

# Special Points relating to Internal Audit in various Entities

## Lesson 7

### KEY CONCEPTS

■ Non-Performing Assets 'NPA' ■ Partnership Firm ■ Limited Liability Partnership 'LLP' ■ Co-operative Society

### Learning Objectives

#### To understand:

- Who is the regulatory body of Banking Company and what are its major functions and responsibilities?
- The prudential norms of banking company and provisioning requirement in case of Non-Performing Assets 'NPA'
- Major's points / areas to be covered in case of audit of Banking Companies, Insurance Companies, Cooperative Societies, Public Sector Undertakings, Partnership, Shipping Companies, Electric Supply Company, Hotels, and Hospital etc.

### Lesson Outline

Special Points relating to Internal Audit in various entities such as:

- Banking Companies
- Insurance Companies
- Cooperative Societies
- Public Sector Undertakings
- Partnership
- Shipping Companies
- Electric Supply Company
- Hotels
- Hospital
- Lesson Round-Up
- Test Yourself
- List of Further Readings

**SPECIAL POINTS RELATING TO INTERNAL AUDIT IN BANKING COMPANIES****Regulating Body**

Banking Industry in India is regulated by the Reserve Bank of India (RBI) known as the Central Bank. Major functions and responsibilities of RBI are:

- Development and supervision of the banks and non-banking financial institutions
- Determining, the monetary and credit policies
- Issuance and regulation of currency
- Acting as banker to the central and state governments, commercial and other types of banks including term-lending institutions
- To regulate the activities of commercial and other banks.

**Regulatory Framework**

- a) Banking Regulation Act, 1949;
- b) Reserve Bank of India Act, 1934;
- c) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970;
- d) State Bank of India Act, 1955;
- e) State Bank of India (Subsidiary Banks) Act, 1959;
- f) Regional Rural Banks Act, 1976;
- g) Companies Act, 2013;
- h) Cooperative Societies Act, 1912 or the relevant State Cooperative Societies Acts;
- i) Information Technology Act, 2000;
- j) Prevention of Money Laundering Act, 2002;
- k) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- l) Credit Information Companies Regulation Act, 2005; and
- m) Payment and Settlement Systems Act, 2007.

**Features of Banking Operations**

- Voluminous and complex of transactions,
- Wide geographical spread of banking network,
- Diversified and large range of products and services offered,
- Extensive use of technology,
- Strict vigilance and compliance.

**Form and Content of Financial Statements**

- Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit. Form A of

the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.

- Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as notified u/s 133 of the Companies Act, 2013, in so far as they apply to banking companies.

### Reporting of Fraud

Circular issued by RBI regarding liability of accounting and auditing profession, provides that “If an accounting professional, whether in the course of internal or external audit or in the process of institutional audit finds anything susceptible to be fraud or fraudulent activity or act of excess power or smell any foul play in any transaction, he should refer the matter to the regulator. Any deliberate failure on the part of the auditor should render himself liable for action”.

This requirement is applicable to all scheduled commercial banks excluding Regional Rural Banks. Auditor is not expected to look into each and every transaction but to evaluate the system as a whole.

### Scope of Internal Audit

- Evaluating the effectiveness of the internal control systems and monitor its application
- Review the adequacy of the risk management procedures and methodologies
- Checking the efficiency of routine operations of the bank
- Evaluate the reliability and accuracy of the financial records and reports
- Review the management information system and the efficiency of the electronic banking services
- Implementation of policies and procedures and ensure its effectiveness
- Ensure that the procedures comply with the legal and regulatory requirements
- The undertaking of fraud investigations, if required
- Ensuring the adequacy of procedures to safeguard the bank's assets
- Monitoring the bank's Non-Performing Assets (NPA) and alarming the management when required.

### Conducting an Audit

- 1. Understanding the Bank and its Environment:** Auditor is required to obtain understating of:
  - Bank and its Environment including Internal Control
  - Bank's Accounting Process
  - Risk Management Process.
- 2. Identifying and Assessing Risk of Material Misstatements:** Auditor is required to identify and assess following risk:
  - Risks of Material Misstatements
  - Risk of Fraud including Money Laundering
  - Specific Risks
  - Risk Associated with Outsourcing of activities.

**3. Understanding the Risk Management Process:** An effective risk management system in a bank generally requires the following:

- a) Identification, measurement & monitoring of risks:** Risks that may significantly affect the achievement of bank's goals and objectives should be identified, measured and monitored against pre-approved limits and criteria.
- b) Control activities:** Banks must have appropriate controls to manage its risks, including, effective segregation of duties, verification and approval of transactions, setting of limits, and reporting and approval of exception.
- c) Monitoring activities:** Independent risk management unit should be set up which regularly assess the risk management models, methodologies and assumptions used to measure and manage risk.
- d) Reliable information systems:** Banks must have a reliable information system that provide adequate financial, operational and compliance information on a timely and consistent basis to management.

#### **4. Engagement Team Discussions**

- To gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.
- All these discussions should be appropriately documented for future reference.
- The discussion should be done on the susceptibility of the bank's financial statements to material misstatements.
- These discussions are ordinarily done at the planning stage of an audit.

##### **a) Benefits of discussion**

- Opportunity for team members to share their insights based on their knowledge of the bank and its environment.
- Opportunity for team members to exchange information about the bank's business risks.
- To make an understanding amongst the team members about effect of the results of the risk assessment procedures on other aspects of the audit, including decisions about the NTE of further audit procedures.

##### **b) Matters to be discussed**

- Errors that may be more likely to occur;
- Errors which have been identified in prior years;
- Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- Need to maintain professional skepticism throughout the audit engagement;
- Need to alert for information or other conditions that indicates that a material misstatement may have occurred.

5. **Establish the Overall Audit Strategy:** Establish the overall audit strategy, prior to the commencement of an audit; and involve key engagement team members and other appropriate specialists while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.
6. **Develop the Audit Plan:** Develop an overall audit plan which cover details of nature, timing and extent of audit procedures planned to be performed.
7. **Execution:** Execution stage considers the following:
  - Engagement Team Discussions
  - Response to the Assessed Risks
  - Establish the Overall Audit Strategy
  - Audit Planning Memorandum
  - Determining Audit Materiality
  - Appropriateness of Going Concern.
8. **Reliance/Review of other Reports:** Auditor should consider the adverse/qualified remarks, if any, appearing in the following:
  - Previous audit reports
  - Internal inspection reports
  - RBI inspection reports
  - Concurrent/Internal audit report
  - Report on verification of security
  - Any other internal reports specially related to particular accounts.

### Assessing Risk of Fraud

Assessing Risk of Fraud – As per SA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”, the auditor’s objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and “Know Your Customer (KYC)” norms. The RBI has from time to time issued guidelines (“Know Your Customer Guidelines – Anti Money Laundering Standards”), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

### Audit of Advances

#### A. Disclosure Requirements

##### 1. Nature wise

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

**2. Security wise**

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

**3. Location wise****1. Advances in India:**

- Priority sectors
- Public sector
- Banks
- Others

**2. Advances outside India:**

- Due from Banks
- Due from Others:
  - (a) Bills Purchased and discounted
  - (b) Syndicated loans
  - (c) Others

**B. Classification as per prudential norms**

- **Standard assets:** Assets which does not disclose any problem and does not carry more than normal risk.
- **Sub-standard assets:** Asset which has been classified as NPA for a period not exceeding 12 months.
- **Doubtful assets:** Doubtful assets Asset which has remained NPA for a period exceeding 12 months.
- **Loss assets:** Asset in respect of which loss has been identified by the bank or internal auditors or the RBI inspection, but the amount has not been written off, wholly or partly.

**C. Creation of Security**

- **Primary security:** Security offered by the borrower for bank finance or the one against which credit has been extended by the bank.
- **Collateral security:** It is an additional security and can be in any form i.e. tangible or intangible asset, movable or immovable asset.

**Note:** Security may be created by different modes like Mortgage, Pledge, Hypothecation, Lien, Assignment etc.

**D. Prudential Norms****1. Non-Performing Advances:** An Advance will be classified as NPA if:

- a) It ceases to generate income for a bank.
- b) Interest and/or instalment of principal in respect of such an advance have remain overdue or out of order for a specified period of time.

**Overdue:** An amount is said to be 'Overdue', if it is not paid on the due date fixed by the Bank.

**Out of Order:** An account should be treated as 'Out-of-order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. Or If there are no credits continuously for 90 days as on the balance sheet date or the credits are not enough to cover the interest debited during the same period.

## 2. NPA classification w.r.t. specified advances

- **Term Loans:** Interest and/or Instalment of principal has remained overdue for a period exceeding 90 days.
- **CC/OD:** The account has remained out-of-order for a period exceeding 90 days.
- **Bills Purchased & Discounted:** The Bill remains overdue & unpaid for a period exceeding 90 days.

## 3. Provisioning Requirements

- **Standard assets:** 0.40% (0.25% on SME/Agricultural Advances) and 1% on commercial Real Estate Loans.
- **Sub-standard assets:** 15% [Additional provision for unsecured portion is required @ 10% (5% for infrastructure advances)]
- Doubtful assets

**Unsecured portion-** 100%

**Secured portion-** 25% to 100% depending upon the period for which advance has remained doubtful.

- Upto one year – 25%
- More than one year but upto 3 years – 40%
- Above three years – 100%
- Loss assets- 100%

## 4. Special cases w.r.t. NPA Classification

- **Accounts regularised near Balance Sheet date:** Where it appears that an account has inherent weakness and few credits near the balance sheet tries to make it regular, the account should be classified as NPA.
- **Asset Classification borrower-wise:** All the facilities granted by bank to borrower will have to be treated as NPA and not the particular facility or part thereof.
- **Agricultural Advances/Loans:** Interest and/or Instalment of principal is overdue for two crop seasons, in case loans granted for Short Duration crops, one crop season, in case loans granted for Long Duration crops (i.e. more than 1 year).

## 5. Erosion in Value of Securities:

In case there arise erosion in the value of security or any fraud is committed by Borrowers, banks can directly classify these accounts as Doubtful Assets or Loss Assets, irrespective of the period for which the account has remained NPA.

Erosion in the value of securities by more than 50% of the value assessed by the bank or accepted by RBI inspection team at the time of last inspection, as the case may be, would be considered as "significant", requiring the asset to be classified as doubtful straightaway and provided for adequately.

The realisable value of security as assessed by bank/approved valuers/RBI is less than 10% of the outstanding in the borrowal accounts, the existence of the security should be ignored and the asset should be classified as loss asset. In such cases the asset should either be written off or fully provided for.

- 6. Agricultural Advances affected by Natural Calamities:** Where, in the wake of natural calamities, short-term agricultural loans are converted into term loans or there is rescheduling of repayment period or fresh short-term loans are sanctioned, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA.
- 7. Computation of Drawing Power:** All working capital limits, at all times, should be kept within both the drawing power and the sanctioned limit. Irregular accounts should be brought to the notice of the Management/Head Office regularly.

## Audit Procedure

### 1. Aspects of Internal Control

- a) Advances should be made only after evaluating creditworthiness of the borrowers and obtaining sanction from the proper authorities of the bank.
- b) All the loan documents like promissory notes, letters of hypothecation, guarantee letter, etc. should be executed by the parties before advances are made.
- c) While determining the loan amount to be sanctioned, sufficient margin should be kept against securities taken so as to cover any decline in the value thereof and also to comply with RBI directives.
- d) Securities should be received and returned by responsible officer and should be kept in the joint custody of atleast two responsible officers.
- e) Securities requiring registration should be registered in the name of the bank.
- f) In the case of physical possession of goods as security, the goods should be test checked at the time of receipts. In respect of hypothecated goods not in possession of the bank, surprise checks should be made.
- g) Personal inquiries should be made so as to determine market value of goods.
- h) For any increase/decrease in the value of securities, drawing power should be adjusted. All the accounts should be kept within both the drawing power and the sanctioned limit at all times.
- i) All irregular accounts should be brought to the notice of the H.O. regularly.
- j) The operation in each advance should be reviewed at least once every year.
- k) There should exist a proper system for post disbursement supervision and follow-up.
- l) Classification of advances should be made as per RBI Guidelines.
- m) Ensure that the funds disbursed should be utilized only for the purpose for which advances has been granted.

### 2. Substantive Audit Procedure

- i. To verify that amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet.
- ii. To verify that advances represent amount due to the bank.

- iii. To ensure that outstanding amount is appropriately supported by Loan documents.
- iv. To ensure that there are no unrecorded advances.
- v. To verify the appropriateness of basis of valuation of advances.
- vi. To ensure that the recoverability of advances is recognised in their valuation.
- vii. To check that the advances are disclosed, classified and described in accordance with recognised accounting policies and relevant statutory and regulatory requirements.
- viii. Ensure that appropriate provisions towards advances have been made as per the RBI norms.

A strong internal control system, including an independent and effective internal audit function, is part of sound corporate governance. Banking supervisors must be satisfied as to the effectiveness of a bank's internal audit function that policies and practices are followed and that management takes appropriate and timely corrective action in response to internal control weaknesses identified by internal auditors. An internal audit function provides vital assurance to a bank's board of directors and senior management (and bank supervisors) as to the quality of the bank's internal control system. In doing so, the function helps reduce the risk of loss and reputational damage to the bank.

The internal audit function should develop an independent and informed view of the risks faced by the bank based on their access to all bank records and data, their enquiries, and their professional competence. The internal audit function should be able to discuss their views, findings and conclusions directly with the audit committee and the board of directors, thereby helping the board to oversee senior management.

### **SPECIAL POINTS RELATING TO INTERNAL AUDIT IN INSURANCE COMPANIES**

An Indian insurance company is formed and registered under the Companies Act, 2013 and the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty-six per cent of the paid-up equity capital of such Indian insurance company. The sole objects of the Indian Insurance Company shall be to carry on life insurance business or general insurance business or re-insurance business.

#### **Verification of Premium**

The premium collections are credited to a separate bank account and no withdrawals are normally permitted from that account for meeting the general expenditure. As per the policy of the insurance company, the collections are transferred to the Regional Office or Head Office. No Risk shall be assumed by the insurer without receipt of premium according to section 64VB of the Insurance Act, 1938. Verification of premium is of utmost importance to an auditor because Insurance premium is collected upon issuing policies. It is the consideration for bearing the risk by the insurance company. The auditor should apply the following procedures: –

- Before commencing verification of premium income, the auditor should look into the internal controls and compliance which are laid down for collection and recording of the premiums.
- Cover notes should be serially numbered.
- The auditor should check whether Premium Registers have been maintained chronologically, giving full particulars including GST charged as per acceptance advice on a day-to-day basis.
- The auditor should verify whether the figures of premium mentioned in the register tally with those in General Ledger.
- The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit.

### Verification of Claims

The auditor should obtain from the divisions/branches, the information for each class of business. The auditor should determine the total number of documents to be checked giving due importance to claim provisions of higher value. The claims under policies comprise the claims paid for losses incurred, and those estimated or anticipated claims pending settlements under the policies. Settlement cost of claims includes surveyor fee, legal expenses, etc. The Claim Account is debited with all the payments including repair charges, firefighting expenses, police report fees, survey fees, amount decreed by the Courts, travel expenses, photograph charges, etc. The auditor should-

- Check whether provision has been made for all unsettled claims.
- Check whether provision has been made for only such claims for which the company is legally liable.
- Check whether provision made is normally not in excess of the amount insured.
- Check in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability.
- Check claimed paid should be duly sanctioned by the authority concerned.

### Verification of Commission

The remuneration of an agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him. Commission is payable to the agents for the business procured and is debited to Commission on Direct Business Account. An insurance business is solicited by insurance agents. The auditor should verify-

- Voucher disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.
- Check whether the vouchers are authorized by the officers- in –charge as per rules and income tax is deducted at source, as applicable.
- Test check correctness of amounts of commission allowed.
- To check whether commission outgo for the period under audit been duly accounted or not.

### Verification of Operating Expenses

All the administrative expenses in an insurance company are broadly classified under 13 heads as mentioned in Schedule IV. The auditor should check-

- Expenses in excess of Rs.5 Lakhs or 1% of net premium, whichever is higher, should be shown separately; and
- Expenses not directly relating to insurance business should be shown separately for example, expenses relating to investment department, bank charges etc. Three Important Audit Points in Insurance Company Balance Sheet.

### Investments

The auditor should keep in mind the following provisions related to Investments of the Insurance Act, 1938 while examining the investments-of an insurance company-

- a. An insurance company can only invest in approved securities. However, it can invest otherwise than in approved securities if the following conditions are satisfied.

- Such investments should not exceed 25% of the total investments; and
  - Such investments are made with the consent of board of directors.
- b. An insurer should not invest in shares or debentures of insurance or Investment Company in excess of least of the following:
- 10% of its own total assets;
  - 2% of the investee's subscribed share capital or debentures.
- c. An insurer company should not invest in shares or debentures of a company other than insurance or investment company in excess of least of the following
- 10% of its own total assets;
  - 10% of investee's subscribed share capital or debentures.
- d. An insurance company cannot invest in shares and debentures of a private company.
- e. The insurance companies cannot invest the funds of its policy holders outside India.

### Cash and Bank Balances

- Bank reconciliation statements shall be prepared.
- The auditor should obtain confirmation of Bank Balances for all operative and inoperative accounts.
- The auditor should physically verify Term Deposit Receipts issued by bankers. Generally all cash at year end deposited as term deposit with the bank.
- The auditor should verify the deposits and withdrawals transactions at random and check whether the Account is operated by authorized persons only.
- In case of funds, in -transit, he should verify that the same are properly reflected in a reconciliation statement.

### Outstanding Premium and Agents' Balance

The audit procedures, which may be followed with regards to agent's balance, are as follows:

- Verify whether agent's balances and outstanding balances in outstanding premium account have been listed, analyzed and reconciled for the purposes of audit.
- Verify whether recoveries of large outstanding have been made in post audit period.
- Verify whether there is any old outstanding debit or credit balances as at the yearend which require adjustment. A written explanation may be obtained from the management is to their nature.
- Verify that agent's balances do not include employees' balances and balances of other insurance companies.
- Verify that no credit of commission is given to agents for businesses directly procured by it.

### Books, Registers & Reports

Books and Registers to be maintained by an insurer are - Register of Policies, Cashbook, Register of Claims, Ledger, and Subsidiary Records & Control Register. Reports and Returns are regulated u/s 18 of the Insurance Act 1938 where every insurer is required to furnish to the authority a certified copy of every report on the affairs of the concern. Financial Statements and Auditor's Report of Insurance Companies have been prescribed by the authority in Regulation 3 under Schedule C of IRDA.

### SPECIAL POINTS RELATING TO INTERNAL AUDIT IN CO-OPERATIVE SOCIETIES

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.

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:

- i. Daily cash sales summary register.
- ii. A register of collection from debtors if credit sales are allowed by bye-laws of society.
- iii. A register of recovery of loans from salaries and directly by receipts from members in case of credit society.
- iv. Loan disbursement register in case of credit society.
- v. Any other columnar subsidiaries depending upon the nature and functions of society.

**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.

**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.

**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.

**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.

**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.

**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.

**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.

**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.

**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.

**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.

**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.

**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.

**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 cooperative 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.

**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.

**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.

## SPECIAL POINTS RELATING TO INTERNAL AUDIT IN PUBLIC SECTOR UNDERTAKINGS

Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals. Another aspect of such audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety.

Public enterprises have been setup with socio-objectives. An objective assessment with reference to such objectives' fulfillment would require comprehensive audit. The starting point of a comprehensive audit of a public enterprise, which covers aspects of economy, efficiency and effectiveness, is the preparation of an audit

programme based on the study of decisions relating to the setting up of the enterprise, its objectives, the areas of operation, organisation, financial and operational details available in the annual reports and accounts, capital and operational budgets, deliberations of the board of directors, material in the earlier audit inspection reports on the enterprise and other relevant available papers.

These audit programmes (or guidelines) identify the areas/aspects which require further detailed audit analysis and criteria, the data required for such analysis and the sources of such data, the extent of the audit analysis including the test checks to be applied and the instructions to the audit parties assigned to the work.

The areas covered are those of investment decisions, project formulation and management, organisation, delegation of powers and management information systems, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, development of complementary ancillary small scale industries, materials management, sales and credit control, budgetary and internal control systems, etc.

The areas covered in audit will naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. Some of the broad areas are listed below:

- Comparison of overall capital cost of the project with the approved planned costs.
- Production or operational outputs vis-a-vis under-utilisation of the installed capacity.
- Systems of project formulation and implementation.
- Cost control measures.
- Research and development programmes.
- System of repairs and maintenance.

### **SPECIAL POINTS RELATING TO INTERNAL AUDIT OF PARTNERSHIP FIRMS / LLPS**

The internal auditors 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.
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.

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

1. Confirming that the letter of appointment, signed by a partner, duly authorized 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.
2. 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.
3. 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.
4. Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
5. 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.
6. 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.
7. Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

**SPECIAL POINTS RELATING TO INTERNAL AUDIT OF SHIPPING COMPANIES**

The following points need to be considered while conducting audit of Shipping Company –

- As per appointment letter, Auditor should know the scope of his audit work along with legal requirements to prepare his audit Program accordingly.
- Study the Articles of Association.
- Also study the contracts between Captains of ship and third parties.
- Thoroughly study the internal control system and should prepare his audit Program accordingly.
- Ensure that separate account has to be maintained for each voyage.
- Verify that all revenue expenses are to be charged to Voyage account and all incomes should be credited to Voyage account.
- Separate ledger account for each voyage should be maintained.
- Transactions relating to foreign exchange must be duly incorporated in the books of accounts.
- Ask for advices from agents and receiving officers to vouch freight charges paid. He should also verify the provisions relating to outstanding freight amount.

- Proper depreciation should be charged for each ship.
- Verify the rates of freight, commission and brokerage etc.
- Proper allocation of insurance premium of each voyage is very much important. Balance amount of unexpired insurance should be carried forward. The claim received on account of insurance should also be properly accounted for.
- Proper adjustment and accounting is must for outstanding liabilities and assets.
- Ensure that the capital expenditure should not be charged to revenue account and vice versa.
- Heavy amount of repair and expenditure should be treated as deferred revenue expenditure.
- Verify the title deed of ships and other related documents on account of purchase of ships.

### SPECIAL POINTS RELATING TO INTERNAL AUDIT OF ELECTRIC SUPPLY COMPANY

The following points need to be considered by an Auditor while conducting Audit of Electricity Supply Company:

- Study the internal control system related to billing, payment collection, collection of debts and payments of wages, electricity charges, etc.
- Well versed with the Provisions of Electricity (Supply) Act, 1948 and the Indian Electricity Act, 1910.
- Go through the Memorandum and Articles of Association, if any, specially noting the provisions relating to accounts.
- Verify the bills issued to consumers.
- Verify tabular ledger of consumers with original records.
- Verify the receipt of cash from cash receipt counterfoils, cash book, bank book.
- Examine the total number of bills generated, payment received and pending for payments.
- Verify whether late deposit bills are paid inclusive of late payment charges?
- Verify whether proper accounting is done for arrear of bills.
- Payment received on account of arrears should be properly accounted for.
- Proper accounting should be done according to the revenue and capital expenditure.
- Vouch payment for repair of sub-power stations, transformers and meters; all these repairs should be treated as revenue expenses.
- All allowances and rebates should be properly sanctioned by the appropriate authority.
- All accounting forms should be according to the requirements of the Act.
- Depreciation should be properly verified according to applicable provisions of the Act.

### SPECIAL POINTS RELATING TO INTERNAL AUDIT IN HOTELS

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, whereas 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

### SPECIAL POINTS RELATING TO INTERNAL AUDIT IN HOSPITALS

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 authorized.
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.

## PRACTICE QUESTIONS

### *Illustration 1:*

Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the CS Course and which charges only Rs. 500 per month from a student for his lodging/boarding.

### **Solution:**

#### **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.
- iii. 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.

#### **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.
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.

**Illustration 2:**

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.

**Solution:****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.

**Illustration 3:**

Central Govt. hold 55% of the paid up share Capital in Kisan Credit Co-operative Society, which is incurring huge losses. Advise when the Central Government can direct Special Audit under Section 77 of the Multi State Co-operative Society Act.

**Solution:**

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. Under section 77 of the Multi-State Co-operative Societies Act, 2002, where the Central Government is of the opinion:

- i. 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
- ii. 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
- iii. that the financial position of any Multi-State co-operative society is such as to endanger its solvency.

Thus, in the given case since Central Govt is holding 55% shares and financial position of Kisan Credit co-operative society is in danger, Central government can direct for special audit.

**Illustration 4:**

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?

**Solution:**

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

**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.

**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.

**Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

**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).

**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.

**Illustration 5:**

As an internal auditor, what would be your areas of consideration while auditing the element of Room Sales during the audit of a 5-Star Hotel.

**Solution:**

Following points merit consideration while auditing the element of ROOM SALES during the audit of a Hotel:

- a. 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.
- b. The source of these entries is the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.
- c. 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.
- d. 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.
- e. Ensure compliance with the provisions of FEMA and RBI if receipts are in foreign currency. Ensure application of proper Conversion rate.
- f. Special emphasis to be laid on receipts through Credit Cards.
- g. The auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts.

**Illustration 6:**

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?

**Solution:**

While planning the audit of an NGO, the auditor may concentrate on the following:

- a) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
- b) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions related to the statutes.
- c) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
- d) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- e) 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.

- f) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- g) Setting of materiality levels for audit purposes.
- h) The nature and timing of reports or other communications.
- i) The involvement of experts and their reports.
- j) Review the previous year's Audit Report.

**Illustration 7:**

State the points which merit consideration in the audit of a CLUB w.r.t its members.

**Solution:**

The points which merit consideration in the audit of a CLUB w.r.t its members:-

- (1) **Entrance Fee-** Vouch the receipt on account of **entrance fees** with –
  - members' applications and counterfoils issued to them,
  - on a reference to minutes of the Managing Committee.
- (2) **Member Subscriptions-** 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) **Subscription Arrears/in Advance-** Ensure that –
  - arrears of subscriptions for the previous year have been correctly brought over,
  - arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
  - Subscriptions received in advance should have been properly accounted for.
- (4) **Arithmetical accuracy-** Check totals of various columns of the Register of members and tally them across.
- (5) **Register of Members-** See the **Register of Members** to ascertain –
  - the Member's dues which are in arrear,
  - enquire whether necessary steps have been taken for their recovery, and
  - the amount considered irrecoverable should be mentioned in the Audit Report.
- (6) **Member Accounts-** 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.

**LESSON ROUND-UP**

- Banking Industry in India is regulated by the Reserve Bank of India (RBI) known as the Central Bank. The lesson covers Major functions and responsibilities of RBI, Regulatory Framework of Banking Company and Major areas to be covered under Audit while conducting audit of banking company.
- An Indian insurance company is formed and registered under the Companies Act, 2013 and the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty-six per cent of the paid-up equity capital of such Indian insurance company. The sole objects of the Indian Insurance Company shall be to carry on life insurance business or general insurance business or re-insurance business.
- Major areas to be covered under Audit while conducting audit of insurance company such as verification of premiums, claims, commission, operating expenses, investments, cash and bank balances etc.
- 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.
- Major areas to be covered under Audit while conducting audit of Co-operative society such as Contributions to Charitable Purposes, Valuation of Assets and Liabilities, Adherence to Co-operative Principles, Observations of the Provisions of the Act and Rules, Verification of Members' Register and examination of their pass books, Special report to the Registrar etc.
- Audit of public enterprises in India is not restricted to financial and compliance audit; it extends also to efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals. Another aspect of such audit relates to questions of propriety; this audit is directed towards an examination of management decisions in sales, purchases, contracts, etc. to see whether these have been taken in the best interests of the undertaking and conform to accepted principles of financial propriety. Some of the major areas of audit includes, Comparison of overall capital cost of the project with the approved planned costs, Production or operational outputs vis-a-vis under-utilisation of the installed capacity, Systems of project formulation and implementation, Cost control measures etc.
- Special Points relating to internal audit of Partnership Firms / LLPs, Shipping Company, Electricity Supply Company etc.
- Special Points relating to internal audit of Hotels such as Internal Controls, Room Sales, Inventories, Fixed Assets, Casual Labour etc. Special Points relating to internal audit of Hospital such as Register of Patients, Collection of Cash, Income from Investments, Legacies and Donations, Reconciliation of Subscriptions, Grants, Budget, Registers, Inventories etc.

**TEST YOURSELF**

*(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)*

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?

