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Primary Agricultural Cooperative Credit Society (PACS) Act - Accounts - Audit

The article discusses the history and creation of Primary Agricultural Cooperative Societies (PACS) in the states, their operations, present accounting practices and audit. The active support from the government has led to a proliferation of cooperative societies in large numbers,

warranting a need to regulate them such that their accounting practices are uniform. Also, accounting standards need to be laid down for adherence and compliance. There is a vast potential for Chartered Accountants to play their professional role to this field. ICAI can contribute to the improvement of accounting procedures and related audit matters, as well as the training of PACS staff.

The Central Government encouraged farmers – both owner-tillers and tenant farmers, residing within a cluster of villages – to form a collective group, register themselves under the Cooperative Societies Act, and register such societies with the respective Registrar of Cooperative Societies (RoCS) in each state. The government enacted the Cooperative Societies Act with a view to regulate the creation and running of such cooperative societies, called Primary Agricultural Cooperative Credit Societies (PACS). At the state level, the Cooperative Societies Act was enacted by each state, which was modelled on similar lines to the central act. PACS were thus born and were affiliated with the nearest branch of District Central Cooperative Bank (DCCB) in the absence of Apex Bank, whose jurisdiction covered the villages wherein the concerned society members reside.

PACS are the lowest tier of the cooperative structure, at the village level, with direct access to the landowner tiller/tenant farmer (who are PACS's members) and connecting them to

the upper tiers of the cooperative structure. Fundamentally, the societies were expected to exclusively serve their members and to share the surplus revenue derived exclusively amongst their own members. Before we dwell upon the accounting and audit of PACS, it would be appropriate to understand some of the pertinent and typical issues relating to PACS governance and its operations.

The Acts

Respective State Governments promulgated their own acts to regulate the operation of PACS. By virtue of these acts, PACS are statutorily mandated to register with RoCS in respective states. For this purpose, land-owners & tenant farmers residing within a specified cluster of villages (and its peripheral jurisdictional areas), join together and collectively form a cooperative society, subject to the maximum limit of members as prescribed by its bye-Laws. These bye-laws stipulate its Share Capital, membership eligibility, Bank operations, Managing Committee constitution and meeting

procedures, office working, Finance and Administration, measures for collecting deposits and giving loans to members, fixing interest rates (and requisite security), conducting meetings of Managing Committee, and Annual General Meetings (AGM).

Class of PACS Members

The Cooperative Societies Act has two classes of Shareholder members - one is 'Member' and the other as 'Associate Member'.

The Society admits as member those farmers who own lands. Share Certificates are issued to them, to the extent they subscribe to the share capital. A member may subscribe for any number of shares within the limit set by its bye-laws. Associate Members, are those who do not own land, but are tilling the land as tenant farmers. Each Associate Member can subscribe for only one share in the PACS wherein they are registered as members.

If any member wants to borrow from society, he has to subscribe for additional shares as security. The quantum of such additional shares is

a percentage of the loan amount. It usually varies between 5% and 10% (of loan quantum) depending on the type of loan sought.

Society members mortgage their land and/or other immovable property (like buildings) as security. In such case, PACS normally ask their legal heirs to be co-executants to the mortgage deed for the property offered as security. The legal heirs being non-members entrust the work of preparing annual Financial Statements to external specialists (RoCS staff or CA firms alternatively), who also issue an Audit Report. Tax deducted by any party, while releasing payment to PACS, is also to be accounted, simultaneously with relevant income account. The net income receipt is to be raised to the extent of such TDS shown in Balance Sheet. With the introduction of Annual Information Statement (AIS), auditor can check both the 26AS, as well as AIS, to account the correct income for the year, matching with these figures.

It is observed that there is some delay in preparation of PACS Annual Accounts. Hence the need for a professional, and reliance on CAs arises. It is felt apt to entrust concurrent audit of PACS to RoCS staff, and the statutory audit to CAs. This blend of both RoCS and CAs will ensure a more professional touch, and timely completion of audit. This is an area where practising Chartered Accountants can render useful service, and add to their potential activity list.

The Central Government has also felt the need for timely and correct preparation of PACS accounts. The Institute of Chartered Accountants of India can play a vital role in this regard by devising and drafting Accounting Standards specific to PACS transactions and also addressing improvements in several aspects of PACS accounting. A pertinent issue is member-wise ledger accounts for each loan availed, security mortgaged for such loans, interest due thereon including subvention, and reconciliation of loan accounts with the linked branch of DCCB (from whom they draw loans and maintain bank accounts), etc.

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Audit Plan & Programme

The primary task before the commencement of the PACS audit is to understand PACS's business operations, its geographical spread, major events and transactions that occurred during the year. Audit of accounts of PACS ensures that its governance is in accordance with applicable statutory obligations and RoCS guidelines, compliance with its bye-laws, Cooperative Societies Act and rules thereunder.

The scope of the audit additionally covers the proprietary nature of transactions, adherence to basic internal control procedures, compliance with accounting standards, and deviation from its accounting policies.

- i) Satisfy that such policies are acceptable, consistent with and appropriate to the nature of PACS's business, and then judge



the degree of reliance that can be placed thereon. Thereafter, determine the nature and extent of audit coverage to be done, while also considering circulars of NABARD/RBI, the state government and DCCB.

- ii) Awareness of any special reporting requirements, as necessitated.
- iii) Review internal control environment; verify evidence of effectiveness of internal controls, and system prevalent checks and balances, and any relevant circulars. Where any loan has become overdue, verify that recovery is factually correct without any window dressing (i.e., by a mere book adjustment/entry).
- iv) Examine entity-specific related issues, warranting a customised audit plan. For instance, PACS may have a gold loan scheme (subsequently discussed).
- v) Peruse previous year's
 - a) files relating to incomplete capital expenditure,
 - b) carry forward of previous year's audited account balances,
 - c) audit observations and their compliance,
 - d) minutes of Management Committee & General Body meetings, with compliance status.
- vi) Auditor has to express his opinion on maintenance of accounts records, internal control measures, identify potential problems and their resolution. All working papers, notes should be preserved by the auditor for any future reference.

Auditor should report any instance where Act (or rules there-under), or society bye-laws have been deviated/flouted. Confirm that loans are disbursed only on basis of eligibility and with adequate security of land holding. Also confirm that repayments are up to date & for correct amount, without any book adjustment. Peruse

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Audit observations of previous year, statutory & legal compliances, rectifications of any defects etc.

The audit classification and rating accorded to PACS for the relevant audit period should be considered. Key indices and performance ratios should be compared with those of the previous year and with other PACS of similar size. Activity areas prone to material misstatement or fraud should be identified. The source of audit evidence and the extent of reliance thereon, especially during the pandemic situation and/or related lockdown periods, should be assessed. Risk factors should be evaluated, concurrent Audit Reports should be perused, and the sample size for audit purposes should be determined. A comparison should be made with the previous year’s financial statements. The audit opinion should be supported by evidence obtained during the audit. The financial statements should comply with the legal requirements applicable to PACS and the applicable financial reporting framework.

Special Features of PACS Audit

- i) Familiarise with Cooperative Society Act (central and relevant State Act and Rules there under), bye-laws of PACS (as duly updated and registered with RoCS). Ensure that PACS amend its bye-laws, to be in conformity with and, in accordance with updated provisions of Central / State Cooperative Societies Act.

- ii) Verify that PACS accept deposits from and lend funds only to its members, with proper records and adequate security.
- iii) PACS have a charge on member’s share/interest in capital/deposits/dividend/bonus/profit.
- iv) PACS can invest their surplus funds only in PO Savings, shares of other Societies, deposits with banks and other prescribed Securities.
- v) Under the Act, PACS have to create Statutory Reserves, including a fixed percentage to Reserve Fund. These funds are not distributable.
- vi) Imbalance: Seasonal Agricultural Operations (SAO Loans) to PACS members provided by DCCB through PACS, are short term in nature and repayable over a ten-month tenure, and against collateral security, which is usually immovable property. The bank verifies the title of the mortgaged land through ‘web-landing’ (an online owner-wise data base of agricultural lands as per revenue records). Every time land parcel is mortgaged and registered, the data is simultaneously captured, updated and uploaded to the website. With an access key, PACS can check in whose favour mortgage exists. The bank debits the concerned PACS in which the borrowing land owner is a member. As loan is routed through PACS, it’s the responsibility of PACS to execute mortgage documents and recover outstanding loan from concerned member. PACS charge a slightly higher interest rate, from its member, than the rate at which bank charges PACS.

Sometimes, borrowers may default, and bank exerts pressure through the PACS (in which borrower is member) for recovery of overdue loan. The bank, in its anxiety not to have a NPA in its books (for which provisioning is mandated by



RBI, (thereby adversely affecting their bottom line), sometimes resorts to window dressing, by recording the loan (with interest due) as having been realised in cash. On subsequent day, same is rolled over as a fresh loan. Thereby a situation exists where the loan is virtually reflected (in bank records) as settled, but the loan still exists as outstanding in PACS records. Thus, imbalance exists and grows. PACS should take effective steps for timely recovery, or resort to auction of mortgaged property.

- vii) Some PACS have added activity of providing loans to its members against security of gold/valuables. Special care is needed to physically verify the number of gold packets in custody with PACS, and ensure it matches with the record. Verify that insurance policy includes this activity and the value tallies with the value as per records. Furthermore, it is prudent to have it verified regularly by an external gold appraiser. Special emphasis is necessary for overdue gold loans, and satisfy that the quality as well as the quantity of pledged jewellery is matching with the records.
- viii) Inspection: District Central Cooperative Bank (DCCB) supervisory staff visit PACS at prescribed frequency, (usually once a quarter). Such inspections have tended to become perfunctory, lacking incisiveness. It is felt that a qualitative

improvement in such inspections be achieved by a blend of in-house and external service providers (i.e. through RoCS staff). An inspection through RoCS staff (similar to RBI/NABARD inspection of scheduled Banks) at prescribed frequency, in conjunction with DCCB staff, may enable in-depth analysis, and more professionalism in content /quality reporting, enhancing incisive qualitative reporting manner. Inspection format can be designed to focus on serious aspects of PACS operations, which warrant intervention by higher authorities.

Report Coverage

PACS Audit Report should cover:

- i) Examination of overdue debts & its analysis
- ii) Physical verification of all securities, cash and bank balance, fixed assets, investments, stock statements and valuation,
- iii) Examine documents for loans/ advances sanctioned and disbursed,
- iv) Demand Collection Balances of members,
- v) Interest income and accrued,
- vi) Over-dues, bad and doubtful debts (provisioning & write-offs/ withdrawals), advances schedule, for non-performing assets (NPAs), investments statement and confirmation from concerned entities from whom amounts are outstanding,
- vii) Tax deduction (TDS) and its cumulative accountability.

Common Accounting System

As envisaged under the Revival Package of GoI, NABARD in collaboration with GTZ has devised a Simplified, Standard and Common Accounting System (CAS) for PACS. While designing the Common Accounting System for PACS, the existing systems

and practices of accounting of the PACS in a number of states have been studied both under manual and computerised systems having regard to the nature and scale of business, prudential norms and best practices in accounting and their relevance to computerization and discussions held with various stakeholders such as State Cooperative Banks, District Central Cooperative Banks, Dept. of Cooperative Audit, Registrar of Cooperative Societies and the Training Institutes of Cooperatives. In line with the "CAS" prepared for "PACS", this operational Accounting Manual ("AM") is prepared to guide PACS in accounting for transactions under "Double Entry System of Accounting" as per "Accrual basis".

Major Components of CAS

- i) Applicability of universally accepted basic concepts and principles in the maintenance of accounts by the PACS.
- ii) Adoption of standard financial statements, viz., Balance Sheet, P&L A/c and Trading A/c.
- iii) List of a common set of General Ledger Heads of Account compatible with financial statements; and
- iv) Maintenance of minimum essential and Standard Books of Accounts.

Audit under Computer Environment

Recently, government earmarked funds to enable PACS, computerise their accounts and maintain uniformity in accounting practice. PACS are in the process of computerisation of their financial data and records for which Government is providing budgetary support to enable PACS computerise operation and also uniform accounting system; providing computer systems, and training PACS staff to work in computerised environment. NABARD has developed an accounting package, developed by intellect and customised for PACS related operations. PACS should ensure that balances in



respective manual ledgers are correctly loaded in the computer system, and also have a migration audit done, to certify the accuracy thereof. While carrying out statutory audit of PACS, it should be ensured that standard test procedures, as laid down in their manual, is followed. Furthermore, before commencement of audit, auditor should familiarise with the different Head of Accounts operated, and their respective account codes; ascertain whether any new accounting policies adopted during the year, its impact in both current year, as well as previous year.

In case of hybrid type of accounting, where control accounts are available on the computer system, but the sub-ledgers are manually maintained, verify at year end, that aggregate of balances in sub-ledger tally with the control account balances. During vouchers verification process, ensure that authorisation is available for each entry, as per existing delegated powers. Auditor should observe any adjustment entries (particularly year end vouchers) passed while finalising financial statements, that same are authorised and correctly entered in books of accounts. While ensuring Trial Balance is correctly generated, and duly tallied, auditor much check whether the Profit & Loss Account and Balance Sheet are correctly prepared, duly authenticated by PACS CEO / Secretary.

Auditor must verify whether software used for accounting package is licensed, and is of current version only. Regular back-up data should be taken periodically, and preserved at some off-site place for safety, ensuring easy retrieval. Check data integrity, and ensure safeguarding of assets; ensure identified System Administrator available and so nominated; all available features of data safety are installed, including biometric based data access levels (based on need-to-know basis and job-based requirement); passwords available for each level of access and same revised on regular basis. The back-up data be periodically tested for easy retrieval of disc and its contents. The system will need to be updated at each stage of version change. Confirm firewall systems installed for data protection.

Further, it must be ensured that the balances in sub-ledgers match the balances in the control accounts. Review accounting process and verify that authorising officer has approved each transaction voucher. Ensure no adjustment entries made at year end are outside of the computer system. Check that the balances, in the manual version of accounts, is correctly migrated to the computer system. Confirm that Trial Balance is tallied without any entry in 'suspense account' (for any possible difference). Verify that date is put on every computer-generated document, numbered and duly authenticated by accounts in-charge. Confirm off-site data storage facility is available, and periodical data verification is done.

Note the maintenance frequency, and how operations run during that period. Confirm licensed copy of software with updating arrangements strictly followed. Verify any mirroring facility exists, so that system is kept running if and when the data is corrupted. Verify AMC exists and is functional for Software maintenance and any updating.

Income Tax on PACS

The general misconception amongst PACS fraternity, is that PACS has no tax liability. Thereby a general aversion

to face tax issues developed, and many PACS try to brush any tax related matter, under the carpet. PACS Management Committee members being agriculture oriented, are often reluctant to file their Society's tax returns.

Being an agrarian economy, a slew of exemptions has been granted to PACS for all agricultural related activities. It is therefore necessary that PACS management ensures strict compliance of time limits imposed under IT Act. Usually delay occurs in issue of statutory Audit Report by RoCS staff. PACS must impress upon statutory auditor to complete their audit, much before the tax return filing date. In case any delay is anticipated, it is advisable that provisional income tax return be filed, on the basis of 'Receipts and Payments' data. After audit is completed, PACS can file a revised return, to reflect the correct income, before tax assessment.

Supreme Court has held that ethos of PACS is embedded in the concept of 'mutuality of interest'. In essence, only members of PACS are exclusively to be eligible to deposit in and borrow from PACS. Emphasis is on linkage of loans to and deposits from only PACS members. Under this philosophy, the earnings of PACS after setting aside stipulated and prescribed statutory funds/ reserves, should be exclusively shared amongst its members only. Otherwise PACS are not eligible for tax reliefs available under Income Tax Act. All Co-operative Societies are required to file Income Tax Returns (ITR). The income of PACS is eligible for deduction only under Section 80P. However, such deduction shall be allowed only if the ITR is filed within the prescribed due date as per Section 80AC of the Income-tax Act. The subject of taxation of PACS requires separate analysis and discussion.

Enhancing Competency

It's imperative to enable staff to independently prepare annual financial statements. Prior to the selection as secretary / CEO of a PACS, mandatory eligibility conditions could



be stipulated, and a skill development course designed and followed by an aptitude test.

NABARD may consider introducing a customised skill development course specific to financial management and accounting aspects for PACS staff, in consultation / association with ICAI.

The audit of PACS is predominantly being done by RoCS staff. While RoCS staff may conduct concurrent audits, the statutory audit turf should be entrusted to professional CAs only.

Goods and Services Tax

PACS are also liable for GST if their turnover exceeds the threshold limit. PACS staff have to be alert enough to register themselves under GST and to avail the Input Tax Credit as available under the GST Act. A GST audit is mandatory for turnover beyond a threshold limit.

To conclude, it is advisable to have a checklist prepared encompassing all relevant PACS operational activities for a comprehensive audit programme.

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