

BARODA BRANCH OF WIRC OF ICAI

Full Day Seminar on Co-Operative Banks

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ACCOUNT, AUDIT AND TAXATION OF THE CO-OPERATIVE BANKS

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The Co-Operative Banks are facing high competition with the Private and Nationalized Banks and also with the Co-Operative Credit Societies. They Need to be improved in all respects to compete with the rest of Banks. There is no doubt about the development and conversion of the co-operative banks in core banking but still there are huge opportunities in the banking and allied banking services for them.

In this paper the attempt has been made to cover general points relating to the Accounts, Audit and Taxation of the Co-Operative Banks. This is a Bird Eye View and primary Guidance.

1) Accounting of Co-Operative Banks

- Accounts of the Co-Operative Banks are to be Maintained As per the Banking Regulation Act, 1949 and to be reported as per Form A (Balance Sheet) and Form B (Profit & Loss Account).
- Further the Accounts shall be in consonance with the Accounting Standard and Guidance Notes issued by ICAI in this regard.
- In addition to above the RBI Guidelines on Investments, On Asset Classification (Advances), Provisioning for the Advances / Bad and Doubtful Debts shall be followed in specific.
- Co-Operative Banks are governed under the Co-Operative Societies Act of the state and if it is a Multi- State Co-Operative Bank the Central Co-Operative Act would apply for its compliance procedures thus the

overall controlling authority of the Co-Operative Banks is RBI and Co-Operative Authority of State / Center.

- The accounting of the Bank shall be complying following accounting standards of ICAI inter alia others:
 - Standard on Cash Flow Statement
 - Standard on Income Recognition
 - Standard on Depreciation
 - Standard on Fixed Assets
 - Standard on Foreign Exchange
 - Standard on Employee Benefits
 - Standard on Segment Reporting
 - Standard on Related Party Disclosure
 - Standard on Lease
 - Standard on Deferred Tax Asset / Liabilities
 - Standard on Contingent Asset / Liabilities
 - Standard on Provisions
 - Standard on Impairment of Assets

2) Audit of Co-Operative Banks

The Gist of the Contents of Audit report of the Co-Operative Banks includes:-

- Auditor's Responsibility
- Management's Responsibility
- **Opinion on**
 - A) Balance Sheet of the Bank
 - B) Profit and Loss Account of the Bank
 - C) Cash Flow of the Bank

- Reporting on Legal and Regulatory Framework
 - A) Specific reference with Note Number for Qualificatory remarks
 - B) Whether the Information and explanations sought for expressing opinion are received and are found satisfactory?
 - C) Whether the transactions during the year are within the Power of the Bank?
 - D) Whether the Proper Books of Accounts and records are maintained as necessitated by Law?
 - E) Whether the Reporting of the Branches is adequate for the purpose of Audit?
 - F) Whether the Financial Statements of the Bank are in agreement with the Books of Accounts of the Bank?
 - G) Whether the FS are adequately complied with the Accounting Standards issued by ICAI. With specific reference to non-compliance, if any?

- An audit also includes evaluating the **Appropriateness of accounting policies** used

The **reasonableness of the accounting estimates** made by management

Evaluating the overall presentation of the financial statements.

AUDIT PROCEDURE :-

- The Audit Planning includes the collection of the Relevant Laws and Circulars related to the
 - 1) Banking Regulation Act, 1949
 - 2) State and Central Co-Operative Act (eg. The Gujarat State Co-Operative Societies Act
 - 3) The Banking Regulation (Co-Operative Societies) Rules
 - 4) Circulars of RBI (Master Circulars and Other Circulars)
 - 5) Circulars of the Central and State Government relating to the Audit of the Co-Operative Banks
 - 6) Internal Framework of the Bank
 - 7) Bye laws of the Bank to be audited
 - 8) Written Documents of the Policies and Procedures (Internal Governance) of the Bank to be audited.
 - 9) Previous Year Audit report of the Bank to be audited
 - 10) RBI Inspection Report of the Bank for the Previous Year of the Bank to be audited.

Preparation of Audit Programme

- Collection of the Information and Explanations necessary to form an Opinion on the Financial Statements of the Bank as per **Annexure A**.

Conducting an Audit of Profit & Loss Account

Expenditure Side:-

Sr No.	Expenditure item	Check Points / Verification
1	Interest Expenditure on Deposits and Borrowings	<ul style="list-style-type: none">➤ Whether the Interest is as per the Circulars Charged by the System periodically.➤ To check the Individual Accounts on Sample basis for the Verification of Correctness of the Calculation of Interest Amount.➤ To check the master of loan accounts for rate of interest and other terms of loans
2	Salaries and Allowances	<ul style="list-style-type: none">➤ Verification of Salaries and Allowances as per H R Policy and statutory deduction therefrom➤ Verification of the Gratuity with the Actuarial Valuation report (AS -15)➤ Leave Encashment Benefit Calculation➤ Verification of Allowances and Perquisites in line with the Banks policy
3	Director's and Local Committee Member's Fees	<ul style="list-style-type: none">➤ To check with the Attendance register and minutes book of director meeting and Fees Paid Register
4	Rent, Taxes, Insurance & Lighting etc.	<ul style="list-style-type: none">➤ To check rent paid with its agreement

5	Law Charges	<ul style="list-style-type: none"> ➤ Check with suit filling register ➤ Verification of the Court matters and proceedings
6	Postage Telegrams & Telephone Charges	
7	Auditor's Fees	
8	Depreciation on and Repairs to Premises, Furniture & Fixture and other Property	<ul style="list-style-type: none"> ➤ Whether AS -6 is complied for the calculation of the depreciation. ➤ Depreciation calculation as per IT and as per the normal rates as per bank policy.
9	Stationery, Printing & Advertisement	<ul style="list-style-type: none"> ➤ Whether the advertisement charges have been incurred with appropriate TDS?
10	Loss from Sale of or Dealing with Non-Banking Assets	<ul style="list-style-type: none"> ➤ To check all the necessary supporting of the third party (Govt. records / Other party ledger) for the fairness of the transactions.
11	<ul style="list-style-type: none"> ➤ Loss on Sale of Assets 	
12	Loss on Sale of Investment	<ul style="list-style-type: none"> ➤ Check whether the loss is due to short term investments or long term investments. ➤ Whether the loss is appropriately dealt with for in the Balance sheet ? ➤ Whether the loss is in normal course or for some exceptional / abnormal transaction?
13	Other Expenditure	<ul style="list-style-type: none"> ➤ Check the volume and nature of the other expenditures.
14	Provision for Taxation	<ul style="list-style-type: none"> ➤ To verify the correctness of the draft working with the

		provisions of the Income Tax.
15	Other Provisions	
16	Provision For Investment Depreciation Fund	➤ To corroborate with the Calculation of Investment Depreciation Fund as per the RBI norms

Income Side:-

Sr No.	Expenditure item	Check Points / Verification
1	➤ Interest and Discount	<ul style="list-style-type: none"> ➤ Income of Interest to be checked on the sample basis with individual Accounts ➤ Rates applied to be verified with the Circular Rates
2	➤ Dividend	
3	➤ Profit on Sale of Investment	
4	➤ Commission, Exchange & Brokerage, Subsidies and Donations	<ul style="list-style-type: none"> ➤ Verification of the subsidies application as per the policies of the subvention documents ➤ To check whether the commission and charges has been applied on the basis of the appropriate circulars.
5	Income from Non-Banking Assets and Profit from Sale of or Dealing with Such Assets	
6	Other Banking Income	
7	Share Transfer fees	
8	Profit on Sale of Assets	

Verification of the Balance Sheet Critical Items :

Liabilities Side :

Sr No.	Particulars	Check Points / Verification
1	Share Capital	➤ To check with the Members Register, Necessary Resolutions and Permissions, Increase and Reduction in it
2	Statutory Reserves and Other Reserves	➤ Corroborate with the Resolutions and Permitted Reserve fund fluctuations (Additions / Utilisations / Transfer)
3	Deposits	➤ To check whether the proper consolidation of the deposits of the branches is done in the HO Balance sheet. ➤ To check last week transactions in it for any Window Dressing
4	Borrowings	➤ Verification of the short term and long term borrowing from Banks and / or Government with its sanctions and associated conditional compliances
5	HO Branch Adjustments	➤ All the Reconciliations of the Branches shall be consolidated to find the

		correctness of the HO Branch adjustment figure.
6	Overdue Interest Reserve	<ul style="list-style-type: none"> ➤ Strictly verify whether the NPA loan interest is taken to Overdue Interest reserve on on going basis / periodical basis? ➤ Further to check whether the Interest related to the loss assets to be written off is excluded from the OIR Account ➤ The movements in the account shall be corroborated with the NPA Movement
7	Interest Payable	
8	Other Liabilities	<ul style="list-style-type: none"> ➤ To verify the Dormant accounts treatment ➤ To check the reasons of the suspense liabilities and know the exact reason why the same stands as suspense ➤ To check it with its periodicity –since how long and why pending
9	Deferred Tax Liabilities	<ul style="list-style-type: none"> ➤ To check with the Supporting calculation of the DTL in accordance with AS-22

Asset side of the Balance Sheet :

Sr No.	Asset Side	Check Points / Verification
1	Cash on Hand	<ul style="list-style-type: none">- Surprise verification of the Physical Balance of the cash shall be carried out for the verification of its correctness.- To check whether the clean note policy of the RBI is followed properly by branches of the Bank.- Whether the Direction of RBI for the fake note / counterfeit notes is followed properly?- Check whether holding of cash is within limit prescribed
2	Balance with Banks	<ul style="list-style-type: none">- To check with all balance confirmations- To check it whether it is within with exposure limits prescribed by RBI for it
3	Money at call or short notice	
4	Investments	<ul style="list-style-type: none">- To Verify the classification of the Investment in HTM (Held to Maturity), HFT(Held for Trading) and AFS (Available for sale).- To verify whether the

		<p>Valuation of the security is done as per the valuation standards and Methods prescribed by the authorities.</p> <ul style="list-style-type: none"> - Whether the purchase and sale of the Investment is done within powers delegated and is in line with RBI Directives. - Income Booking of Government Securities – on Accrual Basis while on other investments – on cash basis. - To ensure the availability of the Investment in physical form except the investment in SGL / DMat form. To verify certificates of PD in case of Dmat / SGL - Whether the Internal Control Guidelines with respect to the Investment is strictly followed? - To check all Exposure Limits for the Investment - To check for any NPA Investment
5	Advances	<ul style="list-style-type: none"> - To check whether the advances has been classified as per the

		<p>Priority sector lending Norms of the RBI and are reported appropriately.</p> <ul style="list-style-type: none"> - To check the Legal and Technical documentation of the Advances – whether the form and formats of the Bank are sufficient for the collection of the Information of borrowers for the Sanction. - To check the independence of the Sanctioning Authority while verification of the Advances - Whether the advances has been approved strictly in line with the Bank Policy. - To verify whether the Documentation duly stamped are Authenticated and Sufficient checks has been done for the same ? - To check whether the Bank has appointed any third party for the customer verification report (e.g. CIBIL) and is taking its report in consideration in true spirit. - To check the necessary
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		<p>Forms and Legal documents has been taken / executed properly?</p> <ul style="list-style-type: none"> - Whether the CERSAI registration and its guidelines are followed for the Mortgage registration in favor of the Bank - Any other financial / legal aspect looking to the compliance and internal controls regarding advances. - Classification of the Advances to be verified in the Balance sheet as Long Term, Medium Term and Short Term and it shall be disclosed appropriately in the financial statements. - Exposure Norms and Statutory restrictions :- - Individual Borrower <= 15% of the Capital Fund - Group Borrower <= 40% of the Capital Fund - Specific Sector - Aggregate Unsecured Advances shall be in compliance with the Celling on Unsecured Advances with reference to
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		<p>the CRAR (Capital Risk Weighted Asset Ratio).</p> <ul style="list-style-type: none"> - The Bank is restricted to provide any Loan / Advances to Directors and their relatives.
<p>Advances :-</p> <p>The Advances Regulations is Taken care by the Prudential Norms of the RBI regarding ;</p> <ul style="list-style-type: none"> A. Income Recognition :- The Income recognition on the Non Performing advances shall be done on the basis of record of recovery. B. Asset Classification :- Asset Classification has to be done on the basis of the Objective criteria. C. Provisioning ;- It shall be made on the basis of the Asset Classification Into the different Categories. 		

Classification of NPA alongwith the provisioning requirements:-

NPA Category	Criteria	Income Recognition Basis	Required Provisioning	
			Category	% to be provided of Total Assets
Standard	Regular Account / Account not Overdue for a period less than 90 Days / Account not earmarked by Bank Authorities as NPA	Accrual Basis	Direct advances to agriculture and SME sectors	0.25%
			Commercial Real Estate sector	1%
			All other loans and advances	0.4%
Sub Standard	The Account is NPA for the Period less than 1 year	Receipt Basis	Secured :- 15 % of the amount of Asset Unsecured :- Additional 10% of the amount of Asset	
Doubtful Debt upto 1 Year	The Account is in Doubtful category for less than 1 year	Receipt Basis	20 % of the amount of Asset	
Doubtful Debt from 1 to 3 Year	The Account is in Doubtful category for more than 1 Year and less than 3 year	Receipt Basis	30% of the amount of Assets	
Doubtful Debt more than 3 Year	Doubtful category for more than 3 years	Receipt Basis	100% of the amount of Assets	

6	Interest Receivable (IR)	
7	Fixed Assets	<ul style="list-style-type: none"> - To check the fixed assets with the Fixed Asset register - To check whether physical verification of fixed assets is done once in a year or not ? Its deviation with book records, if any. - To check whether any asset is impaired in the books of accounts and is it as per AS -28. - Marking of the Fixed Asset with Banks Code shall be there as per the policy of the Bank.
8	Advance Taxes and TDS	<ul style="list-style-type: none"> - To check the Credit of the Tax with Government Records with applicable Form / Certificate.
9	Non- Banking Assets	
10	Other Assets / Advances	<ul style="list-style-type: none"> - To check this with its supporting and to check period and purpose of it and its recoverability - To check for long pending items

D) Taxation of the Co-Operative Banks

- Rates applicable to the Bank in Income Tax

The Co-Operative Banks are taxed by the Income Tax Department under the status of AOP (Association of Persons) and are taxed at MMR [i.e.@ 30%](#) + Applicable Surcharge and Cess.

- Allowed Deduction of Provision for the Bad and Doubtful Debts u/s 36(1)(vii) and (Viia) of the Income Tax Act, 1961

- In respect of the Provision for the Bad and Doubtful debts **7.5 % of the Adjusted Total Income AND 10% of the Adjusted Total Income** in case of Advances made by the Rural branches of such bank is allowed as a deduction while computing the total income of the Bank.
 - In addition to above Bank is allowed in any assessment year deduction in respect of any provision made by it in respect of any **doubtful debt or loss assets upto 5% of the amount of the Assets** in the last day of the previous year.
- The provisions of the AMT (Alternate Minimum Tax) is also applicable to the Co-Operative Banks U/S 115JC.

Issues on Reorganisation of co-operative banks

- S. 44DB: This section is applicable for the purpose of calculating amount of deduction under sections 32, 35D, 35DD and 35DDA if there is a reorganization of business involving amalgamation or demerger of a co-operative bank.
- The amount of deduction shall be determined as if there is no such reorganisation. Once such amount is determined, the same shall be apportioned between the

(a) amalgamating co-operative bank and amalgamated cooperative bank, or

(b) demerged co-operative bank and resulting co-operative bank, as the case may be, in the ratio of number of days for which the assets are used by them during the previous year in which ownership changes.

- **Carry forward and set off of losses [S. 72AB]**

The predecessor has been engaged in the business of banking, in which the accumulated loss occurred, for three or more years.

The predecessor has held at least $3/4^{\text{th}}$ of the book value of fixed assets as on the date of the business reorganization, continuously for 2 years prior to the date of business reorganization.

The successor holds at least $3/4^{\text{th}}$ of the book value of fixed assets of the predecessor acquired through business reorganization, continuously for a minimum period of 5 years immediately succeeding the date of business reorganization.

- The successor continues the business of the predecessor for a minimum period of 5 years from the date of business reorganization.
- The successor fulfills such other conditions as may be prescribed.
- The expressions “amalgamation” and “demerger” have the same meaning which is given u/s 44DB.
- Quantification of unabsorbed loss and unabsorbed depreciation allowance eligible for carry forward:
 - (A) In case of amalgamation Entire business loss and unabsorbed depreciation of the predecessor.

(B) In case of demerger:

- i. Loss or unabsorbed depreciation directly related to the undertakings – goes with such undertaking.
- ii. Indirect loss or unabsorbed depreciation is apportioned in the ratio of assets of demerged and resulting co-operative banks.

Capital Gains on reorganization

The whole transaction in the hands of the transferor, transferee and their respective shareholders is tax neutral virtue of amendments in S. 47, S. 49 and S. 2(42A). The whole treatment is identical to amalgamation or demerger of companies.

Audit Program / Check Points for the Co-Operative Bank Audit

1. Minutes of meetings of Board, AGM and various Sub-Committees
2. Verification of Balance Sheets and Profit & Loss A/cs of Branches
3. Verification of consolidated Balance Sheet and Profit & Loss Account
4. Verification of NPA Details and its Summary and Auditor's Certificate
5. Verification of various Forms / Returns submitted to RBI
6. RBI Inspection Report
7. Concurrent Audit Reports
8. Verification of Salaries and deduction therefrom –increments,
9. Verification of Investment –Govt Securities and others Scripts, Interest income etc
- 10.Verification of Salaries and other details
- 11.Verification of Share Capital, New Members, Their applications, Transfer of Shares, Redemptions of Shares etc
- 12.Verification of other Assets (to take copies of ledger accounts and verify its details with supporting).
- 13.Verification of other Liabilities (to take copies of ledger accounts and verify its details with supporting).
- 14.Verification of addition and sale of Fixed Assets with its Register
- 15.Verification of provision of depreciation on Fixed Assets in books–to check its working

- 16.Verification of provision of depreciation on Fixed Assets as per Income Tax– to check its working
- 17.Verification of accounts maintained with other Banks and its reconciliation with confirmations
- 18.Verification of Fixed Deposits –Original FD Receipts and interest received and receivables, TDS therefrom
- 19.Verification of various Funds –Addition to it and Utilization from with supporting and approval in relation to the Rules and Bye laws.
- 20.Verification of provisions of interest on various Deposits –Savings, FDs, Recurring Deposits, Matured Deposits
- 21.Verification of income tax provisions payable
- 22.Verification of BDDR (Bad and Doubtful Debt Reserve)
- 23.Verification of Deferred Tax Liabilities
- 24.Verification of various provisions of exps –Admin Exps, Auditor Fes, Gratuity, Leave Salary and other
- 25.Verification of Notes to Accounts in final published Balance Sheet
- 26.Verification of NDTL (Net Demand and Time Liabilities), CRAR, Owned Capital, Tier-I and Tier-II Capital, CAGR (Capital Asset Gearing Ratio).
- 27.Verification of exposure limits of investments, deposits with other banks, advances etc
- 28.Verification of advances to Priority Sectors (Advances to MSME, Woman Entrepreneurs, SC/ST, , Housing Loans,)

- 29.Verification of advances under Recovery, Suit Files Cases its Status, Decree obtained and executed etc.
- 30.Verification of Forex Dept Transactions
- 31.Verification of Form No 16A and Form No. 26AS for TDS Receivable from various income / receipts
- 32.Verification of various Statutory Payments with its challan and its Due Dates –Service Tax, PF, Prof Tax, TDS, Advance Income Tax and other taxes
- 33.Verification of filing of various Statutory Returns –Income Tax, Service Tax, PF, Prof Tax, TDS and other taxes
- 34.Verification of inter accounts of Head Office and Branches and its reconciliation
- 35.Verification of various control returns received from Branches and exercise of internal control over Branch working.**
- 36.Verification of Tax Audit Details
- 37.Verification of various admin and other expenses incurred at Head Office (to take copies of ledger accounts and verify its details with supporting).
- 38.Verification of various income at Head Office (to take copies of ledger accounts and verify its details with supporting).
- 39.Verification of Insurance Policies of Cash, Cash in Transit, Cash at Counter of Branches, Buildings, Furniture & Fixtures, Computers Systems and other Equipment, Staff
- 40.Verification of DICGC Insurance Premium Paid
- 41.Verification of calculation of Dividend paid
- 42.Verification of Gifts given to Members.

43. Bad and Doubtful Debt Provision for Standard Assets and NPAs as per Income Recognition and Asset Classification Norms of RBI
44. Various Exposure limits on Investments, Advances, Deposits –as per RBI Circular
45. Provision of interest on matured Deposits a/c
46. Non-Banking Assets
47. Bank Guarantee expired but not received back (Its original document) and B G invoked
48. Pre-paid Exp with its details
49. Provision of Expenditure/ interest with its details (eg- light bills, auditors fees AMC Tax, Salary etc.)
50. Overdue Interest Receivable
51. Borrowing by bank from other Banks, its terms and conditions
52. Checking of final consolidation of Balance Sheet, Profit & Loss Account, its Schedules, Grouping, Notes to Accounts, Cash Flow Statement
53. Details of Contingent liabilities –e.g. Suit filed against bank, bank guarantees issued, letter of credit issued, income tax or other tax liabilities disputed etc