

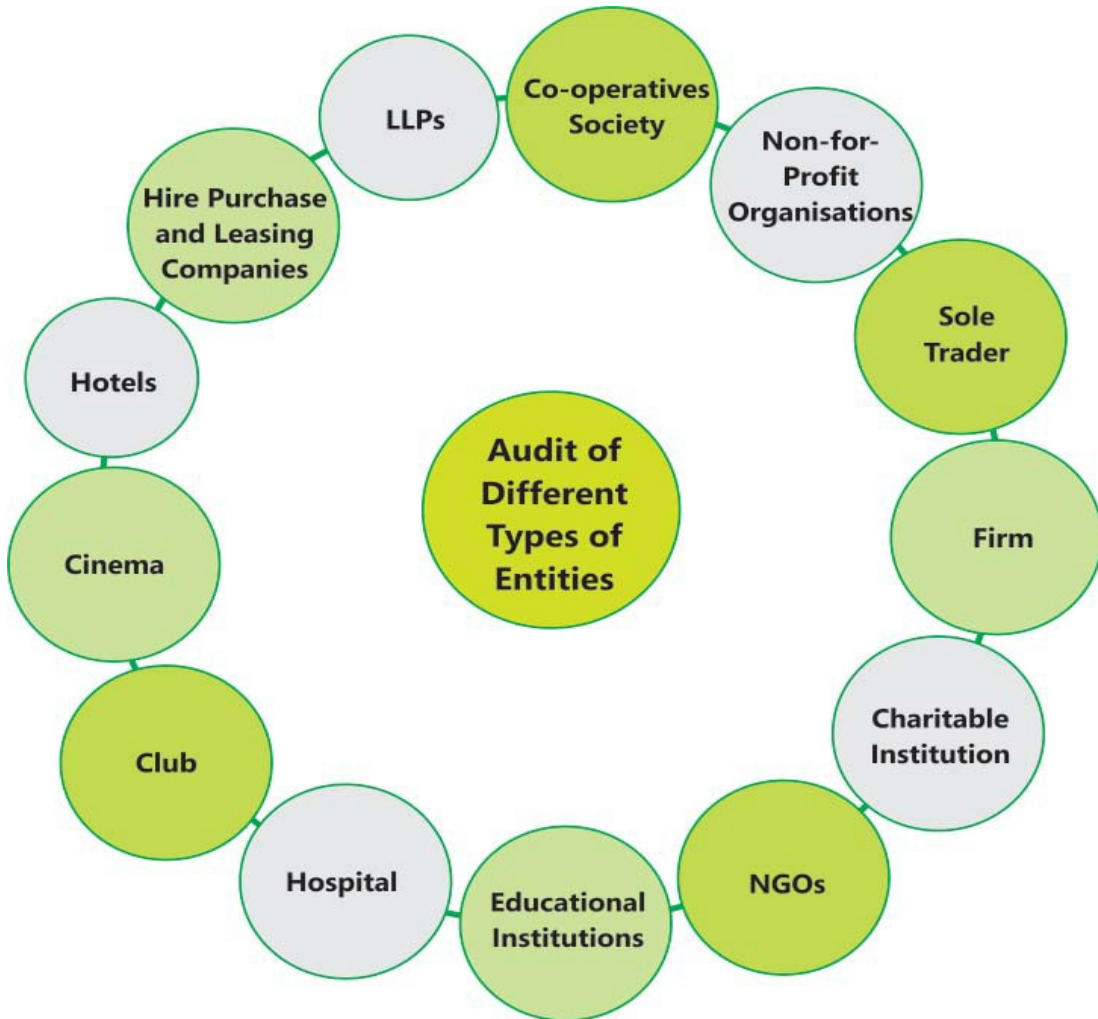
# AUDIT OF DIFFERENT TYPES OF ENTITIES



## LEARNING OUTCOMES

**After studying this chapter, you will be able to:**

- ❑ Understand the procedures to be adopted for auditing of Not-for-profit Organizations (NGOs), Charitable Institutions.
- ❑ Gain knowledge of auditing procedure of sole trader, firm, educational institutions, hospitals, clubs, cinema, hotels, etc.
- ❑ Learn the audit procedure of hire purchase and leasing company accounts.
- ❑ Identify the audit procedures of Government, Local Bodies, Co-operative Societies, LLPs.

**CHAPTER OVERVIEW** **1. GOVERNMENT AUDIT****1.1 Background**

Government Audit is as old as organised governments and has fairly long pedigree even in developing countries. The concept, content and scope of government audit have developed in tune with the political, social and economic development of the countries. It has also responded to the needs of the administration. It aims to ensure accountability of the executive in respect of public revenue and expenditure. Primarily, the Parliament and in case of States, the State legislatures control all

government expenditure through insistence upon demand for grants. The main idea underlying this control is that no expenditure can be incurred unless it has been voted upon by the Parliament or State Legislatures and funds for every such expenditure must be provided from out of the Consolidated Fund of India or of the State. After the expenditure has been incurred and the accounts are closed, the Appropriation Accounts are prepared which are scrutinised by the Public Accounts Committee. Thus, Parliamentary or Legislative control is exercised before spending and after the expenditure is actually incurred.

Since independence there has been a tremendous spurt in governmental activities with the attendant increase in expenditure, revenue and capital, and in receipts and borrowings to match the expenditure. Government has entered the business field and government in business is not the same as government administering law and order and attending to regulatory functions. Independent India witnessed a steady growth of state commercial enterprise. The change in the character of government and the complex nature of its activities, including regulatory functions in an international environment, called for a change in the nature and scope of audit. Audit has evolved from accountancy and regularity check to evaluation of the end results of the operations of government.

Initially, government auditing in India as elsewhere was primarily expenditure-oriented. Gradually, audit of receipts-tax and non-tax was taken up. With the rapid growth of public enterprises, another major area of specialisation, i.e., commercial audit, came into being. There are also a large number of non-commercial autonomous bodies financed by government in diverse fields of development and of academic study and scientific or social research which are also required to be audited from the viewpoint of public accountability.

Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:

Government auditing is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity made subsequently to their execution for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions by the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

Government audit serves as a mechanism or process for public accounting of government funds. It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them. Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration. However, criticism of administrative actions wherever warranted is inherent in auditorial function. This has to be understood and appreciated in a proper spirit, as the criticism is made in a constructive spirit.

In India, the function of Government Audit is discharged by the independent statutory authority of the Comptroller and Auditor General through the agency of the Indian Audit and Accounts Department. Audit is a necessary function to ensure accountability of the executive to Parliament, and within the executives of the spending agencies to the sanctioning or controlling authorities. The purpose or objectives of audit need to be tested at the touchstone of public accountability. The Comptroller and Auditor General (C&AG), in the discharge of his functions, watches that the various authorities act in regard to financial matters in accordance with the Constitution and the laws made by Parliament, and conform to the rules or orders made thereunder.

## **1.2 Legal Framework and Comptroller & Auditor General**

The Constitution of India contains specific provisions regarding the appointment, salary and duties and powers of the C&AG. The constitution guarantees the independence of the C&AG of India by prescribing that he shall be appointed by the President of India and shall not be removed from office except on the ground of proven mis-behaviour or incapacity. As in the case of a Judge of the Supreme Court, he can be removed 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. The Parliament is competent to make laws to determine salary and other conditions of service and they cannot be varied to his disadvantage after his appointment. The Constitution further provides that the conditions of service of person serving in the Indian Audit and Accounts Department and the administrative powers of the C&AG shall be determined by the President after consultation with him.

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

1971 passed in pursuance of the provisions of the Constitution lays down a fixed tenure of the office prescribing that he shall be paid a salary which is equal to the salary of the Judge of the Supreme Court thereby further strengthening his independence.

**Article 149** states that the C&AG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by the Parliament. The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 defines these functions and powers in detail.

**Article 150** of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.

**Article 151** requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the President/Governor who shall cause them to be laid before House of Parliament/State Legislature.

### 1.3 Comptroller and Auditor General's — Duties and Powers

The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 defines functions and powers in detail. The relevant provisions are discussed hereunder—

#### Duties of the C&AG:

- (i) **Compile and submit Accounts of Union and States** - The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. The Comptroller and Auditor General shall, from the accounts compiled by him or [by the Government or any other person responsible in that behalf] prepare in each accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union Territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrator of the Union Territory having a Legislative Assembly, as the case may be, on or before such dates as he may, with the concurrence of the Government concerned, determine.

The C&AG Act of 1971 has provisions for relieving him of this responsibility to give information and render assistance to the Union and States: The Comptroller and Auditor General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union Government, to the State Government or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require and render such assistance in the preparation of the annual financial statements as they may reasonably ask for.

**(ii) General Provisions Relating to Audit** - It shall be the duty of the Comptroller and Auditor General—

- (a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
- (b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
- (c) to audit and report on all trading, manufacturing and profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.

**(iii) Audit of Receipts and Expenditure** - 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 Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

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 rupees twenty-five lakhs and the amount of such grant or loan is not less than seventy-five per cent 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.

- (iv) **Audit of Grants or Loans** - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.
- (v) **Audit of Receipts of Union or States** - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.
- (vi) **Audit of Accounts of Stores and Inventory** - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.
- (vii) **Audit of Government Companies and Corporations** - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 (i.e. appointment of First Auditor or Subsequent Auditor) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

### **Powers of C&AG**

The C&AG Act gives the following powers to the C&AG in connection with the performance of his duties-

- (a) To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
- (b) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
- (c) To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine.

#### **1.4 Expenditure Audit**

The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

- (i) that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.
- (ii) that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.
- (iii) that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
- (iv) that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
- (v) that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

Each of the above audits is discussed in detail in the following paragraphs.

**(1) Audit against Rules & Orders** - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- (i) Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
- (ii) Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and
- (iii) Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) they are not inconsistent with any provisions of the Constitution or any laws made thereunder;
- (b) they are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- (c) they do not come in conflict with the orders of, or rules made by, any higher authority; and
- (d) in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

Audit of expenditure against regularity is of a quasi-judicial type of work performed by the audit authorities. It involves interpretation of the Constitution, statutes, rules, regulations and orders. The final power of interpretation of these, however, does not vest with the C&AG.

**(2) Audit of sanctions** - The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority. The audit of sanctions is directed both in respect of ensuring that the expenditure is properly covered by a sanction, and also to satisfy that the authority sanctioning it is competent for the purpose by virtue of the powers vested in it by the provisions of the Constitution and of the law, rules or orders made thereunder, or by the rules of delegation of financial powers made by an authority competent to do so.

**(3) Audit against provision of funds** - Audit against provision of funds aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.

**(4) Propriety audit** - According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. With the passage of time, it was felt that regularity audit alone was not sufficient to protect properly the public interest in the spending of money by the executive authorities. A transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned, but may still be highly wasteful. A building may be constructed for installing a telephone exchange but may not be used for the same purpose resulting in infructuous expenditure or a school building may be constructed but used after five years of its completion is a case of avoidable expenditure.

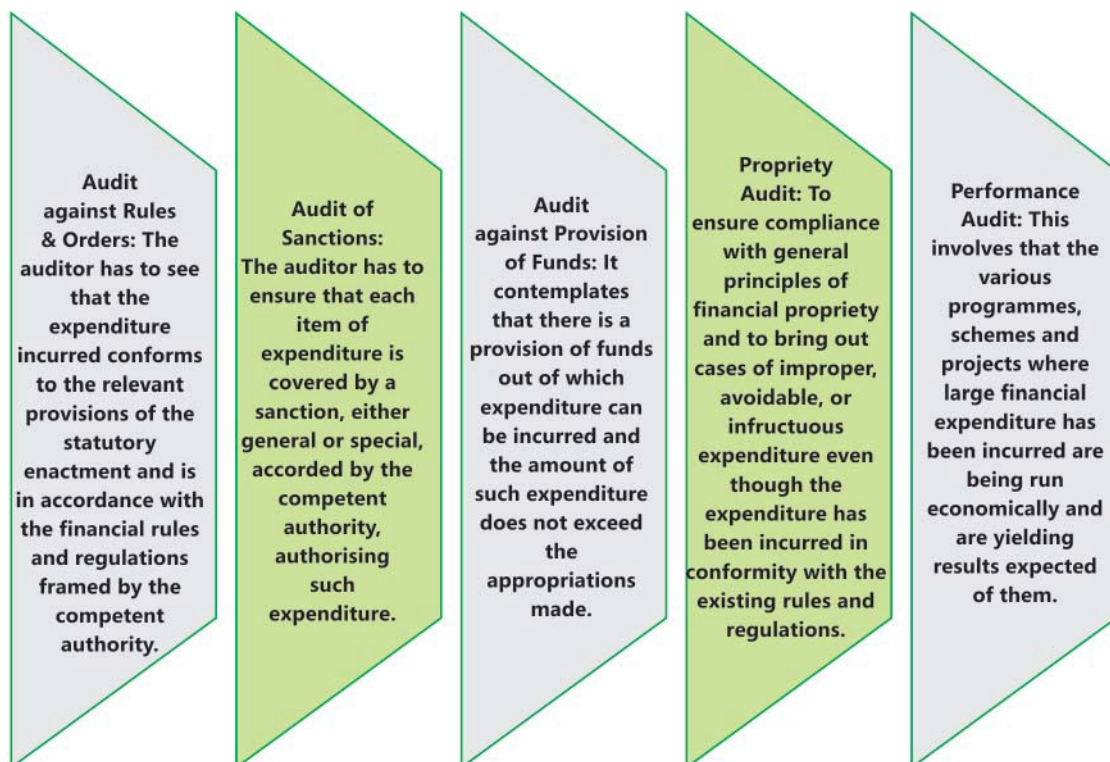
Audit should, therefore, try to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions. These considerations have led to the evolution of audit against propriety which is now being combined by the audit authorities with their routine function of regularity audit. It is hard to frame any precise rules for regulating the course of audit against propriety. Such an objective of audit depends for its acceptance on its appeal to the common sense and straight logic of the auditors and of those whose financial transactions are subjected to propriety audit. However, some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

- (a) The expenditure should not be *prima facie* more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of

expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.

- (b) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
- (c) Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
  - (i) the amount of expenditure involved is insignificant; or
  - (ii) a claim for the amount could be enforced in a Court of law; or
  - (iii) the expenditure is in pursuance of a recognised policy or custom; and
  - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

It may be stated that it is the responsibility of the executive departments to enforce economy in public expenditure. The function of audit is to bring to the notice of the proper authorities of wastefulness in public administration and cases of improper, avoidable and infructuous expenditure



**(5) Performance audit** - The scope of audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or full scope audit. Efficiency audit looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, *i.e.*, the relationship between goods and services produced and resources used to produce them; and examination aimed to find out the extent to which operations are carried out in an economical and efficient manner. Economy audit looks into whether government have acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy. Effectiveness audit is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives. Efficiency- cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness. The procedure for conducting performance audit covers identification of topic, preliminary study, planning and execution of audit, and reporting. While the trend towards a comprehensive approach for conducting performance of full scope audit is visible, the coverage and depth of evaluation vary according to the statutory limitations, and the organisational constraints of C&AG.

### 1.5 Audit of Receipts

The audit of receipts is neither all pervasive or as old as audit of expenditure but has come to stay in some countries. Such an audit provides for checking;

- (i) whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities;
- (ii) whether adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper allocation of cases;
- (iii) whether such regulations and procedures are actually being carried out;
- (iv) whether adequate checks are imposed to ensure the prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or willful omission or negligence to levy or collect taxes or to issue refunds; and

- (v) review of systems and procedures to see that the internal procedures adequately secure correct and regular accounting of demands collection and refunds and pursuant of dues up to final settlement and to suggest improvement. The basic principle of audit of receipts is that it is more important to look at the general than on the particular, though individual cases of assessment, demand, collection, refund, etc. are important within the area of test check. A review of the judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure.
- (vi) The extent and quantum of audit required to be done under each category of audit are determined by the C&AG. These are neither negotiable nor questioned. The prescribed extent and quantum of audit are structured in accordance with the design of test check, random sampling, general review, in-depth study of specified areas, etc. as may be warranted by the nature of transactions, its importance in the scheme of activities of a department and the totality of its transactions, the frequency of check and total plan of audit to be executed during a period. Institutional mechanism provides for primary check by the auditor, test check by the supervisor and control and direction by the group leader. Planning, executing and reporting of work is directed and monitored at middle and top levels of the audit hierarchy. There are built-in arrangements within the C&AG to ensure that the work assigned to each employee is carried out as prescribed. The audit is conducted both centrally where accounts and original vouchers are kept and locally where the drawing and disbursing functions are performed depending on the organisational and institutional arrangements obtaining.

### **1.6 Audit of Stores and Inventories**

Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out. The aim is also to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control. The audit of purchase of stores is conducted in the same manner as audit of expenditure, namely, that these are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority. The auditor has to ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable

to defective or inferior quality of stores are specifically brought by the audit. Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

### 1.7 Audit of Commercial Accounts

Public enterprises are required to maintain commercial accounts and are generally classified under three categories—

- (a) departmental enterprises engaged in commercial and trading operations, which are subject to the same laws, financial and other regulations as other government departments and agencies;
- (b) statutory bodies, corporations, created by specific statutes mostly financed by government in the form of loans, grants, etc.; and
- (c) government companies set up under the Companies Act, 2013.

The audit of departmental concerns is undertaken in the same manner as any department of government where commercial accounts are kept. Audit of statutory bodies or corporations depends on the nature and type of the statute governing the bodies or corporations. Both financial and accounts audit are conducted by the C&AG, and where compilation of accounts is vested with the C&AG, functions, norms and standards of works usually followed by the professional auditors are adopted *mutatis mutandis*. Government companies have their own auditors under the statute appointed by C&AG. In addition, the C&AG conducts a supplementary test audit of the accounts, as well as periodical financial audit and appraisal of performance. The C&AG also issues direction to the company auditors for reporting on specific aspects of their audit work. These are reviewed, and condensed in the audit reports to the government/legislatures. C&AG has adopted the mechanism of an Audit Board-comprising of representatives of the audit and nominees of government including functional specialists to process reviews or appraisals on performance.

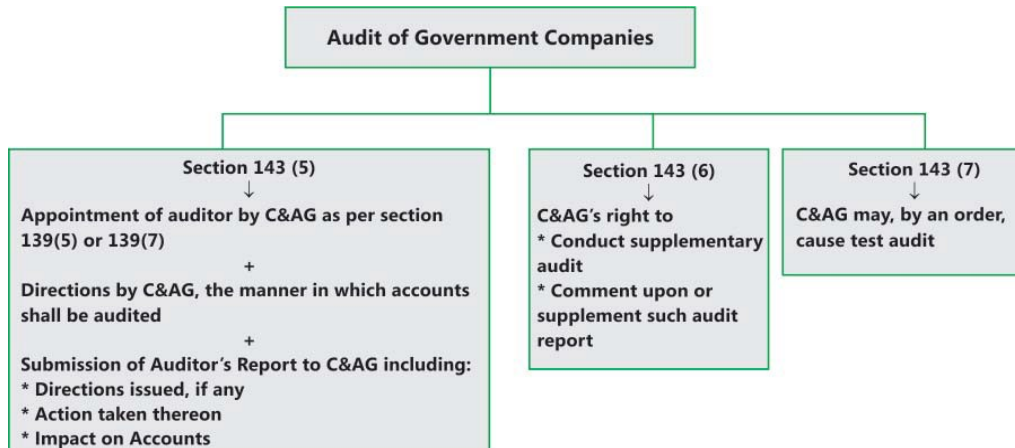
**Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.**

Section 143(5) of the Act states that, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to,

- (a) conduct a **supplementary audit under section 143(6)(a)**, of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
- (b) **comment upon or supplement such audit report under section 143(6)(b)**. Any comments given by the Comptroller and Auditor-General of India upon, or 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 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled 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.

**Test Audit under section 143(6)(b):** Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, 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.



As stated above, in the case of a government company, audit is conducted by professional auditors appointed on the advice of the C&AG and the later is authorised under section 143 of the Companies Act, 2013 to conduct supplementary or test audit.

The C&AG shall direct the manner in which the company's accounts shall be audited by the statutory auditors and give such auditors instructions in regard to any matter relating to the performance of his functions as such. The directions under section 143(6) broadly covers the system of book-keeping and accounts, internal control etc.

The C&AG has power to conduct a supplementary or test audit of the company's accounts by such person as he may authorise in this behalf and for the purposes of such audit require information or additional information to be furnished to any person or persons so authorised on such matters by such person or persons and in such form as the C&AG may by general or special order, direct.

The statutory auditors shall submit a copy of their audit report to the C&AG who shall have a right to comment upon or supplement the audit report submitted by the statutory auditors in such manner as he may think fit. Section 134(3) of the Companies Act, 2013 imposes a duty on the board of directors of

a company to give an explanation or comments on every reservation, or adverse remarks or disclaimer contained in the auditors' report and secretarial audit report of the Company Secretary in practice. In the absence of similar provisions requiring the company to give reply on the reservation made by the C&AG, the board of directors of such a company is not bound to give information or explanation in respect of such comments.

The general standards, principles, techniques and procedures for audit adopted by the C&AG are a mixture of government audit and commercial audit as known and practiced by professional auditors. The concepts of autonomy and accountability of the institution / bodies / corporations / companies have influenced the nature and scope of audit in applying the conventional audit from the angle of economy, efficiency and effectiveness.

### **1.8 Reporting Procedures**

The effectiveness of an audit depends on reporting results to the proper authority so that appropriate action may be taken to rectify the irregularities or impropriety where possible or to prevent re-occurrence. The right as also the obligation to report on the results of audit findings is inherent to the institution of the Auditor General and is usually safeguarded in the Constitution and related enactments. 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. The reports should not only be presented to the legislatures but thereafter also publicised adequately in order to create a proper climate of public opinion for taking remedial action where necessary, on the findings of the Auditor General. This may also constitute a more effective safeguard in the future.

In India, the reporting is factual and the conclusions are left to be drawn by the reader. This is presumably to ensure total objectivity. Nothing debars C&AG from making recommendations in the audit report but traditionally this has been left to be done by the Public Accounts Committee. The overall Indian position regarding reporting standards is contained in instructions issued by the C&AG on the subject. Experience and professional judgment ultimately determines what is to be included in the audit reports. The auditor has to be a thorough professional and the audit reports have to be prepared with great skill for both the presentation and contents should compel readership.



## 2. AUDIT OF LOCAL BODIES

### 2.1 Background

A municipality can be defined as a unit of local self-government in an urban area. By the term 'local self-government' is ordinarily understood the administration of a locality – a village, a town, a city or any other area smaller than a state – by a body representing the local inhabitants, possessing fairly large autonomy, raising at least a part of its revenue through local taxation and spending its income on services which are regarded as local and, therefore, distinct from state and central services. The discussion in following paragraphs is based on an article "Audit of Municipal Administration" by R. Chandrasekharan.

By 1947, the year of independence of India, most of the urban and semi-urban areas had been constituted into municipalities of one kind or another. Among them were the premier corporations of Mumbai, Chennai and Kolkata each with a special kind of constitutional structure, better financial resources and subject to less state control than other municipal bodies. The service which the local bodies had to render was restricted to education, public health, sanitation, medical relief, roads and a few public works. This was so because these bodies were considered to be inefficient and they lacked adequate financial resources. These bodies derived their revenues from a number of sources – taxes on property, taxes on trade, taxes on persons; fees and licences, non- tax resources such as rent of land, houses, income from commercial undertakings; government grants, etc.

Municipal government in India covers five distinct types of urban local authorities, viz., the municipal corporations, the municipal councils, the notified area committees, the town area committees and the cantonment committees. The taxation powers of the corporations are confined to a few items and are of a generally compulsive nature; on the other hand, the tax powers of other types of urban local authorities cover a wider range, optional in nature and subject to a procedure for their imposition requiring the final sanction of the state governments. Municipal authorities are endowed with specific local functions covering (a) regulatory, (b) maintenance and (c) development activities.

Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments, etc.

Property taxes and octroi are the major sources of revenue of the municipal authorities; other municipal taxes are profession tax, non-mechanised vehicles tax,

taxes on advertisements, taxes on animals and boats, tolls, show-tax, etc. Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:

- (a) **General purpose grants:** These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.
- (b) **Specific purpose grants:** These grants which are tied to the provision of certain services or performance of certain tasks.
- (c) **Statutory and compensatory grants:** These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

## 2.2 Financial Administration

It would be imminent on the part of the auditor to understand financial administration of local bodies before embarking upon the audit. Some of the aspects are as under:

**Budgetary Procedure:** This is geared to subserve the twin considerations of financial accountability and control of expenditure. The main objective is 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. Budget preparation is usually the occasion for determining the levels of taxation and rates and the ceilings on expenditure.

Municipal budget formats and heads of accounts vary from state to state. There are variations between the corporation and municipalities. One important feature of the municipal budgets is that there is no strict separation between revenue and capital items; usually there is a 'head' called extraordinary items which cover most of the capital transactions. There are, however, a number of special funds (e.g. roads) or in some cases separate budgets for specific municipal functions (e.g. education) or enterprise activities (e.g., water supply and sanitation, transport, electricity, etc.)

**Expenditure Control:** The system of financial control existing in the state and central government level is conditioned by the fact that there is a clear demarcation between the legislature and executive. The integration of legislation and executive powers in the municipal council makes it difficult for its executive to function as its inquisitorial body as well. Moreover the separation of executive powers and functions in municipal government cannot accommodate the existence of an independent finance officer responsible to the municipal council or its executive

committee. This leaves the system of external audit by state government as the only instrument of controlling municipal expenditure.

**Accounting System:** Municipal accounting and budget format have been criticised as neither simple nor comprehensible, sometimes providing inadequate information and at other times a surfeit of information. Both these situations are not conducive to a proper system of management information.

### 2.3 Objective of Audit of Local Bodies

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. The municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit. The important objectives of audit are:

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

Audit is another method of financial control on local governments. This provision is coupled with the privilege of *ultra vires*. An action of the local authority if it is beyond legal authority can result in 'surcharge' by audit. This procedure is a legacy of colonial days and even in England it is being resorted to less and less. This may well be because of the increasing competence of the local government authorities.

In addition to the external audit, it is also opined by the learned author that there should be a system of internal audit in all municipal institutions. Internal audit should be provided by the institutions' own staff. It should be performed on a continuous basis according to a well-defined programme. The external auditor should be able to rely upon the work of the internal audit as forming part of a complete system of internal financial control. Where there is no internal audit, as may happen in the case of small or poorly staffed municipalities, the external auditor himself has to do detailed checking. As described under government audit above, increasing attention is being given, to what is described as 'value for money' audit. This kind of audit focuses upon assessment of whether urban institutions are fulfilling their responsibilities with efficiency, economy and effectiveness (sometimes known as 'the three Es').

## 2.4 Audit Programme for Local Bodies

- (i) The Local Fund Audit Wing of the State Govt. is generally in-charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc have power to appoint their own auditors for regular external audit. So the auditor should ensure his appointment.
- (ii) The auditor while auditing the local bodies should report on the fairness of the contents and presentation of financial statements, the strengths and weaknesses of system of financial control, the adherence to legal and/or administrative requirements; whether value is being fully received on money spent. His objective should be to detect errors and fraud and misuse of resources.
- (iii) The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.
- (iv) He should ensure that all types of sanctions, either special or general, accorded by the competent authority.
- (v) He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.
- (vi) The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.



## 3. AUDIT OF NON-GOVERNMENTAL ORGANISATION (NGO'S)

### 3.1 Background

NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations.



Source of image: [crossbarriers.org](http://crossbarriers.org)

Therefore, this definition of NGO would include religious organisations, voluntary health and welfare agencies, **charitable organisations, hospitals, old age homes, research foundations etc.** The scope of services rendered by NGOs is extremely wide and as such cannot be covered in a small definition. Some examples of NGOs operating in India include Child Relief and You (CRY), NORAD, UNICEF, Godhuli, Vidya, Concern India Foundation., etc.

Non-Governmental Organisations are generally incorporated as societies under the Societies Registration Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Laws enforced in any part of India. NGOs can also be incorporated as a company under section 8 of the Companies Act, 2013. None of the above mentioned Act warrant a mandatory registration under them for an NGO. But if an NGO is created as a trust and trust relates to immovable property worth more than one hundred rupees, the provision of Section 17(1) of the Registration Act, 1908 read with Section 123 of the Transfer of Property Act, 1882 must be complied with and the registration of trust becomes mandatory. In some states, such as the states of Maharashtra and Gujarat, where Public Trusts Acts have been passed, such as the Bombay Public Trusts Act 1950, all charitable trusts have to be registered under these specific Public Trusts Acts. Registration under the Income Tax Act, 1961 and the Foreign Contribution (Regulation) Act, 1976 would also be invoked in many cases.

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. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 2013. The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either an accrual basis or cash basis.

### 3.2 Sources and Applications of Funds

The main sources of funds include grants and donations, fund raising programmes, advertisements, fees from the members, technical assistance fees / fee for services rendered, subscriptions, gifts, sale of produce or publications, etc.

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. These may either be in the form of corpus contribution or a contribution towards revolving fund. A contribution made towards the capital or the corpus of an NGO is known as corpus contribution. The donors are generally required to specify whether the donation/grant given by him shall form part of the corpus of the NGO. Such contributions are generally given with reference to the total funds required by an NGO. 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. The objective of a 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. However, 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 depending on restrictions laid down by the authority providing the contribution (for the revolving fund) or by the rules and regulations laid down by the concerned NGO in this regard.

Donations and grants received for acquisition of specific fixed assets are those grants whose primary condition is that an NGO accepting them should purchase, construct or otherwise acquire the assets for which the grant is given.

Many a times NGOs receive contributions in kind. These contributions include assets such as land, buildings, vehicles, office equipment, etc. and articles related to programmes / projects such as food, books, building materials, clothes, beds, and raw material for training purposes, e.g., Wool, reeds, cloth, etc.

The areas of application of funds for an NGO include Establishment Costs, Office and Administrative Expenses, Maintenance Expenses, Programme / Project Expenses, Charity, Donations and Contributions given, etc.

### 3.3 Provisions Relating to Audit

The auditors of an NGO registered under the Societies Registration Act, 1860 (or under any law corresponding to this Act, in force in any part of India) or the Indian

Trusts Act 1882 are normally appointed by the Management of the Society or Trust. **The auditors of NGO registered under section 8 of the Companies Act, 2013 are appointed by the members of the company.** Some of the statutes such as the Companies Act, 2013, Foreign Contribution (Regulation) Act 1976, Income Tax Act 1961 required that the accounts of the NGO be audited and submitted to the prescribed authorities and failure to do so could lead to forfeiture of certain exemptions and benefits. In the case of NGO/PDA's different statutes have specified certain audit reports. The Foreign Contribution (Regulation) Act 1976 has prescribed the format 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.

**While planning the audit, the auditor may concentrate on the following:**

- (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
- (ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
- (iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
- (iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- (vii) Setting of materiality levels for audit purposes.
- (viii) The nature and timing of reports or other communications.
- (ix) The involvement of experts and their reports.
- (x) Review the previous year's Audit Report.

The **audit programme** should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted.

- (i) **Corpus Fund:** The contributions / grants received towards corpus be vouched with special reference to the letters from the donor(s). The interest income be checked with Investment Register and Physical Investments in hand.
- (ii) **Reserves:** Vouch transfers from projects / programmes with donors letters and board resolutions of NGO. Also check transfer of gross value of asset sold from capital reserve to general reserve and adjustments during the year.
- (iii) **Ear-marked Funds:** Check requirements of donors institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- (iv) **Project / Agency Balances:** Vouch disbursements and expenditure as per agreements with donors for each of the balances.
- (v) **Loans:** Vouch loans with loan agreements, counterfoil of receipt issued.
- (vi) **Fixed Assets:** Vouch all acquisitions / sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/ agreements for the grant. In the case of immovable property check title, etc.
- (vii) **Investments:** Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis- investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- (viii) **Cash in Hand:** Physically verify the cash in hand and imprest balances, at the close of the year and whether it tallies with the books of account.
- (ix) **Bank Balance:** Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- (x) **Inventory:** Verify inventory in hand and obtain certificate from the management for the quantities and valuation of the same.
- (xi) **Programme and Project Expenses:** Verify agreement with donor/contributor(s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
- (xii) **Establishment Expenses:** Verify that provident fund, life insurance premium, employees state insurance and their administrative charges are deducted,

contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

**The receipt of income of NGO may be checked on the following lines:**

- (i) **Contributions and Grants for projects and programmes:** Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
- (ii) **Receipts from fund raising programmes:** Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
- (iii) **Membership Fees:** Check fees received with Membership Register. Ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
- (iv) **Subscriptions:** Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine / circulars / periodicals. Check the receipts with subscription rate schedule.
- (v) **Interest and Dividends:** Check the interest and dividends received and receivable with investments held during the year.

### **Appointment of Auditors (Other Than Government Company)**

#### **Appointment of AUDITOR at Annual General Meeting (AGM):**

- Every company shall at First AGM, appoint an individual Chartered Accountant in practice or a firm of Chartered Accountants as an Auditor to hold office from the conclusion of that meeting till the conclusion of the sixth (6th) Annual General Meeting (AGM).
- The duration of appointment of auditor of company will be restricted to term of consecutive five (5) years each for Individual and two terms of consecutive five (5) years in case of Audit Firm. However, the restriction of 5 years and 10 years does not apply to One Person Company and Small Companies as per Rule-5- The Companies (Audit and Auditor) Rules, 2014.

#### **Ratification at Every Annual General Meeting (AGM) [First Proviso of Section-139 (1)]**

Although the duration of auditors' office is Five (5) years and Ten (10) years, the company is required to place the matter for ratification at every AGM.

**DRAFT LANGUAGE OF NOTICE OF AGM (ORDINARY BUSINESS):**

**Resolved that** pursuant to the provisions of Section 139, 141 and other applicable provisions, if any, of the Companies Act, 2013 and the Rules framed thereunder, as amended from time to time, and pursuant to the recommendations of the Audit Committee, the appointment of M/s XYZ, Chartered Accountants, Gurgaon (ICAI Firm registration No. 123456), as Auditors of the Company to hold office from the conclusion of this Annual General Meeting (AGM) till the conclusion of the sixth AGM of the Company to be held in the year 2022 be and is hereby ratified at such remuneration plus service tax and out-of-pocket expenses as may be mutually agreed between the Board of Directors of the Company and the Auditors.

Resolved further that the Board of Directors of the Company be and is hereby authorized to do all such necessary acts and take all such steps as may be necessary, proper or expedient to give effect to this resolution”

**Consent and Certificate from Auditor [Second Proviso of Section-139 (1)]**

Following documents are required from Auditor before his Appointment in the AGM:

**Written consent** of auditor for such appointment;

**Certificate** from auditor for such appointment.

Under Rule 4 of Chapter-X, Auditor shall state in said certificate that he satisfies the following conditions [Third Proviso of Section 139(1)]:

The individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013 ('the Act'), the Chartered Accountants Act, 1949 and the rules or regulations made there under;

The proposed appointment is as per the term provided under the Act;

The proposed appointment is within the limits laid down by or under the authority of the Act;

The list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(Detailed discussion on appointment of auditors in case of Companies has been discussed in Chapter 10- Company Audit)



## 4. AUDIT OF SOLE TRADER

A sole trader is under no legal obligation to have his accounts audited. However, many such individuals get their financial statement audited due to regulatory

requirements, such as inventory brokers or on a specific instructions of the bank for approval of loans, etc.

**Appointment of Auditor:** Auditors of sole- proprietary concern shall be appointed by the sole proprietor himself. In case of change of auditor, it would be duty of incoming auditor to communicate with the previous auditor. As such, sole proprietor can determine the scope of the audit as well as the conditions under which it will be carried out.

### *Example*

He can stipulate that only a partial audit shall be carried out, that certain parts of the accounts shall not be checked or that the auditor also shall prepare the final statements of account. He can also decide whether the audit shall be carried out continuously or at the end of the year.

On these considerations, it is desirable that the contract of appointment of auditor in such a case should be in writing; also that it should clearly define the scope of the work which the auditor is expected to carry out. This helps to prevent misunderstanding. If the appointment of the auditor is not in writing, the auditor should write to his client explaining the scope of his duties. While doing so, he should state the limitations, if any, placed upon his work to obtain the client's confirmation.

The advantages and audit procedure discussed in following paragraphs of audit in case of partnership firm would be similar in case of proprietorship.



## 5. AUDIT OF FIRM

**Appointment of Auditors:** The auditor to a firm is usually appointed by the partners either on the basis of a decision taken by them or to comply with a condition in the partnership agreement. His remuneration is also fixed by the partners. It is important that the letter of appointment should clearly state the nature and scope of audit which is to be carried out and particulars of limitations, if any, under which he would have to function. In case of change of auditor, it would be duty of incoming auditor to communicate with the previous auditor.

The auditor may, particularly, ensure application of accounting standards prescribed by the Institute. In case the firm is required to get its accounts audited under the requirements of any statute, the auditor will have to qualify the report in case of non-compliance with the accounting standards. Alternatively, only disclosure of non- compliance with the accounting standards, would be sufficient without making it a subject matter of qualification.

**Matters to be considered before starting audit:** Also, before starting the audit, he should examine the partnership agreement and note the provisions therein as regards the following matters:

1. The name and style under which the business shall be conducted.
2. The duration of the partnership, if any, that has been agreed upon.
3. The amount of capital that shall be contributed by each partner—whether it will be fixed or could be varied from year to year.
4. The period at the end of which the accounts of the partnership will be closed periodically and the proportions in which the profit shall be divided among the partners or losses shall have to be contributed by them; whether the losses shall be borne by the partners or whether any of the partners will not be required to do so.
5. The provisions as regards maintenance of books of account and the matters which must be taken into account for determining the profits of the firm available for division among the partners *e.g.*, creation of reserves, provision for depreciation, etc. also the period within which accounts can be reopened for correcting a manifest error.
6. Borrowing capacity of the partnership (when it is not implied as in the case of non-trading firms).
7. The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.
8. Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent?
9. Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.
10. Who shall operate the bank account of the firm? How will the surplus funds of the partnership be invested?
11. Limitations and restrictions that have been agreed upon, the rights and powers of partners and on their implied authority to pledge the firm's credit or to render it liable.

**Advantages of Audit of a Partnership Firm** - On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:

- (1) Audited accounts provide a convenient and reliable means of settling accounts between the partners and, thereby, the possibility of occurrence of a dispute among them is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them, unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.
- (2) On the retirement or death of a partner, audited accounts, which have been accepted by the partners, constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
- (3) Audited statement of accounts are relied upon by the banks when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.
- (4) Audited statements of account can be helpful in the negotiations to admit a person as a partner, especially when they are available for a number of past years.
- (5) An audit is an effective safeguard against any undue advantage being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm.

**Matters which should be specially considered in the audit of accounts of a partnership:**

- (i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
- (ii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.
- (iii) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

- (iv) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
- (v) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.
- (vi) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
- (vii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

From the foregoing steps involved in the audit of a partnership it would be observed that like the audit of every other commercial undertaking, it culminates in the verification of the Balance Sheet and the Statement of Profit and Loss to ensure that these exhibit a true and fair state of affairs of the firm.

The object of examining the partnership agreement, which is an important feature of such an audit, is that the auditor may be able to report to the partners if the interest of any partner has been prejudicially affected, on account of the firm having engaged itself in an activity which it was not authorised to do or violation of any provision of the partnership agreement.

### **5.1 Basics of Limited Liability Partnerships (LLP) Audit**

An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. A "Statement of Accounts and Solvency" in prescribed form shall be filed by every LLP with the Registrar every year.

The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009. Such rules, inter-alia, provides 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. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

No mandatory insurance has been proposed in the Act. It would be difficult to assess insurance requirements of different types and sizes of LLPs. This would depend upon the nature of commercial risk attached with work or assignment handled by each. Applying common insurance requirements across a class of LLPs

would result in increasing their costs of operation. Therefore, the underlying concern as to the credit worthiness of the LLP in the event of a contractual default is being addressed through statutory provisions for solvency declaration, disclosure of financial information and audit.

Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.

Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the financial year to which the Statement of Account and Solvency relates.

Registrar would have power to obtain such information which he may consider necessary for the purposes of carrying out the provisions of the Act, from any designated partner, partner or employee of the LLP. He would also have power to summon any designated partner, partner or employee of any LLP before him for any such purpose, in case the information has not been furnished to him or in case the Registrar is not satisfied with the information furnished to him.

The following documents/information will be available for inspection by any person:-

- ◆ Incorporation document
- ◆ Names of partners and changes, if any, made therein
- ◆ Statement of Account and Solvency
- ◆ Annual Return

The fees for such inspection of an LLP is Rs 50/- and fees for certified copy or extract of any document u/s 36 shall Rs. 5/- per page.

The provisions of the Act require LLPs to file the documents like Statement of Account and Solvency (SAS) and Annual Return (AR) and notices in respect of changes among partners etc. within the time specifically indicated in relevant provisions. The Act contains provisions for allowing LLPs to file such documents after their due dates on payment of additional fees. It has been provided that in case LLPs file relevant documents after their due dates with additional fees upto 300 days, no action for prosecution will be taken against them. In case there is delay of 300 days or more, the LLPs will be required to pay normal filing fees, additional fee and shall also be liable to be prosecuted.

The Act also contains provisions for compounding of offences which are punishable with fine only.

**Appointment of Auditor:** The auditor may be appointed by the designated partners of the LLP –

1. At any time for the first financial year but before the end of first financial year,
2. At least thirty days prior to the end of each financial year (other than the first financial year),
3. To fill the causal vacancy in the office of auditor,
4. To fill the casual vacancy caused by removal of auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them.

**LLP's are required to maintain books of accounts which shall contain-**

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.

**Advantages / Purpose / Need of Audit**

1. Auditing the accounts of a LLP helps in detecting errors & frauds & verification of financial statements.
2. Disputes, if any between any partners in the matter of accounts can be settled with the help of audited accounts.
3. Banks & financial institutions lend money to the firms only on the basis of audited accounts.
4. Periodical visits & suggestions by the auditor will be helpful in improving the management of the LLP.
5. For settling accounts between partners at the time of admission, death, retirement, insolvency, insanity, etc audited accounts are accepted by those concerned who have dealings with the LLP.

**Auditor's Duty Regarding Audit of LLP**

1. The auditor should get definite instructions in writing as to the work to be performed by him.

2. The auditor should mention
  - (a) Whether the records of the firm appear to be correct & reliable.
  - (b) Whether he was able to obtain all information & explanation necessary for his work.
  - (c) Whether any restriction was imposed upon him.
3. The auditor should read the LLP agreement & note the following provisions
  - (a) Nature of the business of the LLP.
  - (b) Amount of capital contributed by each partner.
  - (c) Interest – in respect of additional capital contributed.
  - (d) Duration of partnership.
  - (e) Drawings allowed to the partners.
  - (f) Salaries, commission etc payable to partners.
  - (g) Borrowing powers of the LLP.
  - (h) Rights & duties of partners.
  - (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
  - (j) Any loans advanced by the partners.
  - (k) Profit sharing ratio
4. If partners maintain minute book he shall refer it for any resolution passed regarding the accounts

(Source: <http://www.mca.gov.in/MinistryV2/disclosureauditandfilingrequirements.html>)



## 6. AUDIT OF CHARITABLE INSTITUTION

In the case of audit of a charitable institution, attention should be paid to the following matters-

### (1) General

- (i) Studying the constitution under which the charitable institution has been set up.
- (ii) Verifying whether the institution is being managed in the manner contemplated by the law under which it has been set up.

- (iii) Examining the system of internal check, especially as regards accounting of amounts collected.
- (iv) Verifying in detail the income and confirming that the amounts received have been deposited in the bank regularly and promptly.

**(2) Subscriptions and donations**

- (i) Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.
- (ii) Whether official receipts are issued;
  - (a) confirming that adequate control is imposed over unused receipt books;
  - (b) obtaining all receipt books covering the period under review;
  - (c) test checking the counterfoils with the cash book; any cancelled receipts being specially looked into;
  - (d) obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
  - (e) examining the system of internal check regarding moneys received from box collections, flag days, etc. and checking the amount received from representatives, with the correspondence and the official receipts issued; paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; and
  - (f) verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

**(3) Legacies** - Verifying the amounts received by reference to correspondence with any figures and other available information.

**(4) Grants**

- (i) Vouching the amount received with the relevant correspondence, receipts and minute books.
- (ii) Obtaining a certificate from a responsible official showing the amount of grants received.

**(5) Investments Income**

- (i) Vouching the amounts received with the dividend and interest counterfoils.
- (ii) Checking the calculations of interest received on securities bearing fixed rates of interest.
- (iii) Checking that the appropriate dividend has been received where any investment has been sold ex-dividend or purchased cum-dividend.
- (iv) Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.

**(6) Rent**

- (i) Examining the rent roll and inspecting tenancy agreements, noting in each case:
  - (a) the amounts of the rent, and
  - (b) the due dates.
- (ii) Vouching the rent on to the rent roll from the counterfoils of receipt books and checking the totals of the cash book.

**(7) Special function, etc.** - Vouching gross receipts and outgoings in respect of any special functions, *e.g.* concerts, dramatic performance, etc., held in aid of the charity with such vouchers and cash statements as are necessary. In particular, verifying that the proceeds of all tickets issued have been accounted for, after making the allowance for returns.

**(8) Income Tax Refunds** - Where income-tax has been deducted from the Investment income, it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of Income-tax. This involves:

- (i) vouching the Income-tax refund with the correspondence with the Income- tax Department; and
- (ii) checking the calculation of the repayment of claims.

**(9) Expenditure**

- (i) Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and

that no trustee, director or member of the Managing Committee has benefited there from either directly or indirectly.

- (ii) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test- basis.
- (iii) Verifying the cash and bank balances.
- (iv) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

## 7. AUDIT OF EDUCATIONAL INSTITUTIONS (SCHOOL, COLLEGE OR UNIVERSITY)

The special steps involved in their audit are the following-

- (1) Examine the Trust Deed or Regulations, in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder.



Source of image: [www.aspiringminds.in](http://www.aspiringminds.in)

- (2) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (3) Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

- (4) Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (5) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (6) Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
- (7) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.
- (8) Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
- (9) Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.
- (10) Verify rental income from landed property with the rent rolls, etc.
- (11) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (12) Verify any Government or local authority grant with the memo of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons thereof.
- (13) Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
- (14) Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet not transferred to revenue, unless they are not refundable.
- (15) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (16) Verify that the Provident Fund money of the staff has been invested in appropriate securities.

- (17) Vouch donations, if any with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (18) Vouch, all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (19) Vouch, in the usual manner, all establishment expenses and enquire into any unduly heavy expenditure under any head. If there was any annual budget prepared, see that any excess under any head over the budgeted amount was duly sanctioned by the Managing Committee. If not, bring it to the Committee's notice in your report.
- (20) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- (21) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- (22) Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.
- (23) Confirm that the refund of taxes deducted from the income from investment (interest on securities etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (24) Finally, verify the annual statements of account and, while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of staff, etc.

## 8. AUDIT OF HOSPITAL

The special steps involved in such an audit are stated below-



1. **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
2. **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. **Income from Investments, Rent etc:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
4. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
6. **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
7. **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
8. **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
9. **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
10. **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.

11. **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
12. **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
13. **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.



## 9. AUDIT OF CLUB

The special steps involved in such an audit are stated below-

- (1) Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
- (2) Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
- (3) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
- (4) Check totals of various columns of the Register of members and tally them across.
- (5) See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
- (6) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.
- (7) Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

- (8) Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
- (9) Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
- (10) Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
- (11) Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.
- (12) Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.



## 10. AUDIT OF CINEMA

The special steps involved in its audit are stated below-

- (1) Verify the internal control mechanism-
  - (a) that entrance to the cinema-hall during show is only through printed tickets;
  - (b) that they are serially numbered and bound into books;
  - (c) that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
  - (d) that for advance booking a separate series of tickets is issued; and
  - (e) that the inventory of tickets is kept in the custody of a responsible official.
- (2) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
- (3) Verify that a record is kept of the 'free passes' and that these are issued under proper authority.

- (4) Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class and vouch and verify the entertainment tax returns filed each month.
- (5) Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.
- (6) Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regard.
- (7) Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalized.
- (8) Confirm that depreciation on machinery and furniture has been charged at an appropriate rate.
- (9) Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
- (10) Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.
- (11) The arrangement for collection of the share in the restaurant income should be enquired into either a fixed sum or a fixed percentage of the taking may be receivable annually. In case the restaurant is run by the Cinema, its accounts should be checked. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drink, etc. as in the case of club.



## **11. AUDIT OF HIRE PURCHASE AND LEASING COMPANIES**

Generally speaking, 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.

Thus, hirer means the person who obtains or has obtained possession of goods from an owner under a hire- purchase agreement and owner means the person who lets or has let, delivers or has delivered possession of goods to a hirer under a hire- purchase agreement in order to complete the purchase of, or the acquisition of property in the goods of which the agreement relates; and includes any sum so payable by the hirer under the hire- purchase agreement by way of a deposit or other initial payment.

While checking the hire- purchase transaction, the auditor may examine the following:

- (i) Hire purchase agreement is in writing and is signed by all parties.
- (ii) Hire purchase agreement specifies clearly-
  - (a) The hire-purchase price of the goods to which the agreement relates;
  - (b) The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;
  - (c) The date on which the agreement shall be deemed to have commenced;
  - (d) The number of instalments by which the hire- purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and
  - (e) The goods to which the agreement relates, in a manner sufficient to identify them.
- (iii) Ensure that instalment payments are being received regularly as per the agreement.

In a lease agreement, a party (called 'lessee') acquires the right to use an asset for an agreed period of time in consideration of payment of rent to another party (called 'lessor'). In certain lease agreements, the legal ownership of the asset remains with the lessor (the leasing company), but in substance, all the risks and rewards of

ownership of the asset are transferred to the lessee. In other words, the lease is, in effect, a financing arrangement. Such leases are termed as finance leases. An operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.

A normal financial lease transaction usually goes through the following modality:

The lessee will select the equipment, and satisfy himself about its functional fitness and specifications, the lessor has no participation at this stage.

Having chosen the equipment, the lessee approaches a lessor, either directly or through a lease-broking agency.

The lease agreement is broadly negotiated and the rates are finalised. The lessor places an order on the manufacturer as chosen by the lessee.

The manufacturer delivers the equipment at the site of the lessee, and the latter gives notice of acceptance to the lessor.

The lease agreement giving detailed terms of contract is signed between the parties. Leases will normally be full pay-out, with term varying as per requirements.

During the lease period, the lessee:

- ◆ Will pay rentals regularly at periods agreed-upon, which are usually each calendar month;
- ◆ Will keep the equipment in good repair and working condition, etc.
- ◆ Will be entitled to any manufacturer's warranties or after-sales services.

At the end of the lease period, the equipment shall retreat to the lessor. The lessee may, however, be given a renewal right, or may be allowed to participate in purchase of the equipment when the lessor intends to sell it. No purchase option shall be given to the lessee in the lease agreement itself.

In respect of leasing transaction entered into by the leasing company, the following procedures may be adopted by the auditor:

- (1) The 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 like lessee's ability to meet the commitment under lease, past credit record, capital strength, availability of collateral security, etc.

- (3) The lease agreement should be examined and the following points may be noted:
- (i) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).
  - (ii) the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
  - (iii) whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
  - (iv) whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.
- (4) Examine the lease proposal form submitted by the lessee requesting the lessor to provide him the equipment on lease.
- (5) Ensure that the invoice is retained safely as the lease is a long-term contract.
- (6) Examine the acceptance letter obtained from the lessee indicating that the equipment has been received in order and is acceptable to the lessee.
- (7) See the Board resolution authorising a particular director to execute the lease agreement has been passed by the lessee.
- (8) See that the copies of the insurance policies have been obtained by the lessor for his records.

Students need to pay attention that AS-19/ Ind-AS 17 define that lease arrangements could be of 2 types i.e. 1 Finance Lease and 2 Operating Lease.

**Finance Lease:** An arrangement with the following attributes qualifies as a Finance Lease:

The lease arrangement transfers ownership of the asset to the lessee at the end of the lease term;

- ◆ The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- ◆ The lease term is for the major part of the economic life of the asset even if title is not transferred;

- ◆ At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- ◆ the leased assets are of such a specialized nature that only the lessee can use them without major modifications

### Operating Lease

An arrangement that does not transfer substantially all the risks and rewards incidental to ownership qualifies as an Operating Lease. In other words, an operating lease is a lease arrangement "Other than finance lease".

The below table captures the broad differences under both the above said types of lease arrangements:

	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 administration costs are to be borne for example: registration, repairs etc. since it gives only right to use the asset.	Lessee generally bears insurance, maintenance and taxes.
Tax benefit	Since operating lease is as good as renting, lease payment is considered as expense. No depreciation can be claimed by the lessee.	Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.

## 12. AUDIT OF HOTELS

There are many problems involved in any hotel audit, some of which are peculiar to the hotel industry such as control of cash assumes greater proportions.

Almost all sales points in a hotel make both cash and credit sales. The auditor should reconcile the total sales reported with the total of the bills issued by the sales point; this total may take the form of a bill roll or a series of numerically controlled bills. This numerical control must be checked to ensure that all bills are included in the total. The cash element of the sales must then be checked to the cash records and the credit sales in total and detail to the guest's bills.

The special considerations in a hotel audit can be summarised as follows:

**(1) Internal Controls** - Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being

investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

**(2) Room Sales** - The charge for room sales is normally posted to guest bills by the receptionist/ front office or in the case of large hotels by the night auditor. The source of these entries is invariably the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period. Any difference between the charged rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorised.

In many hotels, the housekeeper prepares a daily report of the rooms which were occupied the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.

**(3) Inventories** - The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.

Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager. The key should be released only to trusted personnel and unauthorised persons should not be permitted in the stores areas except under constant supervision. In particular, any movement of goods in or out of the stores should be checked. Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end. Although such valuers are independent of the audit client, it is important that the auditor satisfies himself that the amounts included for such inventories are reasonable. In order to satisfy himself of this, the auditor

should consider attending the physical inventory taking and carrying out certain pricing and calculation tests. The extent of such tests could well be limited since the figures will have been prepared independently of the hotel.

**(4) Fixed Assets -** The accounting policies for fixed assets of individual hotels are likely to differ. However, many hotels account for certain quasi-fixed assets such as silver and cutlery on inventory basis. This can lead to confusion between each inventory items and similar assets which are accounted for on a more normal fixed assets basis. In such cases, it is important that very detailed definitions of inventory items exist and the auditor should carry out tests to ensure that the definitions have been closely followed.

**(5) Casual Labour -** The hotel trade operates to very large extent on casual labour. The records maintained of such wage payments are frequently inadequate. The auditor should ensure that defalcation on this account does not take place by suggesting proper controls to the management.

**(6) Other points -**

- (i) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.
- (ii) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.
- (iii) The auditor should ensure that proper records re-maintained for booking of halls and other premises for special parties and recovered on the basis of the tariff.
- (iv) The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.
- (v) The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, where as costs of major alterations and additions to the hotel building and facilities capitalised.
- (vi) The auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts.

- (vii) The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities.



## 13. AUDIT OF CO-OPERATIVE SOCIETIES

### 13.1 Background

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 and is applicable in many states with or without amendments. In many states, viz., Maharashtra, West Bengal, Orissa, the co-operative societies are governed by specific state Acts. An auditor of a co-operative society should be familiar with the provisions of the particular Act governing the society under audit.

Co-operative society is a business organisation 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.

A chartered accountant has to play a significant role in the development of co-operative organisations on scientific lines. In this Unit, it is proposed to give a few guidelines in the matter of audits of co-operative societies.

Apart from audit, some other professional services could be rendered by chartered accountants such as-

- (1) guidance in accounts writing,
- (2) installation of accounting system,
- (3) internal audit,
- (4) management accounting services,
- (5) taxation etc.

However, the main focus is to give some guidelines about the audit of co-operative societies in general. The special features of audit applicable to all societies will be considered first, and subsequently a few special points with reference to audit programmes of specific types of societies will be considered.

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

- (1) 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.

- (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 authorised 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.

The following points should be kept in mind in connection with the audit of a co-operative society:

**1. Qualifications of Auditors** - Apart from a chartered accountant 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 and also a person who has served as an auditor in the co-operative department of a government to act as an auditor.

**2. Appointment of the Auditor** - 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 his report to him as also to the society. The audit fees are paid by the society on the basis of statutory scale of fees prescribed by the Registrar, according to the category of the society audited.

**3. Books, Accounts and other records of Co-operative Societies** - Under section 43(h) of the Central Act, a state government can frame rules prescribing the books and accounts to be kept by a co-operative society.

For example, in Maharashtra, the co-operative societies are required to maintain books of account in terms of the instructions of the Registrar as following:

- (i) All sums of money received and expended by the society and the matters in respect of which receipts and expenditure take place.
- (ii) All sales and purchases of goods by the society.
- (iii) Assets and liabilities of the society.

In order to maintain proper financial accounting records so as to disclose full financial results of working of the society, the statutory or mandatory provisions provide a directive, but they are not conclusive. The society is at liberty to maintain such additional records according to its convenience and which it thinks more

useful for clarity and detailed explanation. Ultimately the financial transactions and the results thereof must be presented very clearly and in the best possible manner.

Depending upon the nature and object of the society, different kinds of books and registers will be maintained, so as to disclose a proper and fair picture of financial transactions. In case of large scale co-operative organisation, different subsidiary books and registers shall be maintained and the daily summary totals will be transferred to main Cash Book. For example:

- (a) Daily cash sales summary register.
- (b) A register of collection from debtors if credit sales are allowed by bye-laws of society.
- (c) A register of recovery of loans from salaries and directly by receipts from members in case of credit society.
- (d) Loan disbursement register in case of credit society.
- (e) Any other columnar subsidiaries depending upon the nature and functions of society.

**1. Restrictions on share holdings** - According to 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/-. The auditor of a co-operative society will be concerned with this provision so as to watch any breach relating to holding of shares. One should also watch whether any provision in the bye-laws of the society is not contrary to this statutory position. The State Acts may provide limits as to the shareholding, other than that provided in the Central Act.

**2. Restrictions on loans** - Section 29 of the Central Act puts restriction on loan. It states that a 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.

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.

**3. Restrictions on borrowings** - Section 30 of the Central Act further puts restriction on borrowings. According to this section, 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. The auditor will have to examine the bye-laws in this respect.

**4. Investment of funds** - According to 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.

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.

**5. Appropriation of 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.

**6. 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.

**7. Investment of Reserve Fund outside the business or utilisation 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).
- (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. The auditor should ensure strict compliance with the State Act and Rules in this regard.

**8. 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.

Apart from statutory provisions relating to Reserve Fund, the auditor may have regard to the provisions in bye-laws and Rules and Regulations of the society regarding the appropriation of profits. Transfers to other reserves, dividends to members etc. are the other appropriations. Appropriations of profits must be approved by the General Body of the society, which is the supreme authority in the co-operative management. Further, it may be noted that necessary accounting entries for the appropriation of profits must be passed after the date of approval by the General Body. Here there is a departure from corporate accounting practice, where entries are passed for proposed appropriations, subject to approval of Annual General Meeting.

According to certain State Acts, transfers to 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 provisions of any law are in contradiction with the generally accepted accounting principles.

### 13.3 Special Features of Co-Operative Audit

The general processes of auditing involved in audit work such as checking of posting, ascertainment of arithmetical accuracy, vouching, verification of assets and liabilities and final scrutiny of Balance Sheet are well known to the students, and the same are to be applied in co-operative audit as well. It need not be discussed in detail.

However, 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 6 months to 5 years and more than 5 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.

**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 the said rules, 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** - 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.

**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 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.

**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.

**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. 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.

### 13.4 Rights and Duties of Co-Operative Auditors

Section 17 of the Co-operative Societies Act, 1912 contains audit provision as under:

- (i) 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.
- (ii) 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.
- (iii) The Registrar, the Collector or any person authorised 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.

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. The audit report has to be submitted in the prescribed form specified by the Registrar or as given in the related Rules. According to the present prescribed form in some of the States, the auditor has to state:

- (a) 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.
- (b) 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.
- (c) Whether the Profit and Loss Account of the society gives a true and fair view of the Profit and Loss made by the society.
- (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 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.
- (f) 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.

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

### **13.5 Form of Audit Report**

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.

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 questionnaire is specific for a particular type of society. These questionnaires are drafted in detail and serve the practical purpose of audit programme.

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.

### **13.6 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. The Act contains detailed provisions regarding registration, membership and management of such 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.

**Books of Accounts** - As per Multi-State Co-operative Society Rules 2002, every Multi- State Co-operative society shall keep books of account with respect to-

- a. all sum of money received and expended and matters in respect of which the receipt and expenditure take place;
- b. all sale and purchase of goods;
- c. the assets and liabilities;
- d. in the case of a Multi-State Co-operative society engaged in production, processing and manufacturing, particulars relating to utilization of materials or labour or other items of cost as may be specified in the bye-hours of such a society.

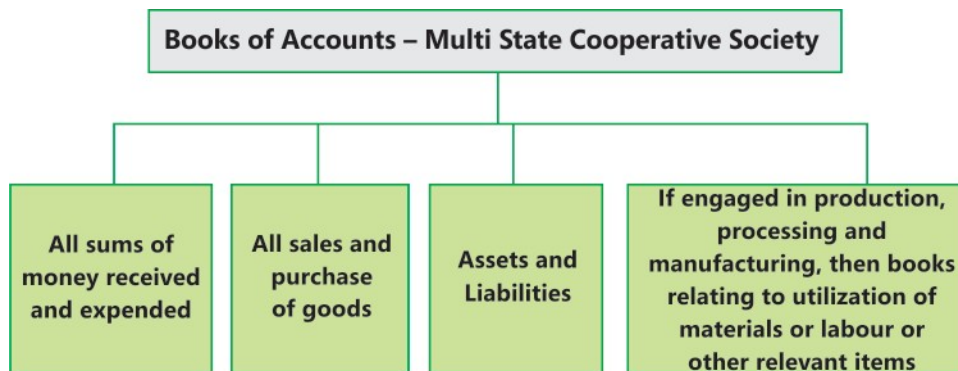


Diagram showing the Books of Accounts to be maintained by Multi State Co-operative Society

### 13.6.1 Audit of Multi-State Co-operative Society –

**1. Qualification of Auditors** - Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of Multi-State co-operative society.

However the following persons are not eligible for appointment as auditors of a Multi- State co-operative society-

- (a) A body corporate.
- (b) An officer or employee of the Multi-State co-operative society.

- (c) A person who is a member or who is in the employment, of an officer or employee of the Multi-State co-operative society.
- (d) A person who is indebted to the Multi-State co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an amount exceeding one thousand rupees.

If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

**2. Appointment of Auditors** - Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative 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. If the board fails to exercise its powers under this sub-section, the Multi-State co-operative society in the general meeting may appoint the first auditor or auditors.

The subsequent auditor or auditors are appointed by Multi-State co-operative society, at each annual general meeting. The auditor or auditors so appointed shall hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

**3. Power and duties of Auditors** – Section 73 of the Multi-State Co-operative Societies Act, 2002 discusses the powers and duties of auditors. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi-State co-operative 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.

As per section 73(2), the auditor shall make following inquiries:

- (a) 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,
- (b) 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,

- (c) Whether personal expenses have been charged to revenue account, and
- (d) 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.

**4. Content of Auditor's Report** - As per sub-section (3) & (4) of section 73 of Multi- state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account, which are laid before the Multi-State co-operative society in general meeting during his tenure of office, and the report shall state 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) In the case of the balance-sheet, of the state of the Multi-State co-operative society's affairs as at the end of its financial year; and
- (b) In the case of the profit and loss account, of the profit or loss for its financial year. The auditor's report shall also state:
  - (i) 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.
  - (ii) Whether, in his opinion, proper books of account have been kept by the Multi- State co-operative 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.
  - (iii) 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.
  - (iv) 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.

Where any of the matters referred to in sub-section (3) or (4) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

**5. Power of Central Government to direct special audit in certain cases -**

Under section 77 of the Multi-State Co-operative Societies Act, 2002, 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 deed 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.

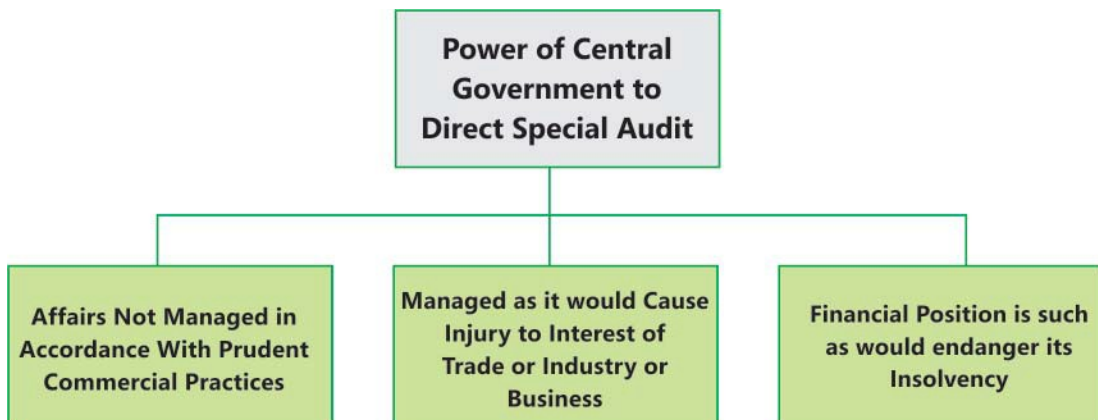


Diagram showing Power of Central Government to Direct Special Audit

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 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 percent 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 receipts 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.

However, 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 Co-operative 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 Co-operative 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.

### **13.6.2 Inquiry by Central Registrar under Section 78**

The Central Registrar may, on a request from a federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or not less than one-third of the members of the board or not less than one-fifth of the total number of members of a Multi-state co-operative society, 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 condition of a Multi-State Co-operative society. However, before holding such inquiry fifteen days notice must be given to the Multi-State co-operative society.

The Central Registrar or the person authorized by him shall have the following powers, namely:

- (a) he shall at all reasonable times have free access to the books, accounts, documents, securities, cash and other properties belonging to or in the custody of the Multi-State co-operative society and may summon any person in possession or responsible for the custody of any such books, accounts,

documents securities, cash or other properties to produce the same at any place specified by him.

- (b) he may, notwithstanding any bye-law specifying the period of notice for a general meeting of the Multi-State co-operative society, require the officers of the society to call a general meeting of the society by giving notice of not less than seven days at such time and place at the head quarters of the society to consider such matters as may be directed to him, and where the officers of the society refuse or fail to call such a meeting, he shall have power to call it himself.
- (c) he may summon any person who is reasonably believed by him to have any knowledge of the affairs of the Multi-State co-operative society to appear before him at any place at the headquarters of the society or any branch thereof and may examine such person on oath.

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 Multi-State co-operative society, the financial institutions, if any, to which the society is affiliated, and to the person or authority, if any at whose instance the inquiry is needed.

### 13.6.3 Inspection of Multi-State Co-operative societies under Section 79

The Central Registrar may, on a request from federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or not less than one-third of the members of the board or not less than one-fifth of the total number of members of a Multi-State co-operative society by general or special order in writing in this behalf inspect 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 Multi- State co-operative society.

However, no inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.

The Central Registrar or the person authorized by him shall have the following powers:

- (a) He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society and may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.

- (b) Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.

A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.



## 14. AUDIT REPORT IN RESPECT OF DIFFERENT ENTITIES

In respect of Report on the Audit of Financial Statements of the Companies, students are advised to refer Chapter 10 – “The Company Audit” and Chapter 11 – “Audit Report” and regarding other entities, refer Chapter 11- “Audit Report”.

### SUMMARY

Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of government transactions but has also added new concepts, techniques and procedures to the audit profession. Government auditing is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity. Government audit serves as a mechanism or process for public accounting of government funds. In India, the function of audit of Government accounts is discharged by the independent statutory authority of the Comptroller and Auditor General of India. The C&AG shall direct the manner in which the company's accounts shall be audited by the statutory auditors. The C&AG has power to conduct a supplementary or test audit of the company's accounts.

NGOs are non-profit making organisations which raise funds from members, donors or contributors for achieving their social objectives. The auditors of an NGO registered under the Societies Registration Act, 1860 (or under any law corresponding to this Act, in force in any part of India) or the Indian Trusts Act 1882 are normally appointed by the Management of the Society or Trust. The auditors of NGO registered under section 8 of the Companies Act, 2013 are appointed by the members of the company.

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts.

A sole trader is under no legal obligation to have his accounts audited. However, many such individuals get their financial statement audited due to regulatory

requirements. Auditors of sole- proprietary concern shall be appointed by the sole proprietor himself. The auditors of a firm are usually appointed by the partners. The object of examining the partnership agreement, which is an important feature of such an audit, is that the auditor may be able to report to the partners if the interest of any partner has been prejudicially affected. The accounts of every LLP shall be audited in accordance with 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.

## TEST YOUR KNOWLEDGE

### MCQs

1. While auditing a cinema hall, the auditor needs to verify that-
  - (a) entrance to the cinema-hall during show is only through printed tickets
  - (b) tickets are serially numbered and bound into books
  - (c) that for advance booking a separate series of tickets is issued
  - (d) All of the above
2. Article 151 requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the ----- who shall cause them to be laid before House of Parliament/State Legislature
  - (a) President/Governor
  - (b) Prime Minister/ Chief Minister
  - (c) Union Finance Minister/State Finance Minister
  - (d) All of the above
3. The C&AG Act gives which of the following power to the C&AG in connection with the performance of his duties-
  - (a) To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
  - (b) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.

- (c) To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.
- (d) All of the above
4. \_\_\_\_\_ aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.
- (a) Audit against provision of funds
- (b) Propriety audit
- (c) Audit of sanctions
- (d) Audit against rules and orders

**Correct/Incorrect**

**State with reasons (in short) whether the following statement is correct or incorrect:**

1. Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.
2. According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.
3. Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments.
4. The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.
5. NGOs may be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives.

### Theoretical Questions

1. You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation?
2. The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital?
3. Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges only ₹ 500 per month from a student for his lodging/boarding.
4. Explain in detail the duties of Comptroller and Auditor General of India
5. An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.

## ANSWERS/SOLUTIONS

### Answers to MCQs

1. (d)    2. (d)    3. (d)    4. (a)

### Answers to Correct/Incorrect

1. **Incorrect.** Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.
2. **Correct.** According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.
3. **Correct .** Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and

revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments, etc.

4. **Incorrect.** The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts.
5. **Correct.** NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations.

### Answer to Theoretical Questions

1. While planning the audit of an NGO, the auditor may concentrate on the following:
  - (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
  - (ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions related to the statutes.
  - (iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
  - (iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
  - (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
  - (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
  - (vii) Setting of materiality levels for audit purposes.
  - (viii) The nature and timing of reports or other communications.
  - (ix) The involvement of experts and their reports.
  - (x) Review the previous year's Audit Report.

2. Special points of consideration while auditing certain transactions of a hospital are stated below-

- (i) **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (iii) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (iv) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (v) **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.

3. 1. **General**

- (i) Study the constitution under which the charitable institution has been set up whether under the Society Registration Act, as a trust or as a company limited by guarantee. Verify whether it is managed as contemplated by the law and rules and regulations made thereunder.
- (ii) Examine the internal control structure particularly with reference to admission to hostel, expenses incurred on different kinds of activities.
- (ii) Verify the broad nature of expenses likely to be incurred with reference to the previous year's annual audited accounts.

**2. Verification of the receipts**

- (i) Check the amounts received on account of, monthly rentals, etc., and receipts issued for the same.
- (ii) Ascertain that there is adequate internal control over the issue of official receipts, custody of unused receipt books, printing of receipt books, etc.
- (iii) Cross - tally the rent received along with the number of students (from the student register) staying in the hostel during the year.
- (iv) Check the amounts received from additional services rendered like guest fees, receipts for breakage, fines, penalties, etc.

**3. Verification of expenses**

- (i) Check the day-to-day administration expenses incurred along with the necessary vouchers, supporting for the same like salary registers, repairs register, etc.
  - (ii) Verify whether the expenses incurred are in conformity with the budgets prepared internally or filed with the relevant authorities.
  - (iii) Check the amount spent on provisions of hostel facilities with reference to bills, etc.
  - (iv) See that whenever heavy expenditure has been incurred on renovation of the hostel, computer centre, etc. the same is accounted for properly (if such facilities are being provided by the hostel).
- 4.** Verify investments made from surplus funds as well as existing investments by physically verifying the same and that they are in the name of the institution and that there is no charge/pledge against the same.
- 5.** Verify all capital expenditure and expenditure on repairs, etc., incurred with the vouchers and also whether proper tenders, etc., were invited for the same. See that all furniture, glass, cutlery, kitchen utensils, liner, etc. are adequately depreciated.
- 6.** Library Facilities: See that proper library register are maintained. The system regarding issue and receipt of books is in order. Late fee fines and money received on account of lost book is accounted for properly. Obsolete books are written off only after proper authorisation.

Expenses incurred on newspapers and weekly magazines as compared to Journals and periodicals have been accounted for properly.

7. Check the provision of other additional facilities like computer facilities, etc. Ensure that proper registers are maintained for charging fees, based on monthly or hourly basis. In case such facility is extended to each room, whether the charges are payable on lump-sum basis or on actual usage basis. Also ensure that amounts spent have been allocated properly.
  8. Verify whether the institution is eligible for income tax exemption and if not, whether provision for taxation has been made.
4. **Duties of C&AG:** The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under-
- (i) **Compile and submit Accounts of Union and States** - The C&AG shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.
  - (ii) **General Provisions Relating to Audit - It shall be the duty of the C&AG –**
    - (a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
    - (b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
    - (c) to audit and report on all trading, manufacturing profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.
  - (iii) **Audit of Receipts and Expenditure** - Where any body 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 Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body

or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

- (iv) **Audit of Grants or Loans** - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.
- (v) **Audit of Receipts of Union or States** - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make this purpose such examination of the accounts as he thinks fit and report thereon.
- (vi) **Audit of Accounts of Stores and Inventory** - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.
- (vii) **Audit of Government Companies and Corporations** - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 (i.e. appointment of First Auditor or Subsequent Auditor) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

**5. Receipt of Donations:**

- (i) **Internal Control System:** Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) **Custody of Receipt Books:** Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) **Receipt of Cheques:** Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (iv) **Bank Reconciliation:** Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) **Cash Receipts:** Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) **Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

**Remittance of Donations to Different NGOs:**

- (i) **Mode of Sending Remittance:** All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.
- (iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- (v) **Donation Utilisation:** Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.
- (vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.