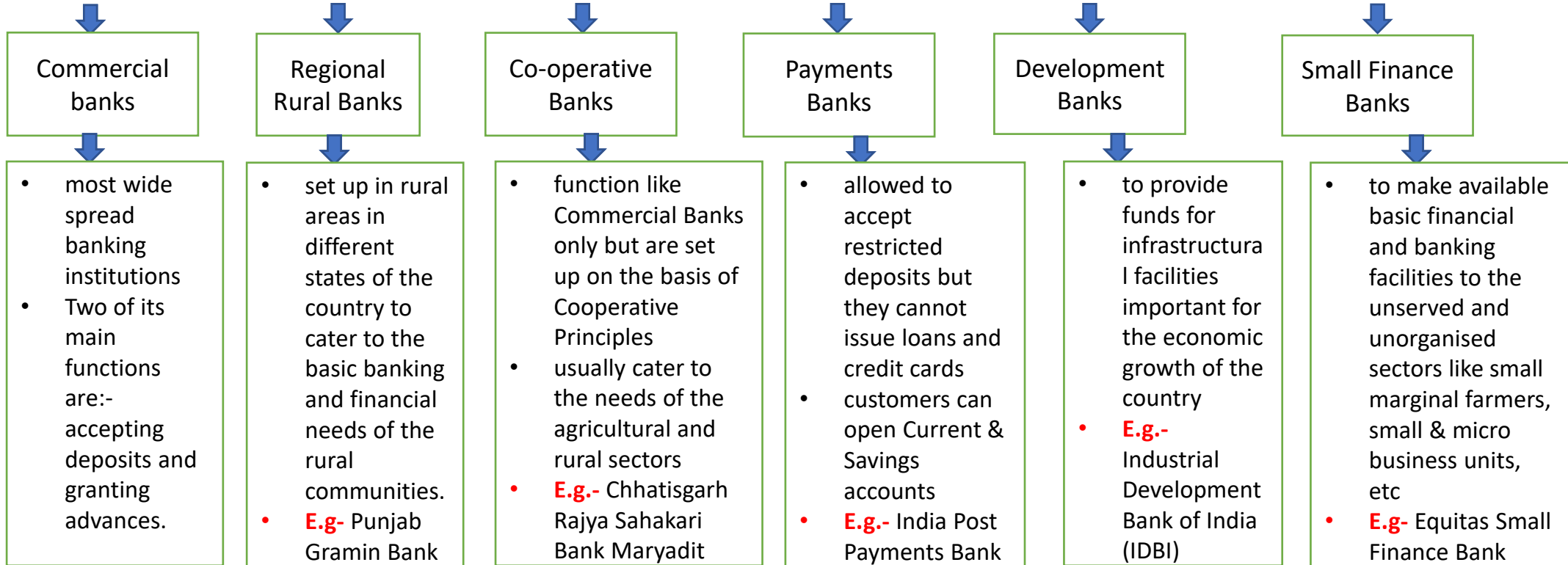
10+ years of experience! Unbeatable Passion for Audit Subject!!! That's CA Pragnesh Kanabar Sir!

Brahmastra Revision CA Inter Audit- New Syllabus- ALL NON SAs

Part II of CA Inter Audit Marathon- It covers Chapter 5, 9 and 10
Inter Audit New syllabus

**Watch Revision Videos on our Youtube Channel- The Audit Academy
to get maximum benefit of these notes**

Visit our website- www.theauditacademy.com to join our Youtube channel, telegram channel and to Download our app.

1. Different types of Banks**2. Reserve Bank of India: Regulating Body**

The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country.

RBI is responsible for :- RIP

- **R- Regulating the activities of commercial and other banks**
- **I- Indian financial system's development and supervision**
- **P- Policy determination along with CG- monetary and other credit policies**

Important functions of RBI are :- CCB

- **C- Currency issuance**
- **C- currency regulation**
- **B- banker to central and state government**

3. Regulatory frameworks governing bank audit

BRICS

- B- Banking Regulation Act, 1949
- R- Regional Rural Banks Act, 1976
- R- Reserve Bank of India Act, 1934
- I- Information Technology Act, 2000
- C- Companies Act, 2013.
- S- State Bank of India Act, 1955.

4. Peculiarities involved:

- VC Large Geography with Technology
- V- Volume of transactions
- C- Complexity of transactions
- Geography- Geographical spread of network
- Large- Large range of products and services
- Technology- Extensive use if IT

5. Types of Bank Audit Reports to be issued (generally):

GHOSH'S LIST

- GHOSH- Ghosh committee's recommendation implementation report
- L- Long Form Audit Report (LFAR)
- I- Irregularity in the working of bank
- S- SLR compliance report
- T- Treasury operations compliance report

6. Understanding of accounting system in banks

- A) Computerized environment- auditor should be satisfied whether all norms/parameters as per latest applicable RBI guidelines are incorporated into the system.
- B) Should not assume that system generated information is correct without proper testing and evidence.

7. Drawing an Audit Plan

Audit Plan should be drawn based upon:

PROF

- P- Previous report
- R- Risk- Audit risk due to inadequate controls
- O- Operations- nature and level of operations
- F- Features- nature of adverse features

8. Engagement Team discussion

Matters covered in such discussion:

Error Fraud Risk Response

- Error- Errors that are more likely to occur
- Error- Errors identified in prior years
- Fraud- Method used for fraud planning
- Risk Response- Audit responses to RoMM

9. Engagement Team discussion- Advantages

- A) enables the engagement team to consider an appropriate response to fraud risks
- B) enables the audit engagement partner to delegate the work
- C) partner may review the need to involve specialists

10. Accounts and Audit Technical requirements

A) Third Schedule to the Act (Banking Regulation Act, 1949)- B/S and P/L format.

Form A of the Third Schedule- B/S. Form B contains- P/L

B) Follow Accounting Standards (AS) of the ICAI

C) APPOINTMENT OF AUDITOR

i) Auditor of: nationalised bank

Appointed by: BOD of the bank

RBI's Prior approval: Yes

CG's Prior Approval: NA

ii) Auditor of: regional rural banks

Appointed by: by the bank (BOD)

RBI's Prior approval: NA

CG's Prior Approval: Yes

iii) Auditor of: Banking company

Appointed by: AGM of the shareholders

RBI's Prior approval: Yes

CG's Prior Approval: NA

Note- Remuneration of SBI and Nationalised bank= fixed by RBI in consultation with CG

11. Audit of Banks- Auditor's report

In the case of a nationalised bank and SBI, the auditor is required to make a report to the Central Government in which he has to state the following:

LFAR- Long Form Audit report

Additional reporting requirement prescribed by RBI to be followed by all types of banks.

The Statutory Central Auditors are required to submit the LFAR to the banks latest by 30th June every year

- (a) whether, in his opinion, the financial statements present a true and fair view of the affairs of the bank and in case he had called for any explanation or information,
- (b) whether it has been given and whether it is satisfactory;
- (c) whether or not the transactions of the bank, which have come to his notice, have been made within the powers of that bank;
- (d) whether or not the returns received from the offices and branches of the bank have been found adequate for the purpose of his audit; and any
- (e) other matter which he considers should be brought to the notice of the Central Government.

number of unaudited branches and quantification of advances must also be given in the audit report

12. Application of SAs in Bank Audit

12.1 Initial considerations by statutory Auditor: I EAT CD

I- Internal Assignments in Banks not to be accepted by Statutory Auditors

E- Establish the Engagement Team based upon size, nature and complexity of the bank.

A- Assessment of Engagement Risk (Acceptance and continuance of the client)

T- Terms of Audit Engagements as per SA 210- document the agreement

C- Communication with Previous Auditor as per code of ethics of the ICAI

D- Declaration of Indebtedness- Auditor/Firm/Relatives/Staff have not become NPA

12.1 Understanding the Risk Management Process:

CRIC Monitor

(same as components of internal control discussed in Chapter 3- Risk assessment and Internal Control)

C- Control environment- Oversight and involvement in the control process by those charged with governance (BOD/MD/Audit Committee)

R- Risk Assessment process of the entity- Identification, measurement and monitoring of risks by the entity

I- Information system and related business processes relevant to FR- reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis

C- Control activities- appropriate controls to mitigate its risks

Monitor- Monitoring activities

13. Some technical terms in banking industry



13.1 Reliance on / review of other reports:

The auditor should take into account the adverse comments, if any, on advances appearing in the following-

- Previous year's audit reports.
- Report on verification of security.
- Reserve Bank's latest inspection report.

13.2 Stress Testing:

RBI has required that all commercial banks shall put in place a Board approved 'Stress Testing framework' to suit their individual requirements which would integrate into their risk management systems. Stress testing is a software testing activity that determines the robustness of software by testing beyond the limits of normal operation

13.3 BASEL III framework:

Basel norms or accords are the International Banking regulations issued by the BCBS. The Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) have developed the set of agreement by the BCBS, which mainly focuses on risks to banks and the financial system are called Basel accord.

14. Discussion on Audit of Advances

Types of Advances:

- **Funded loans** are those loans where there is an actual transfer of funds from the bank to the borrower. E.g.- Term loans, Demand Loans etc.
- **Non-funded facilities** are those which do not involve such transfer. E.g. Letter of credit

Advances comprise of funded amounts by way of:

Code- TOPIC of Bill and Demand

- Term loans
- Cash credits,
- Overdrafts,
- Demand Loans
- Bills Discounted and Purchased
- Participation on Risk Sharing basis
- Interest-bearing Staff Loans

Legal requirements of Disclosure in the Balance Sheet:

Nature of Advance

- (i) Bills purchased and discounted
- (ii) Cash credits, Overdrafts and loans repayable on demand
- (iii) Term Loans

Nature of security

- (i) Secured by tangible assets
- (ii) Covered by Bank/ Government guarantees
- (iii) Unsecured

Geographical classification

- (i) Advances in India
 - A. Priority sector
 - B. Public sector
 - C. Banks
 - D. Others
- (ii) Advances outside India
 - A. Due from Banks
 - B. Due from others
- (i) Bills purchased and discounted
- (ii) Syndicated loans
- (iii) Others

Classification of Advances

Sector Wise:

RBI issues common guidelines for lending to Priority Sector which banks are required to follow. RBI also issues targets for banks for lending to Priority Sector. Examples of Priority Sectors are Agriculture , MSME , Education , Housing , etc.

Security Wise:

A) Primary security- principal security for an advance. one against which credit has been extended by the bank
 B) Collateral security- additional security. i.e. tangible or intangible asset, movable or immovable asset.

Mode of creation of security

Mortgage: E.g Home loan
 Property- Immovable
 Ownership- Borrower
 Possession- Borrower

A) Equitable mortgage: delivery of title deeds or other documents of title with intent to create security thereof.
 B) Registered Mortgage: affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security.

Pledge: E.g. Gold loan
 Property- Movable
 Ownership- Borrower
 Possession- Lender

delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance.

Hypothecation: E.g. Car Loan
 Property- Movable
 Ownership- Borrower
 Possession- Borrower

The borrower periodically submits statements regarding quantity and value of hypothecated assets (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is fixed.

Assignment: E.g. Insurance policy

Assignment represents a transfer of an existing or future right or property belonging to a person in favor of another person

An assignment gives the assignee absolute right over the moneys/debts assigned to him.

Set off:

statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor.

combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right

Lien:

Lien is creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose / liquidate the asset under lien.

Please refer NPA handwritten notes taught in the class- Click on this link to download those notes

https://drive.google.com/file/d/16ra4_2Hs2QjsBWb7dsWuGJqwZ5XjZdn/view?usp=drivesdk

Audit of Income and Expense in case of banks

Audit of Revenue

- A) any income which exceeds one percent of the total income of the bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual
- B) Write NPA income recognition points from above notes
- C) Take-out finance: A takeout loan is a method of financing whereby a loan that is procured later is used to replace the initial loan. Commonly used in property development. Main objective is to boost the availability of longer tenor debt finance for projects

Audit of Expense

- i) assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid to the liabilities during the year
- ii) verify the calculation of interest and ensure that:
 - (a) Interest has been provided on all deposits upto the date of the balance sheet;
 - (b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
 - (c) Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.
 - (d) Interest on inter-branch balances has been provided at the rates prescribed by the head office/RBI.

Follow general audit checklist like verification of documents, accounting treatment and disclosure of the items. Use the knowledge of Accounting standard while writing the answer

Income

The following items are included under this head:

Interest Earned	Other Income
<ul style="list-style-type: none"> Interest/ Discount on Advances/ Bills: Interest Income on Investments: Interest on Balances with RBI and Other Inter-bank Funds: Others: This includes any other interest/discount income not included in the above heads 	<ul style="list-style-type: none"> Commission, Exchange and Brokerage: This item comprises of the following: <ol style="list-style-type: none"> Commission on bills for collection. Commission/exchange on remittances and transfers, e.g. demand drafts, NEFT, RTGS, etc. Commission on letters of credit and guarantees, letter of comforts. Loan processing, arranger and syndication fees. Mobile banking fees. Credit/Debit card fee income including annual fee income, merchant acquiring income, interchange fees, etc. Rent from letting out of lockers Commission on Government business. Commission on other permitted agency business including consultancy and other services. Brokerage on securities. Fee on insurance referral. Commission on referral of mutual fund clients. Service/transaction banking charges including charges levied for transaction at other branches. Income from rendering other services like custodian, demat, investment advisory, cash management and other fee based services. Profit on Sale of Investments

- Profit/Loss on Revaluation of Investments
- Profit on sale of Land, Buildings and Other Assets:
- Profit/Loss on Revaluation of Fixed Assets
- Profit on exchange transactions: This includes revaluation gains/losses on forward exchange contracts and other derivative contracts, premium income/expenses on options, etc.
- Income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India.
- Miscellaneous income.

Expense

Interest Expense	Operating Expenses	Provisions and Contingencies
♦ Interest on Deposits	♦ Payments to and Provisions for Employees	♦ Provisions made in respect of the Non-performing assets.
♦ Interest on Reserve Bank of India/Inter-Bank Borrowings	♦ Rent, Taxes and Lighting ♦ Printing and Stationery	♦ Provisions for Taxation
♦ Others	♦ Advertisement and Publicity	♦ Provisions for Diminution in the value of investments
	♦ Depreciation on Bank's Property	♦ Provisions for contingencies
	♦ Directors' Fees, Allowances and Expenses	
	♦ Auditors' Fees and Expenses	
	♦ Legal expenses	
	♦ Postage, Telegrams, Telephones, etc.	
	♦ Repairs and Maintenance	
	♦ Insurance	
	♦ Marketing Expenses	
	♦ Other Expenses	

Government Audit Framework in India

→ Is conducted under the authority of **CAG- Comptroller and Auditor General of India.**

→ It is done through the agency (department) of **IAAD- Indian Accounts and Audit Department.**

→ **Broad framework of Government Expenditure in India:**

→ In India, no expenditure can be incurred unless it has been voted upon by the Parliament or State Legislatures.

→ The funds for every such expenditure must be provided from out of the Consolidated Fund of India or of the State

→ **As per Article 266, the Consolidated Fund of India consists of all the revenue received from direct and indirect taxes, all the loans taken by the Govt. of India and all the amount of repayment of loans received by the Govt. of India.**

→ After the expenditure has been incurred and the accounts are closed, the Appropriation Accounts are prepared which are scrutinised by the Public Accounts Committee.

→ **Government Audit consists of:**

- Audit of Expenditure
- Audit of Receipts (tax and non-tax)
- Audit of PSU (public sector undertakings)
- Audit of non-commercial autonomous

bodies financed by government in diverse fields

Definition by UN handbook on Government Auditing

What? → the (OSPI) ***objective, systematic, professional and independent*** examination

of ***financial, administrative and other operations***

of a public entity

When? → made subsequently to their execution

Why? → ***for the purpose of evaluating and verifying them***

How → presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions

Who? → by the responsible officials

and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation

Objectives- Memory code → Fund the Policy Base

Accounting for
Public **Funds**

Appraisal (evaluation) of
Government **policies**

Acts as **Base** for
Corrective
actions

Legal Framework- Government Audit & CAG of India**Articles of Constitution of India:**

Article 149 → Rights and Duties of CAG of India.

Article 150 → Accounts of Union and State to be maintained in the format.

Article 151 → Reports of CAG shall be submitted to the President/Governor of the state who shall cause them to be laid before parliament/state legislature.

Appointment of CAG:

a) **appointed by the President of India.**

b) Salary and other conditions of service: as determined by the Parliament but it should not cause disadvantage to CAG

(Note: salary which is equal to the salary of the Judge of the Supreme Court)

c) the administrative powers of the C&AG shall be determined by the President after consultation with him

d) Removal- detailed procedure:

i) shall not be removed from office except on the ground of **proven mis-behaviour** or incapacity

ii) only when each House of Parliament decides to do so by a majority of **not less than 2/3rd of the members of the House present and voting**

E) Tenure of CAG:

Fixed tenure of six years or upto the age of 65 years, whichever is earlier.

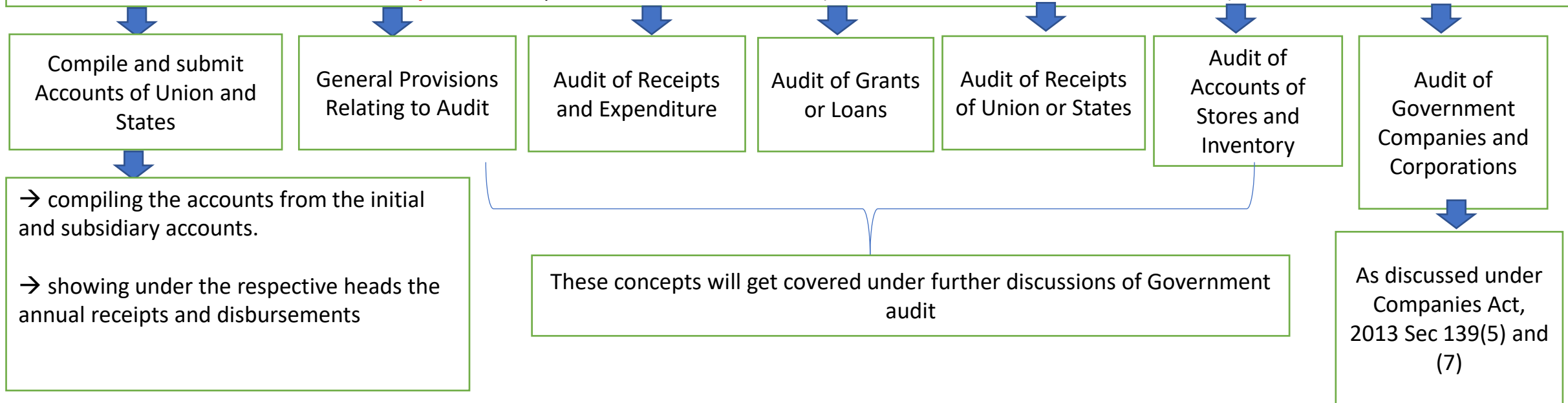
Powers of CAG as per The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971

To **inspect** any office of accounts under the control of the Union or a State Government

To require that any accounts, books, **papers be sent to specified places**

To put **such questions** or make such observations as he may consider necessary

to dispense with any part of detailed audit of any accounts or class of transactions and to **apply such limited checks** (i.e. right to decide the extent of checking to be done)

Duties of CAG as per The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971

Accounts of	Compile and Submit to
Union	President
State	Governor of a State
each Union Territory having a Legislative Assembly	Administrator of the Union Territory having a Legislative Assembly

Note:

A) Article 151 of the Indian Constitution enjoins that the C&AG shall report on the accounts of the Union and of each of the States to the President or the Governor concern and the letter shall cause the report to be laid before the legislatures.

B) The report should thereafter be publicized adequately in order to create a proper climate of public opinion. Recommendations are given by Public Accounts Committee after reading the reports

Expenditure Audit

Basic objective → to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred

audit against 'rules and orders'

audit of sanctions

audit against provision of funds.

propriety audit.

performance audit.

Approval by competent authority.
Either General approval or special approval in case of large expenditure.

expenditure incurred has been on the purpose for which the grant and appropriation had been provided and it does not exceed the budget.

Try to bring out cases of improper and avoidable expenditure even though expenditure incurred is as per rules and orders.
(public interest)

various programmes, schemes and projects are being run economically and are yielding results expected of them

Expenditure incurred should confirm to regulatory provisions and orders of the competent authority.

Categories of Rules

- Regulating Consolidated Fund of India/State and Contingency Fund of India/State
- dealing with the mode of presentation of claims against government
- regulating the conditions of service, pay and allowances, and pensions of government servants.

Audit of Orders issued by Executives:

- not inconsistent with constitution
- not inconsistent with CAG requirements
- not in conflict with higher authority
- whether the executive had the power to issue such orders

Principles of propriety audit:

- expenditure should not be prima facie more than the occasion demands
- No authority should exercise its powers of sanctioning expenditure to gain own advantage
- Public moneys should not be utilised for the benefit of a particular person **unless:**
 - amount is insignificant
 - Ordered by Court
 - Expense → Recognised custom
 - travelling allowances
- No other source of revenue apart from agreed remuneration

Scope of Performance Audit:

- Economy Audit:** whether government have acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.
 - Efficiency Audit:** relationship between goods and services produced and resources used to produce them
 - Effectiveness Audit:** appraisal of the performance with reference to the overall targeted objective
- The procedure for conducting performance audit:**
→ Identification of Topic → Preliminary Study → Planning → Execution of audit → Reporting

Other Government Audits- every sub-point can be an exam question**Audit of Receipts****Audit of all revenues (tax and non-tax) and debts due to the government:**

- Correctly assessed, realised and credited to Government?
- whether adequate regulations and procedures have been framed by the department/agency?
- whether rules are actually followed?
- adequate checking of irregularity, tax fraud etc.
- review of internal control systems (systems and procedures)

Audit of Stores and Inventories**It is a part of expenditure audit.**

- Whether the rules and regulations governing purchase and sale of stores/inventory are properly framed?
- any defects in the system of control or quantities of stores held?
- purchases are properly sanctioned?
- prices paid are reasonable and are in agreement with those shown in the contract?
- check the accounts of receipts, issues and balances?
- valuation of the inventories?

Audit of Commercial Accounts**Categories of Commercial accounts** (maintained by PSU):

- a) departmental enterprise: engaged in commercial and trading operations (RAILWAYS)
- b) statutory bodies, corporations, created by specific statutes (LIC)
- c) government companies set up under the Companies Act, 2013.

The audit of

- a) departmental concerns is undertaken in the same manner as any department of government
- b) statutory bodies or corporations depends on the nature and type of the statute governing the bodies or corporations.
- c) Government companies is conducted by their own auditors under the statute appointed by C&AG

Where anybody or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the CAG shall audit all receipts and expenditure of that body or authority.

Meaning of Substantially financed :-

Where the grant or loan to a body or authority from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly in a financial year is **not less than ₹ 25 lakhs and the amount of such grant or loan is not less than 75% of the total expenditure** of that body or authority, such body or authority shall be deemed, for this purpose to be substantially financed by such grants or loans as the case may be.

**Role of CAG in the audit of Government Company/ Power of CAG as per Companies Act 2013
Sec 143(5) (6) and (7) of Companies Act, 2013**

Sec 143 (5)

Power to appoint Government Company Auditor:

- shall appoint the auditor under sub-section (5) or sub-section (7) of section 139
- direct such auditor the manner in which the accounts of the Government company are required to be audited
- the auditor so appointed shall submit a copy of the audit report to the CAG of India which includes report on the directions issued by CAG of India.

Sec 143(6)- very important

Power to conduct Supplementary Audit & comment upon auditor's report:

within 60 days from the date of receipt of the audit report have a right to

- conduct a supplementary audit under section 143(6)(a)
(additional audit of FS through persons authorized by him)
- comment upon or supplement such audit report under section 143(6)(b)

Note: Any

- a) comments given by the CAG of India upon, or
- b) supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report

Sec 143(7)

if he considers necessary, by an order, **cause test audit to** be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit`

Audit of Local Bodies

Audit of Municipality/Municipal Government/ Local Body Corporation (every sub-point can be examination question)

Types of Urban Local Authorities

Five types:

- i) the municipal corporations
- ii) the municipal councils
- iii) the notified area committees
- iv) the town area committees
- v) the cantonment committees

Local Functions of Municipal authority

3 functions:

- a) Regulatory
- b) Maintenance
- c) development activities

6 heads:

- i) general administration and revenue collection
- ii) public health
- iii) public safety
- iv) education,
- v) public works
- vi) others such as interest payments, etc

Classification of Expenditure incurred by Municipality

- a) Tax- Property taxes, octroi and other municipal taxes.** Corporations- taxation powers of are confined to a few items. Other authorities- need prior approval from state
- b) Classification of Grants received from States:**
 - i) General Purpose Grant
 - ii) Specific/ Special Purpose Grant
 - iii) Statutory and compensatory grant (given when a tax is abolished or taken over by state government)

Classification of Revenue earned by Municipality

- (a) Budgetary Procedure:** (financial accountability and control of expenditure) to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the legislature or council.
- (b) Expenditure control:** external audit by state government monitors expenditure control.
- c) Accounting System:** Municipal accounting and budget format have been criticised for maintaining incomplete information.

Financial Administration

Objective of Audit of Local Bodies

- Reporting upon**
- a) the fairness of the content and presentation of **FS**
 - b) the strengths and weaknesses of systems of financial **control**
 - c) the adherence to **legal** and/or administrative requirements
 - d) whether **value is being fully received** on money spent
 - e) detection and prevention of **error, fraud** and misuse of resources

Audit Programme (points to be covered by auditor)

- (Explain first objectives of audit of local bodies in the answer in exam)
- Expenditure audit (same as discussed in Government Audit)
- a) Rules and Regulations:
 - b) Authorisation/ sanction:
 - c) Provisioning
 - d) Propriety audit
 - e) Performance audit

Note: The Local Fund Audit Wing of the State Govt. is generally incharge of the audit of municipal. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc have power to appoint their own auditors for regular external audit

Audit of

Multi- State Co-operative Societies

Important Examination Questions:

- A) Books of Accounts
- B) Qualification of Auditors
- C) Appointment of Auditors
- D) Power and duties of Auditors
- E) Content of Auditor's Report
- F) Power of Central Government to direct special audit in certain cases- Sec 77
- G) Inquiry by Central Registrar under Section 78
- H) Inspection of Multi-State Co-operative societies under Section 79

Other Co-operative Societies

Important Examination Questions:

- A) Audit as per Section 17 of the Co-Operative Societies Act, 1912
- B) Books, Accounts and other records of Co-operative Societies
- C) Restrictions on share holdings, loans and borrowings
- D) Investment of funds
- E) Appropriation of profits
- F) Contributions to Charitable Purposes and Education Fund
- G) Investment of Reserve Fund outside the business
- H) Special Features of Co-Operative Audit
- I) Form of Audit Report

Note:

- a) **The Co-operative Societies Act, 1912**, a Central Act, contains the fundamental law regarding the formation and working of the co-operative societies in India. **It is applicable in many states with or without amendments.**
- b) In many states, viz., Maharashtra, West Bengal, Orissa, the co-operative societies are governed by specific state Acts.
- c) **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.

Audit of Multi-State Co-operative Society (MSCS)

Books of Accounts- shall keep books of account with respect to:

- a) all sums of money received and expended.
- b) all sale and purchase of goods
- c) the assets and liabilities
- d) if MSCS engaged in PPM (Production, processing and manufacturing) → cost records

Qualification of Auditors- Sec 72

a person who is a CA within the meaning of the CA Act, 1949 can **only** be appointed as auditor

Disqualification:

- A) A body corporate,
- B) An officer or employee of the MSCS,
- C) A person who is a member or who is in the employment, of an officer or employee of the MSCS,
- D) A person who is indebted to the MSCS or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the MSCS for an amount exceeding one thousand rupees

Appointment of Auditor- Sec 70

first auditor:

- shall be appointed by the board within one month of the date of registration of such society.
- shall hold office until the conclusion of the 1st AGM
- If the board fails then members shall appoint in General Meeting.

Subsequent Auditor:

- appointed by MSCS at each AGM.
- shall hold office from the conclusion of that meeting until the conclusion of the next AGM.

Powers and Duties of Auditor

Section 73 (2)

(SIMILAR TO SEC 143(1) of COMPANIES ACT, 2013. INSTEAD OF 'COMPANY' WRITE 'MSCS')

Content of Auditor's Report:

Sec 73(3)& (4)

Whether in his opinion and to the best of his information and according to the explanation given to him, the said account give the information required by this act in the manner so required, and give a true and fair view-

- a) State of affairs (B/S),
- b) Profit or loss for the year ended,
- c) branch accounts
- d) B/S and P/L in agreement with BOA?

Audit of Multi-State Co-operative Society (MSCS)- Inquiry/Special Audit/ Inspection

Inspection of Multi-State Co-operative societies under Section 79:

a) When? All conditions same as Sec 78 except request from creditor not allowed.

b) How? Content same as Sec 78 (instead of inquiry write inspection)

c) Prior notice? Same as Sec 78

d) Powers available? Similar to Sec 78 and additionally also has power to take things into custody.

e) Reporting? Similar to Sec 78

Inquiry by Central Registrar (CR) under Section 78:

When? On a request from

- A) a federal co-operative to which a MSCS is affiliated
- B) a creditor or
- C) not less than one-third of the members of the board or
- D) not less than one-fifth of the total number of members of a MSCS

How?

hold an inquiry or direct some person authorized by him to hold an inquiry into the constitutions, working and financial condition of a MSCS

Prior notice?

before holding such inquiry fifteen days notice must be given to the MSCS

Powers given?

- a) free access to the records securities, cash and other properties of MSCS and issue summons.
- b) require the officers of the society to call a general meeting of the society by giving notice of not less than seven days
- c) summon any person who is reasonably believed by him to have any knowledge of the affairs of the MSCS.

Reporting?

The Central Registrar shall, within a period of three months of the date of receipt of the report, communicate the report of inquiry to the MSCS and its stake holders.

Power of Central Government to direct special audit in certain cases: Sec 77

When? IF CG is of the opinion that

- A) Affairs not managed as per prudent commercial practices
- B) it would cause injury to the interest of trade/industry
- C) Financial position is such that it would endanger its solvency.

How?

- A) CG's order required
- B) Appointment of the Auditor- CG may appoint stat auditor of MSCS or any other CA

Note: CG shall order special audit only of such MSCS which is controlled by CG or SG or both (fifty-one percent or more of the paid-up share capital)

Special Auditor's Powers , Duties & Report:

same powers and duties as per Sec 73. make the report to the Central Government.

Action by the Central Government:

The CG may take such action on the report as it considers necessary.

IF CG does not take any action within 4 months from the date of receipt of the report then CG shall send a copy of the report or extract to MSCS which shall circulate it amongst members.

Expenses pertaining to the Special Audit:

Determined by the Central Government which determination shall be final and paid by the MSCS.

IF MSCS defaults it will be recovered as an arrear of land revenue

Audit of Other Co-operative Societies (general provisions as per the Central Act)

Audit as per Section 17 of the Co-Operative Societies Act, 1912:

- The Registrar shall audit or cause to be audited by some person authorised by him by general or special order in writing in this behalf the accounts of every registered society once at least in every year.
- “Registrar” means a person appointed to perform the duties of a Registrar of Co- operative Societies under this Act.

Qualification of Auditor:

CA in practice as per CA Act, 1949 unless otherwise specified by the State Act.

Note:

Some of the State Co-operative Acts have permitted persons holding a government diploma in co-operative accounts or in co-operation and accountancy and also a person who has served as an auditor in the co-operative department of a government to act as an auditor.

Appointment of Auditor:

appointed by the Registrar of Co-operative Societies

Note:

the auditor so appointed conducts the audit on behalf of the Registrar and submits his report to him as also to the society.

Remuneration:

- statutory scale of fees prescribed by the Registrar , according to the category of the society audited.
- The audit fees are paid by the society

Other provisions governing the co-operative societies:

- a) Restrictions on share holdings
- b) Restrictions on loans
- c) Restrictions on borrowings
- d) Investment of funds
- e) Appropriation of profits and Reserve fund.
- f) Contributions to Charitable Purposes
- g) Investment of Reserve Fund outside the business or utilisation as working capita
- h) Contribution to Education Fund
(explained on the next page)

Books, Accounts and other records:

- section 43(h) of the Central Act, a state government can frame rules prescribing the BOA to be kept.
- Depending upon the nature and object of the society, different kinds of books and registers will be maintained. For example:
 - a) Daily cash sales summary register.
 - b) A register of collection from debtors
 - c) A register of recovery of loans from employees and members
 - d) Loan disbursement register in case of credit society.
 - e) Any other columnar subsidiaries (records) depending upon the nature and functions of society.

Audit of Other Co-operative Societies (provisions governing such societies)

Restriction on:

a) Shareholding:

Section 5 of the Central Act:

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 ₹ 1,000/

b) Loans and advances:

Section 29 of the Central Act:

→ registered society shall not make a loan to any person other than a member

→ However, with the special sanction of the Registrar, a registered society may make a loan to another registered society.

c) Borrowings:

Section 30 of the Central Act:

a registered society shall accept loans and deposits from persons who are not members subject to the restrictions and limits of the bye-laws of the society

Investment of Funds:

Section 32 of the Central Act.

A Society may invest its funds 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.

Appropriation of profits and charge on profits:

→ According to **section 33 of the Central Act**, a prescribed percentage of the profits should be transferred to Reserve Fund, before distribution as dividends or bonus to members.

→ 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.

→ 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..

→ In 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.**

Special Feature of Co-operative Society Audit- DID V C Law SPECIAL CLASS PD

Examination of overdue debts- Overdue debts for a period from 6 months to 5 years and more than 5 years will have to be classified and shall have to be reported by an auditor. Examine whether sufficient provision has been made.

Overdue Interest- Overdue interest should be excluded from interest outstanding and accrued due while calculating profit.

Certification of Bad Debts- As per Maharashtra State Act, bad debts should be certified by the auditor before it is written off. In other states, if there is no such requirement then the managing committee of the society must authorize the write-off.

Valuation of Assets and Liabilities- As per the general principles of accounting.

Adherence to Co-operative Principles- how far the objects, for which the co-operative organisation is set up, have been achieved in the course of its working.

Observations of the Provisions of the Act (LAW) and Rules- provisions of Co-operative Societies Act and Rules and bye-laws

Verification of Members' Register and examination of their pass books- regarding the loan given and its repayments, and confirmation of loan balances

Discussion of draft audit report with managing committee- audit report should never be finalised without discussion with the managing committee.

Audit classification of society- After a judgement of an overall performance of the society, the auditor has to award a class to the society. Management can make an appeal to the Registrar, and the Registrar may direct to review the audit classification

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.

Examples of such irregularities:

- a) Personal profiteering by members of managing committee in transactions 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 etc.

Applicability

The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009. Such rules provide that any LLP, **whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited.**

BOA of the LLP

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

Returns to be maintained and filed by an LLP :-

- A) FORM 11- Annual return with ROC within 60 days of closure of financial year
- B) FORM 8- Statement of Account and Solvency within a period of thirty days from the end of six months of the relevant financial year

Appointment of Auditor

- A) First Auditor- At any time for the first financial year but before the end of first financial year by the designated partner
- B) Subsequent auditor- At least thirty days prior to the end of each financial year- by designated partner
- C) Casual Vacancy due to any reason- to be filled by designated partner
IF DP fails then other partner shall appoint the auditor

A Small LLP is any LLP:

- a) the Contribution of which, does not exceed twenty-five lakh rupees (INR 25,00,000) or such higher amount, not exceeding five crore rupees, as may be prescribed;
- and**
- b) the Turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees (INR 40,00,000) or such higher amount, not exceeding fifty crore rupees, as may be prescribed;

Hire Purchase Agreement

A Hire-purchase agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which-

- (i)** possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments
- ii)** the property in the goods is to pass to such person on the payment of the last of such instalments, and
- iii)** such person has a right to terminate the agreement at any time before the property so passes.

Audit of Hire Purchase Companies (HP Seller)

examine the following:

1. Hire purchase agreement is in writing and is signed by all parties
2. Hire purchase agreement specifies clearly hire-purchase price, cash price of the goods, date on which the agreement shall be deemed to have commenced, number of instalments, goods to which the agreement relates etc.
3. Ensure that instalment payments are being received regularly as per the agreement.

Lease Agreement

Refer Lease Accounting Standard AS 19 properly.
Difference between finance and operating lease is a very important question.

	Operating Lease	Financial Lease
Common examples	Lease of Projector, Computers, Laptops, Coffee Dispensers etc.	Lease of Plant and Machinery, Land, Office Building etc.
Ownership	Ownership of the asset remains with the lessor for the entire period of lease.	Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.
Accounting treatment	Operating lease is generally treated like a renting arrangement. That means, the lease payments are treated as operating expenses and the asset does not appear as an asset on lessee's balance sheet.	Financial lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.
Purchase Option	Under operating lease, the lessee does not have any option to buy the asset during the lease period.	Financial lease allows the lessee to have a purchase option at less than the fair market value of the asset.
Lease Term	Lease term generally extends to less than 75% of the projected useful life of the leased asset.	Lease term is generally more than or equal to estimated economic life of the asset under the lease arrangement.
Operating/ running expenses	Lessee pays only the monthly lease payments. No running or	Lessee generally bears insurance, maintenance and taxes.

Audit of Leasing companies

Auditor should check the following:

1. object clause of leasing company to see that the goods like capital goods, consumer durables etc. in respect of which the company can undertake such activities. Further, to ensure that whether company can undertake financing activities or not.
2. Whether there exists a procedure to ascertain the credit analysis of lessee
3. examine lease agreement and all the relevant clauses
4. Whether purchase invoice is retained safely as the lease is a long-term contract
5. Board resolution authorising a particular director to execute the lease agreement has been passed by the lessee.

Background**1. Non-Governmental Organisations are generally incorporated as**

- A) societies under the Societies Registration Act, 1860 or
- B) as a trust under the India Trust Act, 1882 or
- C) as a company under section 8 of the Companies Act, 2013.

2. Maintenance of BOA

- A. NGOs registered under the Companies Act, 2013 **must maintain their books of account under the accrual basis** as required by the provisions of section 128 of the said Act.
- B. The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either an accrual basis or cash basis.

Sources and Applications of Funds

1. Donations and grants received in the nature of promoter's contribution are in the nature of capital receipts and shown as liabilities in the Balance Sheet of NGO.

A contribution made towards the capital or the corpus of an NGO is known as corpus contribution

2. Section 11(1)(d) of the Income Tax Act 1961 also states that income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the computation of total income.

3. contribution or grant towards a Revolving Fund is to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects and then recover the loan so as to give temporary loans again and so on. any interest earned from the beneficiary on such temporary loans from the revolving fund could be either added back to the fund or credited to the Income and Expenditure Account

Audit Provisions

1. The Foreign Contribution (Regulation) Act 2010 has prescribed the format for reporting sources of funds and utilisation and requires that the same be furnished to the Ministry of Home Affairs within 60 days from the close of the financial year i.e. by May 30 each year.

2. Audit Procedures:

A. Planning: auditor should concentrate on the following: Knowledge of the NGO's work; Updating knowledge of relevant statutes; Reviewing the legal form of the Organisation; Study the accounting system, procedures, internal controls; Setting of materiality levels

B. Audit of income/corpus/contribution

- (i) Corpus Fund: The contributions / grants received towards corpus be vouched with special reference to the letters from the donors.
- (ii) Reserves: Vouch transfers from projects / programmes with donors letters and board resolutions of NGO
- lii) Ear-marked Funds: (Earmarking refers to a fund allocation practice to use for a specific goal) Check requirements of donors institutions, board resolution of NGO, rules and regulations
- lv) Use general knowledge of NPO accounts in audit of subscription fees, membership fees, interest income etc.

Refer the markings done by CA Pragnesh Sir on this module pdf- Just read it once.

<https://drive.google.com/file/d/1TCIT48EkMptDyaHmw-tS2BE4fTsyyVpw/view?usp=sharing>

Chapter 5- Audit of Different items of FS

Refer the summary notes given by CA Pragnesh Sir on this topic:

https://drive.google.com/file/d/1fPOtOMsh4729yRXPohWgHUWVV4P2K5kD/view?usp=drive_link