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Technical Guide on

Accounting and Auditing for Chit Fund Business

Research Committee
The Institute of Chartered Accountants of India
New Delhi

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Foreword

A Chit Fund business has several peculiar features, including accounting and auditing aspects that differentiate it from other industries. As a result of these distinctive features, the members of the Institute, during the course of discharge of their professional duties, may come across several accounting and auditing issues that are unique to this activity. Therefore, a need was being felt for providing guidance to the members on these issues as well as on other aspects peculiar to Chit Fund business so that they may be able to discharge their professional duties in an effective and efficient manner. It is really heartening to note that the Research Committee, realising the need for guidance, has brought out this 'Technical Guide on Accounting and Auditing for Chit Fund Business'.

I sincerely hope that this Technical Guide would be of immense use not only to the members of our Institute but also to others concerned.

New Delhi
May 20, 2004

(Sunil Goyal)
President

Preface

Chit Fund is one of the oldest means of providing finance, which has its origin in the rural parts of Southern India in the form of grain chits. Subsequently, in the absence of organised banking, Chit Funds started dealing in money. With the growth of commerce and industry, Chit Funds became popular even in urban areas as individual consumer financing intermediaries. During the last few years, some corporates have also become members of Chit Funds. Over the years, it has also been noticed that various Chit Funds have been following different accounting practices and, therefore, the information provided by their respective financial statements is not comparable.

Keeping in view the above background, this 'Technical Guide on Accounting and Auditing for Chit Fund Business' primarily focuses on suggesting the accounting and financial reporting framework for Chit Fund business for presentation of true and fair view of the state of affairs and the operating results in the financial statements. The Technical Guide discusses salient features peculiar to the Chit Fund industry. The Technical Guide also discusses various accounting, control and audit aspects that may be useful in the audit of a Chit Fund business. The appendices to the Technical Guide contain the formats of financial statements of a Chit Fund business prescribed by the Chit Funds Act, 1982 and an illustrative audit programme checklist which lays down the procedures that might be gainfully used by the auditor for verification of various items appearing in the financial statements of a Chit Fund.

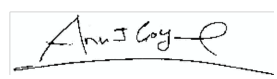
On behalf of the Research Committee, I would like to place on record my deep appreciation of the efforts put in by Mr. Jose Pottokaran, a senior member of our profession, for preparing the basic draft of this publication. I am also thankful to Prof. S. Sundararajan for his initiative and valuable suggestions.

I place on record my gratitude to my predecessor Shri Rajkumar S. Adukia, and his fellow members of the Research Committee, during whose tenure considerable work was done on this Technical Guide. My thanks are also due to the members of the Research Committee for the year 2004-05, namely, Shri V. Murali (Vice-Chairman), Shri Sunil Goyal (President), Shri K.S.

Vikamsey (Vice-President), Shri Abhijit Bandyopadhyay, Shri Charanjot Singh Nanda, Shri Harinderjit Singh, Shri Pawan Kumar Sharma and Shri. S.C. Vasudeva (Special Invitee) for their invaluable contribution in this endeavour.

I also express my appreciation of the efforts put in by Dr. Avinash Chander, Technical Director, Ms. Anuradha Jain, Secretary, Research Committee, and Ms. Deepa Agarwal, Technical Officer of the Institute of Chartered Accountants of India, for their invaluable inputs in the finalisation of this Technical Guide.

I am confident that this Guide would prove to be useful to our members at large and to others interested in the subject.



(Anuj Goyal)
Chairman
Research Committee

New Delhi
May 19, 2004

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Introduction

ORIGIN OF CHIT FUNDS

1.1 The origin of the Chit Funds can be traced back to many centuries in the rural parts of Southern India. Chit Fund is one of the oldest forms of indigenous financing in India. It is also a means of saving. In the ancient form of a Chit Fund scheme, a group of persons would deposit a fixed measure of grains with a trustee periodically, and the total quantity of grains collected at the end of any given period would be given to one among them, by drawing lots, in such a manner that every person in the group would get his share, turn by turn, by the end of the scheme. The inscription made for drawing lots is called 'kurippu' in Malayalam from which the word 'kuri' is derived. The words 'kurippu' and 'kuri', translated into English, means 'Chit' from which the term 'Chit Fund' was coined.

1.2 The Chit Fund schemes have remained much the same even today as they were in the beginning. One difference that has arisen over the centuries is that now the subscribers contribute in terms of money instead of agricultural produce as it used to be in the earlier days. The basic characteristics of a Chit Fund scheme, namely, all subscribers contributing to a common fund which is given to one of the subscribers on each instalment by drawing lots or by auctioning so that every subscriber is rewarded with the Chit amount (known as 'Chit prize amount') by the end of the scheme, remain without any change even today.

1.3 In the olden days, when banking facilities were not available in the rural parts of the country, the needy people mainly depended on Chit Funds, as a mutual benefit activity for satisfying their financial needs. Even now, the procedural difficulties in availing bank finance make Chit Funds an attractive and easy source of finance to a common man. In recent years, the Chit Fund activity has assumed the characteristics of a business and it has spread from the rural areas to urban areas.

1.4 A Chit Fund is, thus, a mutual benefit saving scheme of a group of people who are the subscribers to the scheme. All subscribers contribute to the scheme in instalments. After receipt of every instalment, a lump sum amount is given to one of the subscribers by draw of lots or by auction, so that everyone of them is awarded the amount by the end of the scheme. The Hon'ble Supreme Court has held in *M/s Shriram Chits & Investments (P) Ltd v. Union of India (AIR 1993 SC 2063)* that Chit Fund business cannot be termed as money lending business.

1.5 Most of the subscribers to the Chit Fund schemes are individuals who use these schemes to channelise their savings or are planning to meet their financial commitments in future. Whenever a subscriber needs money, he may bid for the Chit to receive the Chit amount. Since the instalments may be spread over many years as per a Chit Fund scheme, the prize amount is repaid over the years. Small traders form a sizable chunk of subscribers who use Chit Fund schemes as a means of financing their businesses.

1.6 The popularity of Chit Fund schemes is on the increase in certain parts of the country. More and more Chit Fund enterprises are coming up with attractive prizes. Many of such Chit Fund schemes are fully subscribed.

OBJECTIVES AND SCOPE OF THE TECHNICAL GUIDE

1.7 Although much of the Chit Fund business is carried on by companies, yet other forms of organisations are also involved in this business. Further, Chit Fund business is popular only in certain parts of India. As a consequence, divergent accounting practices are being followed by the enterprises carrying on Chit Fund business. The objective of this Technical Guide is, therefore, to provide a unified accounting framework for the business, including preparation and presentation of financial statements. Another objective of the Technical Guide is to provide guidance for the conduct of audit of a Chit Fund enterprise.

1.8 The Technical Guide deals with the operation of the Chit Fund schemes, their peculiar accounting aspects and procedures to conduct audit of transactions peculiar to the business. The aforesaid aspects are dealt with in the context of the Chit Funds Act, 1982, being the Central Act, which is applicable to certain States* specified in pursuance of notifications issued

*Dates on which the provisions of the Act came into force.

Sl. No.	Name of the State/ Union Territory	Date of enforcement of the Chit Funds Act, 1982
1.	Andaman and Nicobar Islands	1.7.1985
2.	Bihar	2.10.1982
3.	Chandigarh	1.5.1984

under sub-section (3) of section 1 of the Act. Accordingly, the State Acts have not been considered. It may, however be mentioned that the accounting principles recommended in this Technical Guide are also relevant in respect of a Chit Fund to which a State Chit Fund Act is applicable. The same is true with regard to the conduct of audit of a Chit Fund business, with appropriate modifications, where necessary.

4.	Dadra and Nagar Haveli	3.9.1984
5.	Goa, Daman and Diu	1.1.1986
6.	Himachal Pradesh	1.11.1984
7.	Karantaka	2.1.1984
8.	Lakshadweep Islands	3.9.1984
9.	Madhya Pradesh	1.7.1986
10.	Meghalaya	2.1.1988
11.	Orissa	1.9.1985
12.	Pondicherry	1.11.1986
13.	Punjab	1.4.1999
14.	Rajasthan	1.7.1989
15.	Sikkim	6.11.1984
16.	Tamilnadu	13.4.1984
17.	Uttar Pradesh	1.2.1988
18.	West Bengal	2.4.1984

2

Operational Aspects

2.1 As in every business, there are certain terms which are peculiar to Chit Fund business. An understanding of these terms is useful in appreciating the operational, accounting and auditing aspects of the business. Certain key terms defined under section 2 of the Chit Funds Act, 1982 are as follows:

(a) *'Chit'* means a transaction whether called chit, chit fund, *chitty, kuri* or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical instalments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount.

Explanation - A transaction is not a chit within the meaning of this clause, if in such transaction,–

(i) some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or

(ii) all the subscribers get the chit amount by turn with a liability to pay future subscriptions.

(b) *Chit agreement* means the document containing the articles of agreement between the foreman and the subscribers relating to the chit.

(c) *Chit amount* means the sum-total of the subscriptions payable by all the subscribers for any instalment of a chit without any deduction of discount or otherwise.

(d) *Chit business* means the business of conducting a chit.

(e) *Defaulting subscriber* means a subscriber who has defaulted in

the payment of subscriptions due in accordance with the terms of the chit agreement.

(f) *Discount* means the sum of money or the quantity of grain which a prized subscriber is, under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscribers or for both.

(g) *Dividend* means the share of the subscriber in the amount of discount available under the chit agreement for rateable distribution among the subscribers at each instalment of the chit.

(h) *Draw* means the manner specified in the chit agreement for the purpose of ascertaining the prized subscriber at any instalment of the chit.

(i) *Foreman* means the person who under the chit agreement is responsible for the conduct of the chit and includes any person discharging the functions of the foreman under section 39.

Section 39 (2) provides that where a foreman is adjudicated an insolvent, or withdraws from the chit or fails to conduct the chit at any instalment or on any other date before the next succeeding instalment as may have been agreed upon by a special resolution, any one or more of such subscribers authorised by such resolution may, in the absence of any provision in the chit agreement for the future conduct of the chit, take the place of the foreman and continue the chit or make other arrangements for the further conduct of the chit.

(j) *Non-prized subscriber* does not include a defaulting subscriber.

(k) *Prize amount* means the difference between the chit amount and the discount, and in the case of a fraction of a ticket means the difference between the chit amount and the discount proportionate to the fraction of the ticket, and when the prize amount is payable otherwise than in cash, the value of the prize amount shall be the value at the time when it becomes payable.

(l) *Prized subscriber* means a subscriber who has either received or is entitled to receive the prize amount.

(m) *Subscriber* includes a person who holds a fraction of a ticket and also a transferee of a ticket or fraction thereof by assignment in writing or by operation of law.

(n) *Ticket* means the share of a subscriber in a chit.

2.2 An explanation of some of the terms defined in paragraph 2.1 above, and certain other terms commonly used in Chit business, are as below:

(a) Discount may be of two types, viz., auction discount and fixed discount.

(i) *Auction discount* is the discount agreed to be foregone by the prized subscriber at any instalment of the Chit where the prized subscriber is required to be determined by auction.

(ii) *Fixed discount* is a fixed sum of money set apart from the Chit amount on each instalment, as per the Chit Fund scheme.

(b) *Draw or auction of a Chit* is the process of determination of the subscriber who is eligible to receive the Chit amount on any instalment by draw of lots or, as the case may be, by open bidding.

(c) *Closure of Chit* takes place when all the dues outstanding in respect of a scheme, are realised by the Foreman from all the prized subscribers or written off as irrecoverable, as the case may be.

(d) *Fraction* refers to subscription of one single ticket by more than one subscriber. In a case where more than one subscriber subscribe to one single ticket, the subscribers would be required to pay proportionate subscription and be entitled to receive their proportionate share in the prize money. It is also known as a *division*.

(e) *Instalment amount* is the amount actually payable by the subscriber to the Foreman on each instalment, which is generally the ticket amount less dividend.

OPERATION OF CHITS

2.3 The subscribers to a Chit agree to pay a fixed sum of money (instalment amount) to the Foreman at periodic intervals (due dates of instalments) for a fixed period of time (tenure of the scheme). On every due date of the instalment, draw and/or auction is conducted as per the Chit scheme. Generally, the instalment amount payable by the subscriber subsequent to the first instalment is the instalment amount stated in the Chit agreement less dividend which is a part of the discount as decided by auction/draw in respect of the preceding instalment. Thus, the subscriber generally pays in respect of each instalment subsequent to the first instalment the full ticket value less the dividend. Where a subscriber makes a default in the payment of the instalment amount, the foreman may forfeit the dividend payable in accordance with the terms of the Chit agreement.

2.4 As per section 21(1)(a) of the Chit Funds Act, 1982, the Foreman shall be entitled, in the absence of any provision in the chit agreement to the contrary, to obtain the chit amount at the first instalment without deduction of the discount specified in the chit agreement, subject to the condition that he shall subscribe to a ticket in the chit, provided that in a case where the foreman has subscribed to more than one ticket, he shall not be eligible to obtain more than one chit amount in a chit without discount.

2.5 The instalment amount is payable by the subscribers on or before the due date of every instalment. Foreman may charge default interest and penalty, as per the Chit scheme, for the delay in payment of the instalment amount.

2.6 Section 22(1) of the Chit Funds Act, 1982, prescribes as below:

> "The foreman shall, on the prized subscriber furnishing sufficient security for the due payment of future subscriptions, be bound to pay him the prize amount.
>
> Provided that the prized subscriber shall be entitled to the payment of the prize amount without any security whatsoever if he agrees to the deduction therefrom of the amount of all future subscriptions and in such a case, the foreman shall pay the prize amount to the prized subscriber within seven days after the date of the draw or before the date of the next succeeding instalment, whichever is earlier:
>
> Provided further that where the prize amount has been paid to the prized subscriber under the first proviso, the amount deducted shall be deposited by the foreman in an approved bank mentioned in the chit agreement and he shall not withdraw the amount so deposited except for the payment of future subscriptions."

The above deposit is popularly known as 'Chit Security Deposit' or

'Chit Security Trust Money'. The money so retained will not, in any case, exceed the future liability of the subscriber in the Chit scheme. Further, the money so retained will not be treated as public deposit as per the provisions of section 58A of the Companies Act, 1956, and the Companies (Acceptance of Deposit) Rules, 1975.

2.7 As per section 22(2) of the Act, if, owing to the default of the prized subscriber, the prize amount due in respect of any draw remains unpaid until the date of the next instalment, the foreman shall deposit the prize amount forthwith in a separate account in an approved bank mentioned in the chit agreement and intimate in writing the fact of such deposit and the reasons therefor to the prized subscriber and the Registrar of Chits. However, where any prized subscriber does not collect the prize amount in respect of any instalment of a chit within a period of two months from the date of the draw, it shall be open to the foreman to hold another draw in respect of such instalment.

2.8 As per section 14(1)(b) of the Chit Funds Act, 1982, the Foreman may utilise the moneys collected in Chit business for "giving loans and advances to non-prized subscribers on the security of subscriptions paid by them". Thus, the subscribers who need money temporarily may raise a loan from the Foreman, without auctioning their tickets in the Chit Fund.

2.9 Default in paying Chit instalment amount by subscribers is a normal feature of Chit business. It is a matter of great concern to the Foreman especially in case of defaults by prized subscribers. Default in payment of instalment amounts by subscribers affects the inflow of funds which makes it difficult for the Foreman to make payment of prize amounts to the prized subscribers on every instalment. Thus, timely follow-up of the defaulted instalment is an important aspect of Chit operations.

2.10 A non-prized subscriber who defaults in paying his subscription in accordance with the terms of the Chit agreement shall be liable to have his name removed from the list of subscribers as per section 28(1) of the Chit Funds Act, 1982. A Foreman may substitute in the list of subscribers any person in place of the defaulting subscriber. In such a case, the Foreman shall deposit in an approved bank mentioned in the Chit agreement, an amount equal to the contributions made by the defaulting subscriber less such deductions as may be provided for in the Chit agreement out of the amounts realised from the substituted subscriber. The amount so deposited shall be paid to the defaulting subscriber as and when he claims the amount. But in case, the defaulting subscriber has not been substituted till the termination of the Chit, then the contributions due to the defaulting subscriber shall be paid to him within fifteen days from the date of termination of the Chit.

2.11 Some of the prized subscribers, i.e., the subscribers who have already received their prize money, may not pay their subsequent instalments. The loss arising due to the non-payment has to be borne by the Foreman. Presently, no prudential norms for provisioning have been designed for Chit Fund business as is prevalent in the case of banking, insurance and non-banking finance companies. In such situations, Accounting Standard (AS) 4, ‘Contingencies and Events Occurring After the Balance Sheet Date’, issued by the Institute of Chartered Accountants of India, will apply (see paragraph 3.11 of chapter 3 for details) despite issuance of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets' (see Announcement 'Applicability of AS 4 to impairment of assets not covered by present Indian Accounting Standards' published in April 2004 issue of 'The Chartered Accountant' pp. 1151).

Remuneration of the Foreman

2.12 As per section 21(1)(b) of the Chit Funds Act, 1982, the Foreman shall be entitled “to such amount not exceeding five per cent, of the chit amount as may be fixed in the chit agreement, by way of commission, remuneration or for meeting the expenses of running the chit.”

Termination of Chits

2.13 Section 40 of the Chit Funds Act, 1982, provides that:

“A chit shall be deemed to have terminated,

(a) when the period specified therefor in the chit agreement has expired provided the payment of dues to all subscribers has been completed; or

(b) when all the non-prized and unpaid prized subscribers and the foreman’s consent in writing to the termination of the chit and a copy of such consent is filed with the Registrar as required under section 41; or

(c) where a foreman dies or becomes of unsound mind or is otherwise incapacitated and the chit is not continued in accordance with the provisions of the chit agreement:

Provided that, in a case where the foreman is a firm, if a partner thereof dies or becomes of unsound mind or is otherwise incapacitated, the chit shall not be deemed to have terminated and the surviving partner or partners shall conduct the chit in the absence of any provision to the contrary in the chit agreement."

DIFFERENT TYPES OF CHIT FUND SCHEMES

2.14 Many enterprising Chit Fund businesses organise different types of schemes to attract subscribers. The main differences among various Chit Fund schemes are in their duration, number of instalments, instalment amount and prize amount. Chit Fund schemes are devised for varying durations and instalment amounts so that the subscribers can choose the scheme that suits their requirements keeping in view their capacity to invest, the period for which they can invest, the time at which they need their return of investment, etc. Some of such schemes are dealt with herein below.

Simple Chit

2.15 In a simple Chit, all the subscribers get the Chit amount by turn with a liability to pay future subscription. There is no auction or draw. However, such schemes are not Chits within the meaning of the term 'Chit' as defined in the Chit Funds Act, 1982.

Short-term Chit

2.16 In short-term Chits, instalments may be paid daily, weekly or monthly basis. Generally, the duration of short-term Chits goes upto 30 months.

Long-term Chit

2.17 Chits having a tenure of over 30 months are considered as long-term Chits. In long-term Chits, instalments are paid every three months, four months or six months. The advantage of long-term Chits is based on the principle that since the prize amount is repaid to the Foreman over a longer period, the cost of finance of the prize amount received gets lowered.

'Pooval' Chits

2.18 'Pooval' in Malayalam means a crop. In agrarian Kerala, rice used to be planted and harvested thrice a year and, thus, there used to be three crops in a year. When the traditional scheme of Chit was in operation, farmers used to deposit a fixed measure of grain at the end of each 'pooval' and the needy farmers among the subscribers were given the proceeds of total collection of grains. The present day 'pooval' Chit is evolved from this ancient scheme. In this kind of Chit, the instalments are paid every four months and, thus, there are three instalments in a year.

Mahila Chit

2.19 This is a Chit promoted for the welfare of women. The amount of instalment is low and it is promoted as a savings scheme.

Marriage Chit

2.20 Under such a Chit, if the investor has a young female child, by investing in the Chit, he can get the amount required for meeting the expenses at the time of her marriage. This has made many parents having female children to invest in the Chit.

Education Chit

2.21 This is intended for the parents who want to save for the education of their children. Under such a Chit, if a parent of a child of less than 5 years starts investing in the Chit, he will be able to meet the expenses of the child for pursuing its higher education.

Businessman's Chit

2.22 This Chit is meant for the business community. Generally, a higher prize money, higher instalment amount and shorter tenure of the scheme are the characteristics of this type of Chits. In the case of short-term Chits, the prize money is more and the liability is liquidated in a relatively shorter period. In case of long-term Chit, the businessmen can bid the Chit early and the repayment is made over a longer period of time.

2.23 The above schemes are merely illustrative. There are many other schemes in operation in different parts of the country. From the nature of the above schemes, it can be inferred that the naming of the Chits is just to catch the attention of a particular section of the society with a view to induce them to invest in the Chit.

INCENTIVE SCHEMES

2.24 The modern trend in Chit Fund business is to provide different kinds of incentives to attract subscribers, while retaining the basic features of a Chit Fund scheme. To make investment in Chit Funds more attractive, many enterprises have started to incorporate schemes to give away prizes like cars, motor cycles, household appliances, gold coins, etc., by drawing lots, to non-defaulting subscribers, whether prized or non-prized. The prizes to be given away on each instalment are announced before the commencement of the Chit. The expenditure on prizes is generally met out of the discount.

2.25 The incentive schemes are designed with a view to encourage prompt payment by subscribers. Incentives given under such schemes do not constitute the prize amount awarded to each subscriber by draw or auction. Further, such schemes are not banned under the Prize Chits and Money Circulation Scheme (Banning) Act, 1978, dealt with hereinafter in paragraphs 2.32 to 2.34.

Bonus Schemes

2.26 Bonus schemes as a kind of incentive schemes also encourage subscribers to make payment of instalments on due date. A portion of Chit amount is set apart for bonus distribution by the Foreman, as per the Chit scheme. From this amount, a deduction from the instalment amount, called 'bonus', is allowed to the subscribers who make payment of the instalment amount on the due date or at an earlier date. If a subscriber defaults in making payment of instalment amount on or before the due date, he is not eligible for bonus.

Other Incentives

2.27 The latest marketing techniques adopted by Chit Fund enterprises include providing the subscribers with free accident insurance coverage, mediclaim insurance, etc., to make the Chit Fund schemes more attractive.

LEGISLATIONS/REGULATIONS RELEVANT TO THE CHIT FUND BUSINESS

2.28 The Central Government has enacted the Chit Funds Act, 1982 (Act No. 40 of 1982) which extends to the whole of India except the State of Jammu and Kashmir. According to section 1(3) of the Act, it shall come into force on such date as the Central Government by notification in the official gazette, appoint and different dates may be appointed for different States (Refer paragraph 1.8 of chapter 1).

2.29 With a view to regulate the acceptance of deposits by the Chit Fund companies, the Reserve Bank of India issued Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977, on 20.06.1977, which came into force from 01.07.1977. Presently, Chit Fund companies are included in the category of Miscellaneous Non-Banking Companies by the Reserve Bank of India and all directions to Miscellaneous Non-Banking Companies are applicable to Chit Fund companies to the extent they are relevant to the Chit Fund business.

2.30 Chit Fund business can be carried on by a company, a sole proprietor, a partnership firm, a trust, an association of persons or any other form of organisation. As per section 12(1) of the Chit Funds Act, 1982, except with the general or special permission of the State Government, no company carrying on Chit Fund business shall conduct any other business. Further, as per section 86(1) of the Act, notwithstanding anything contained in the Act, no bank shall commence or carry on Chit Fund business after the commencement of this Act. Thus, in effect, banks, financial institutions, non-banking finance companies or other companies engaged in any other business do not carry on Chit Fund business. Therefore, the existence of a separate entity for the conduct of Chit Fund business has become necessary by law.

2.31 Most of the larger enterprises conducting Chit Fund business are companies incorporated under the Companies Act, 1956. Therefore, all the provisions of the Companies Act, 1956, are also applicable to the Chit companies.

Prohibition of Certain Operations

2.32 The Central Government has enacted the Prize Chits and Money Circulation Scheme (Banning) Act, 1978, extending to all States except Jammu & Kashmir, which bans promotion/conduct of two activities, namely, (a) Money Circulation Schemes and (b) Prize Chits.

Money Circulation Scheme

2.33 In a money circulation scheme, normally, the promoter collects money from the members of the public on the stipulation that they will receive a share from the contributions from certain number of members they enroll, who in turn are encouraged to enlist more members. The scheme is designed in such a way that if the chain is continued uninterruptedly, each member by contributing small sums of money gets in return a disproportionately large sum of money as share from further subscriptions. The Act defines a 'money circulation scheme' as "any scheme, by whatever name called, for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrollment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions."

Prize Chit Scheme

2.34 Prize Chit includes any transaction or arrangement by whatever name called under which a person collects whether as a promoter, foreman, agent or in any other capacity, monies in one lump sum or in instalments by way of contributions or subscriptions or by sale of units, certificates or other instruments or in any other manner or as membership fees or admission fees or service charges to or in respect of any savings, mutual benefit, thrift, or any other scheme or arrangement by whatever name called, and utilises the monies so collected or any part thereof or the income accruing from investment or other use of such monies for all or any of the following purposes namely:

(i) giving or awarding periodically or otherwise to a specified number of subscribers as determined by lot, draw or in any other manner, prize or gifts in cash or in kind, whether or not the receipient of the prize or gifts is under a liability to make any further payment in respect of such scheme or arrangement.

(ii) refunding; to the subscribers or such of them as have not won any prize or gift, the whole or part of the subscriptions, contributions or other monies collected, with or without any bonus, premium, interest or other advantage by whatever name called, on the termination of the scheme or arrangment, or on or after the expiry of the period stipulated therein.

but does not include a conventional chit. This scheme may permit entry at any time during the course of its operation with stipulations for payment of arrears, etc. It may be noted that there is no limit on the number of members who can join the chit in contradistinction to a conventional chit where the number of instalments (tickets) and the number of members match.

3

Accounting and Control Aspects

3.1 This Chapter deals with the accounting aspects of Chit Fund enterprises, particularly, in the context of Accounting Standards issued by the Institute of Chartered Accountants of India. It also deals with the control aspects peculiar to a Chit Fund business.

BOOKS AND RECORDS TO BE MAINTAINED BY THE FOREMAN

3.2 Companies, sole proprietors, partnership firms, trusts, associations of persons and other forms of organisations can carry on Chit Fund business. Where the Chit Fund business is in the form of a company, books of account and other records as required by the Companies Act, 1956, have to be maintained. In addition, section 23 of the Chit Funds Act, 1982, has specified certain books and registers to be maintained by the Foreman. As per the aforesaid section, the following books and registers are to be maintained by all forms of enterprises carrying on Chit Fund business:

(a) a register containing -

  (i) the names and full particulars of the subscribers in each chit together with the number of tickets held by each subscriber;

  (ii) the dates on which the subscribers signed the chit agreement; and

  (iii) in the case of an assignment of a ticket by a subscriber, the name and full address of the assignee with the date of assignment and the date on which the assignment had been recognised by the foreman;

(b) a book containing the minutes of the proceedings of each draw. (This book should contain the information of the Chit amount, fixed discount, auction discount and net amount payable by the subscribers in respect of each instalment.)

(c) a ledger containing -

   (i) the amounts paid by the subscribers in each chit and the dates of such payments;

   (ii) the amounts paid to the prized subscribers and the dates of such payments; and

   (iii) in the case of any deposit in an approved bank mentioned in the chit agreement, the date and the amount of such deposit;

(d) a register in the prescribed form showing the amounts deposited in approved banks as required under the provisions of the Chit Funds Act, 1982, in respect of all chits conducted by the foreman at his office. Such a Register may be termed as Bank Deposits Register.

(e) Such other registers and books in such form as may be prescribed by the State Government within whose jurisdiction the Chit is conducted.

3.3 A Foreman may carry on more than one Chit. In order to maintain better control and accountability, separate daybooks, ledgers, registers and other records are maintained for each Chit scheme.

3.4 Apart from the above, the Foreman may maintain the following registers:

- *Security/Trust Money Deposit Register*: This register may contain details regarding the amount of deposit made by each subscriber as security for the future liability in the Chit Fund scheme, along with the date of deposit, amount of interest paid, date of interest payment and other relevant particulars.

- *Document Register:* This register may contain details regarding the documents executed at the time of payment of prize money.

- *Security Document Register:* This register may contain particulars of all documents lodged with the Foreman by way of creating mortgage, charge, lien, etc., by the subscribers as security for receiving the Chit amount.

- *Suit-filed Register:* This register is maintained to record all cases of litigation in respect of the defaulting subscribers. The register records the amount outstanding, date of suit-filing, date of decree, recovery amount and date, and other relevant particulars.

3.5 All the records pertaining to a Chit Fund scheme are required to be kept by the Foreman for a period of eight years from the date of termination of a Chit, as per section 45 of the Chit Funds Act, 1982.

APPLICABILITY OF ACCOUNTING STANDARDS TO A CHIT FUND BUSINESS

3.6 The 'Preface to the Statements of Accounting Standards'(revised 2004), issued by the Institute of Chartered Accountants of India, states the following:

> "3.3 Accounting Standards are designed to apply to the general purpose financial statements and other financial reporting, which are subject to the attest function of the members of the ICAI. Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, irrespective of whether it is profit oriented or it is established for charitable or religious purposes....."

In view of the above, for all enterprises carrying on Chit Fund business, the accounting standards issued by the Institute of Chartered Accountants of India, are relevant where the financial statements of such enterprises are subject to the attest function by the members of the Institute.

Mandatory Vs. Recommendatory Accounting Standards

3.7 Chit Fund enterprises incorporated under the Companies Act, 1956, are required to comply with the Accounting Standards by virtue of sub-section (3A) of section 211 of the Companies Act, 1956. Sub-section (3B) of section 211 requires that where the Profit and Loss Account and Balance Sheet of a company do not comply with the Accounting Standards, the company shall disclose in its Profit and Loss Account and Balance Sheet the fact of such deviation, the reason therefor and the financial effect, if any, arising due to such deviation. Further, section 227(3)(d) requires the auditor to state whether Profit and Loss Account and Balance Sheet comply with Accounting Standards referred to in sub-section (3C) of section 211. Sub-section (3C) of section 211 provides that for the purposes of this section, the expression 'accounting standards' means the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949), as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under sub-section (1) of section 210A. Proviso to sub-section (3C) of the section provides that standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the Accounting Standards until the Accounting Standards are prescribed by the Central Government under this sub-section. So far, the Central Government has not prescribed any Accounting Standards under this sub-section.

3.8 As far as other enterprises are concerned, it is the duty of the members of the Institute to examine while conducting an audit of general purpose financial statements under any law that the accounting standards which have been made mandatory by the Institute have been complied with in the presentation of financial statements covered by their audit. In the event of any deviation from a mandatory accounting standard, it is their duty to make adequate disclosures in their audit reports so that the users of the financial statements may be aware of such deviations. In respect of a recommendatory accounting standard, the duty of the members of the Institute is to examine whether the recommendations made in the standard have been followed in the presentation of financial statements covered by their audit. If the same have not been followed, the members have to consider whether, keeping in view the circumstances of the case, a disclosure in the audit report is necessary. In other words, they have to exercise their professional judgement to determine whether the departures from the recommendatory accounting standards are justified under the circumstances or not.

So far, The Institute of Chartered Accountants of India has issued 29 Accounting Standards. The details of their mandatory status and the applicability of the individual Accounting Standards, for accounting periods commencing on or before 31.3.2004 and for accounting periods commencing on or after 1.4.2004, are given in Appendix I and Appendix II respectively.

3.9 A Chit Fund business will have to apply an Accounting Standard keeping in view its relevance to the transaction entered into by it. Some of the Accounting Standards such as Accounting Standard (AS) 2, 'Valuation of Inventories'; Accounting Standard (AS) 7, 'Construction Contracts', etc., would not be applicable to a Chit Fund business since such a business would not normally have inventories and construction contracts as envisaged in the respective standards. Similarly, Accounting Standard (AS) 12, 'Accounting for Government Grants', would not be relevant to a Chit Fund business since normally such a business would not be receiving any government grants. Further, certain Accounting Standards may be relevant in case of specific situations. For example, Accounting Standard (AS) 14, 'Accounting for Amalgamations', will be applicable in the situation where one enterprise carrying on Chit Fund business amalgamates with another enterprise. Similarly, Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', will be applicable only where a Chit Fund business has any foreign currency transactions and/or has foreign branches. In the application of certain standards to Chit Funds, certain peculiarities may arise which are discussed hereinafter.

Accounting Standard (AS) 1, Disclosure of Accounting Policies

3.10 The financial statements of an enterprise carrying on Chit Fund business should disclose, at one place, all significant accounting policies followed for the preparation and presentation thereof. It is recommended that, amongst others, the following accounting policies may be disclosed:

(i) Recognition of revenue in respect of the Foreman's commission.

(ii) Recognition of revenue in respect of default interest and penalty charges.

(iii) Accounting policy related to auction discount and fixed discount.

Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date*

3.11 In a Chit Fund business, it is possible that some prized subscribers may not pay their instalments after receiving the prized amount. The loss arising on account of non-payment of instalments by a prized subscriber is borne by the Foreman. Accordingly, in respect of the instalments which have become due on the balance sheet date but not paid by the prized subscribers as well

* Pursuant to Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', issued by the Institute of Chartered Accountants of India, becoming mandatory in respect of accounting periods commencing on after 1-4-2004, all paragraphs of AS 4 that deal with contingencies stand withdrawn to the extent covered by present Indian Accounting Standards including AS 29. Accordingly, these paragraphs of AS 4 are applicable to the extent not covered under present Indian Accounting Standards including AS 29. For example, the impairment of financial assets, such as impairment of receivables (commonly known as provision for bad and doubtful debts), would continue to be governed by AS 4, till the issuance of the proposed Accounting Standard on Financial Instruments: Recognition and Measurement. (See Announcement 'Applicability of AS 4 to impairment of assets not covered by present Indian Accounting Standards' published in April 2004 issue of 'The Chartered Accountant' pp. 1151.) Thus, in respect of creation of provision for non-payment of instalments by a prized subscriber, AS 4 would continue to apply.

as the instalments which have not become due on the balance sheet date but the prized subscriber has defaulted in respect of the instalments which have become due, a provision has to be created or a contingent liability has to be disclosed keeping in view the requirements of paragraphs 10 and 11 of AS 4 reproduced below:

> ***"10. The amount of a contingent loss should be provided for by a charge in the statement of profit and loss if:***
>
> ***(a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and***
>
> ***(b) a reasonable estimate of the amount of the resulting loss can be made.***
>
> ***11. The existence of a contingent loss should be disclosed in the financial statements if either of the conditions in paragraph 10 is not met, unless the possibility of a loss is remote."***

3.12 The amount of the provision for loss in respect of the defaulting prized subscribers, can be estimated on the basis of, amongst other things, the past experience of the enterprise, information about the ability of the individual subscribers to pay, and the appraisal of the uncollectibles based on the current business environment of the business of the relevant subscribers. For instance, where the past experience of a particular Chit Fund business indicates that the prized subscribers do not generally pay after a continuous default of paying, say, three instalments, it may be appropriate to make a provision for the entire amount outstanding. In estimating the amount of the provision for loss, the realisable value of the security lodged with the Foreman should also be considered.

Accounting Standard (AS) 9, Revenue Recognition

3.13 In a Chit Fund business, the following items of revenue ordinarily arise:

(i) Foreman's commission.

(ii) Default interest.

(iii) Interest on loans and advances.

Application of the principles of AS 9 in respect of the above items of revenue is dealt with hereinafter.

Foreman's commission

3.14 The Foreman is rendering a service to the subscribers in return of which he gets a commission as a percentage of the Chit amount which is defined in Chapter 2 as "the sum-total of the subscriptions payable by all the subscribers for any instalment of a Chit without any deduction of discount or otherwise." For recognition of revenue from rendering of a service, the accounting treatment has been prescribed in paragraph 12 of AS 9, which provides that "***in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.***"

3.15 The proportionate completion method and the completed service contract method have been further explained in paragraph 7.1 of AS 9 as below:

> "7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.
>
> *(i)* *Proportionate completion method* – Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.
>
> *(ii)* *Completed service contract method* – Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot

be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable."

3.16 As per paragraph 12 of AS 9, it is not optional for an enterprise to choose either the completed service contract method or the proportionate completion method since the said paragraph provides that the performance should be measured as per the method, which *relates the revenue to the work accomplished.*

3.17 The most crucial issue to be settled in case of a Chit Fund business is what is the 'service' being performed by the Foreman and whether the service being performed involves performance of more than a single act and, if so, then what are those acts. It is obvious that the subscribers join a Chit scheme with a view to avail of the service of obtaining funds in lump sum for using such funds for the purpose of investing the same for higher returns elsewhere or use in their respective businesses or for their personal use. Thus, the service being rendered by the Foreman is that of facilitating subscribers to raise funds for their use. For this purpose, the Foreman has to perform various activities which are essential to provide this service. Such activities include collection of subscriptions from the subscribers, conducting of auctions, distribution of dividends, maintenance of books of account and other administrative activities. These activities are incidental, though essential, in the rendering of service of providing finance to the subscribers. In themselves, these are not services rendered to the subscribers. In other businesses also various essential activities are performed for the sale of goods or rendering of services. Thus, it is obvious that the Foreman renders the service of providing finance to the subscribers of the Chit and, in return, earns commission on the Chit amount. Insofar as a Chit scheme is concerned, in terms of the Chit agreement, he undertakes, periodically to perform this service to a group of persons, i.e., all the subscribers. Making the prize amount available, by drawing a lot or by auctioning, to the prized subscriber at each instalment constitutes performance of an act towards providing the service. Such acts are performed over the tenure of the Chit scheme in respect of all the subscribers. Thus, in respect of a Chit scheme more than one act is performed in the rendering of the service. Accordingly, revenue should be recognised proportionately by reference to the performance of each act, i.e., at the time when a prized subscriber is determined by auction or draw. Further, there is normally no uncertainty with regard to the consideration, viz., the commission amount, since the amount of the same is fixed by the Chit agreement. In view of this, it is appropriate to recognise commission at that point of time provided there is reasonable certainty that ultimate collection will be made.

3.18 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time when the prized subscriber is determined, recognition of revenue from the commission is postponed to the extent of uncertainty involved. For example, where a prized subscriber is not paying instalments after receiving the prize amount and the Foreman's ability to assess the ultimate collection with reasonable certainty is lacking at the time when his subsequent instalment becomes due, recognition of revenue, to the extent of the amount of commission due from the defaulted prized subscriber, is postponed. In such cases, it would be appropriate to recognise revenue only when it becomes reasonably certain that the ultimate collection will be made. In many cases, uncertainty related to collectability is removed only when cash is actually received. In such cases, it would be appropriate to recognise revenue when cash is actually received. When revenue is recognised in this manner, it does not mean that accrual basis of accounting has not been followed. Where the uncertainty relating to collectability arises subsequent to the time of recognition of revenue, it is more appropriate to make a provision as per AS 4 to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

Default Interest

3.19 A subscriber who has defaulted in the payment of subscriptions due in accordance with the terms of the Chit agreement is called a defaulting subscriber. A defaulting subscriber is liable to pay the defaulted instalment, within the specified period, with interest at such rates as may be prescribed. Such interest for delay in payment of instalment amount by subscribers and penalty therefor, if any, are to be recognised only when the uncertainty regarding its realisation is removed, in view of paragraph 9.2 of AS 9, which provides as under:

> "9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate

collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments."

3.20 In many cases, uncertainty related to collectability is removed only when cash is actually received. In such cases, it would be appropriate to recognise revenue when cash is actually received. When revenue is recognised in this manner, it does not mean that accrual basis of accounting has not been followed.

Interest on Loans & Advances

3.21 The Foreman may give loans and advances to the subscribers to make best use of the surplus funds. Interest on loans and advances given to the subscribers is recognised on a time proportion basis taking into account the amount outstanding and the rate applicable, provided no significant uncertainty as to measurability and collectability exists (paragraph 13 of AS 9).

Accounting Standard (AS) 18, Related Party Disclosures

3.22 This Standard assumes importance because related parties may enter into transactions which unrelated parties would not enter into. In such a case, the concerned enterprises will have to make disclosures as required by AS 18. Related party transactions in a Chit Fund business carried on by a company may include the following:

(a) Subscriptions to Chits by whole-time directors of the company and their relatives.

(b) Guarantees given by whole-time directors as security for payment of prize money.

(c) Deposits accepted as security from whole-time directors and their relatives.

OTHER ACCOUNTING ISSUES PECULIAR TO CHIT FUNDS

Chit canvassing commission

3.23 The Chit canvassing commission is paid by a Foreman to an agent or broker for enrolling subscribers to a Chit scheme. There is also a practice of giving canvassing commission to the subscribers themselves when they enroll directly in the scheme. Chit canvassing commission is in the nature of a promotional expenditure. According to paragraph 56 of Accounting Standard

(AS) 26, ‘Intangible Assets’, promotional expenditure should be expensed in the year in which it is incurred by way of a charge to the profit and loss account.

Accounting for incentives

3.24 The Foreman sometimes gives incentives, e.g., gifts to subscribers to encourage them to make the payments promptly. Such incentives are given for promotion of the Chit Fund business and should be charged as an expense when incurred.

Discount

3.25 The amount of discount distributable as dividend is often adjusted in the amount payable by the subscriber when the next instalment becomes due, in accordance with the terms specified in the Chit agreement. This amount may be credited to the subscribers' accounts when the same is determined, i.e., at the time of determination of the prized amount or the same may be credited to a separate account, say, 'distributable discount account'. When any of the subscribers makes a default in payment of an instalment on due date, the Foreman may forfeit the dividend so distributable to that subscriber. In other words, the defaulting subscriber would be required to pay the full amount of the instalment without getting any credit for his share of dividend. The dividend forfeited in this manner should be treated as income of the period in which such forfeiture is made. However, where the Foremen as per his established practice with a view to maintain good business relations with the subscriber, allows such dividend on payment of future instalments, such dividend is carried forward for adjustment against the amount of future instalment(s). In case, the dividend so carried forward is decided to be forfeited at a later date, the same should be recognised as income in the period in which such a decision is taken.

3.26 Where the discount is used in accordance with the terms of the Chit agreement for meeting the expenses of running the Chit, the amount of the discount corresponding to the expense incurred should be credited to the profit and loss account and the expense should be charged to the profit and loss account.

Offsetting

3.27 On the balance sheet date, a subscriber may owe some amount and some amount may be owed to him. In such a case the said amounts should be offset in respect of the concerned subscriber for the purpose of reflecting the same in the balance sheet.

ACCOUNTING IMPLICATIONS OF FOREMAN BEING A SUBSCRIBER OF TICKETS

3.28 The Foreman can subscribe to more than one ticket in a Chit Fund scheme. According to section 21(1)(a) of the Chit Funds Act, 1982, the foreman is entitled to obtain the Chit amount at the first instalment without deduction of the discount. However, in a case where the foreman has subscribed to more than one ticket, he is not eligible to obtain more than one Chit amount in a Chit without discount. Section 22(4) of the Act clearly provides that where the foreman is himself a prized subscriber, he shall be entitled to the prize amount subject to his complying with the furnishing of sufficient security for the due payment of all the future subscriptions as specified by section 31 of the Act. Further, the Foreman, like other subscribers, would receive share in the dividend at the time of awarding the prize amount to other subscribers. Similarly, he would incur expenditure on account of discount at the time of receiving the prize amount on second and all subsequent tickets in a Chit (in case he has subscribed to more than one ticket). The accounting treatment in the books of the Foreman is discussed hereinafter.

3.29 The Foreman as a subscriber to the Chit should, for the first ticket in respect of which he is entitled to receive the prize amount without deduction of any discount, debit the Chit Investment Account with the instalments paid at the gross amount (i.e., without deduction of any dividend). The prize amount when received is credited to the Chit Investment Account. Since the Foreman is not required to bear any discount on receiving the prize amount, the dividend received/receivable in respect of each instalment should be recognised in the profit and loss account when the right to receive the same is established.

3.30 Where the Foreman has subscribed to more than one ticket, he will have to bear the discount on the prize amount of subsequent tickets. In respect of such tickets, since the Foreman has to bear the discount, the Chit Investment Account should be debited with the instalments amount net of the relevant dividend till the prize amount is received. On receipt of the prize amount, the Chit Investment Account is credited. The difference between the prize amount received in respect of such ticket and the sum of instalments paid on the ticket till that date (net of discount) plus the instalments payable at gross amount in future, if positive, is treated as a profit on the Chit and recognised in the profit and loss account. If the aforesaid difference is negative, the same should be treated as a finance charge which should be apportioned over the life of the Chit at the implicit rate. Alternatively, weighted average method can be used where it gives approximately the same results as that under the implicit rate method; the weights to be assigned would be the gross amounts of instalments outstanding. The dividend received in respect of the subsequent instalments should be recognised in the profit and loss account when the right to receive the same is established. Accordingly, after receipt of the prize amount, the instalments debited to the Chit Investment Account are recorded at the gross amount.

PRESENTATION OF FINANCIAL STATEMENTS

3.31 Financial statements are the end-products of the accounting process. It is through these statements that financial information is communicated to various users to assist them in taking economic decisions concerning the reporting entity. Where the Chit Fund business is carried on by a company, the financial statements are prepared in accordance with the requirements of the Companies Act, 1956. However, for the purpose of filing with the Registrar, the financial statements have to be prepared in accordance with section 24 of the Chit Funds Act, 1982, which provides that "Without prejudice to the provisions of the Companies Act, 1956 (1 of 1956), every foreman shall prepare and file with the Registrar within such time as may be prescribed, a balance sheet as on the last date of each calendar year, or, as the case may be, the financial year of the foreman, and a profit and loss account relating to the year of account, in the forms set out in Parts I and II of the Schedule, or as near thereto as circumstances admit, in respect of the chit business and audited by auditors qualified to act as auditors under the Companies Act, 1956, or by a chit auditor appointed under section 61." The aforesaid formats are reproduced in Appendix III.

INTERNAL CONTROL ASPECTS

3.32 The existence and effective operation of an adequate system of internal control is an essential pre-requisite for efficient and effective functioning of an enterprise. The need for a sound internal control system assumes even greater importance in the case of a Chit Fund business owing to the financial nature of the business.

3.33 Paragraph 8 of the Auditing and Assurance Standard (AAS) 6, 'Risk

Assessments and Internal Control' (revised June 2002), issued by the Institute of Chartered Accountants of India, states that:

> "8. "Internal Control System" means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal audit function constitutes a separate component of internal control with the objective of determining whether other internal controls are well designed and properly operated."

3.34 Paragraph 14 of (AAS) 6 further states that the "internal controls relating to the accounting system are concerned with achieving the following objectives:

- Transactions are executed in accordance with management's general or specific authorisation.
- All transactions and other events are promptly recorded in the correct amount, in the appropriate accounts and in the proper accounting period so as to permit preparation of financial statements in accordance with the applicable accounting standards, other recognised accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets.
- Assets and records are safeguarded from unauthorised access, use or disposition.
- Recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences."

3.35 The specific internal control procedures to be followed in an enterprise depend on the nature, size, organisational set up, volume of transactions, complexities in its operations and the management's attitude towards control. In a Chit Fund business, the Foreman is responsible for designing and incorporating various internal control procedures which are appropriate to the enterprise. Internal control procedures in respect of certain important areas in a Chit Fund business are discussed hereinafter.

Segregation and Rotation of Duties

3.36 One of the fundamental features of an effective internal control system is the segregation and rotation of duties in a manner conducive to prevention and timely detection of occurrence of frauds and errors. The duties typically segregated are:

- authorisation of transactions;
- execution of transactions;
- physical custody of the assets; and
- maintenance of records and documents.

3.37 A Chit Fund business may employ the following measures as a part of its internal control system:

- Work of one staff member is invariably supervised or checked by another staff member;
- The jobs undertaken by each staff member are rotated periodically. This tends to reduce the possibility of occurrence of frauds and errors and is also useful in detection of fraud and error.

3.38 Management of an enterprise delegates authority to different levels to execute specified kinds of transactions in accordance with the prescribed procedures. Authorisations may be general (relating to all transactions that conform to prescribed procedures) or specific with reference to a single transaction. Internal control procedures should be designed to establish that the authorisations issued by persons are within the scope of their authority and that the transactions conform to the terms of the authorisations. The following procedures are usually employed by an enterprise carrying on Chit Fund business:

(a) The financial and administrative powers of officials at each level are fixed and communicated to all concerned.

(b) Confirmation is obtained from the next higher level for all transactions executed by the lower level.

(c) In case of any deviation from the laid down policies and procedures, proper ratification is obtained from the higher authorities.

(d) Appropriate periodical reports are given to the controlling authority about the transactions executed by the lower authorities.

Maintenance of adequate records and documents

3.39 Accounting controls should ensure that the transactions are recorded at correct amount and that they correspond to the accounting period in which they are executed and also that they are appropriately classified. In order to ensure the efficiency of the accounting control system, the following measures may be adopted by a Chit Fund enterprise:

(a) All records are maintained in the prescribed books and registers only. This will ensure recording of all transactions in the books of account and also help in the finalisation of accounts.

(b) Signatures/initials of the officials making the initial entries and authorising officials are appended in the books/registers.

(c) All books are to be balanced periodically. Balancing is to be confirmed by an official.

(d) Accounts of branches are periodically reconciled.

(e) Bank accounts are reconciled periodically and confirmations are obtained at regular intervals.

Accountability for and Safeguarding of Assets

3.40 The accountability for assets starts at the time of their acquisition and continues till their use and disposal. The accountability for assets is achieved by maintenance of records of assets and their periodic physical verification. To safeguard the assets, it is also necessary that access to assets is limited to authorised personnel. Access includes both direct physical access as well as indirect access through the preparation and processing of documents that authorise the use or disposal of assets. Some important controls which may be followed by a Chit Fund business with regard to cash and bank balances are as follows:

(a) Cash should be maintained in the joint custody of two officials.

(b) Sufficient insurance coverage should be made for the physical cash balance maintained by the Chit Fund enterprise.

(c) The duties of cashier should be rotated among staff members occasionally.

(d) The cashier should maintain a rough cash book which should be agreed with the fair cash book maintained by another staff member at the end of the day.

(e) The cash balance should be verified by the officials of the Chit Fund enterprise frequently.

(f) Inward mails should be opened by persons not connected with handling cash or the Accounts Department.

(g) Bank deposits should be made by someone other than the one responsible for cash receipts and/or ledger.

(h) If collection agents are appointed, the agent should issue serially numbered temporary/provisional receipts to the subscribers.

(i) Permanent receipts should be issued in lieu of temporary/provisional receipts issued by the collection agent.

(j) Bank balances should be reconciled periodically and confirmation certificates should be obtained from the banks.

Collection of instalment amount from the subscribers

3.41 The Foreman is responsible for collecting the instalment amount on or before the due date of every instalment because he is under an obligation to pay the prize amount on the due dates whether or not all the members have paid their subscription. It is, therefore, essential to ensure that all subscribers have paid the amount at the due date. The Foreman may substitute in the list of subscribers any person in place of the defaulting subscriber whose name has been removed for default in payment of subscriptions. The Foreman should design a suitable internal control system for detection of defaulting subscribers.

Utilisation of funds

3.42 The Foreman or any other person carrying on Chit Fund business should not utilise the moneys collected in respect of such business (other than commission or remuneration payable to such person or interest or penalty, if any, received from a defaulting subscriber) for purposes other than those mentioned in section 14 of the Chit Funds Act, 1982. The control procedures adopted in this area should primarily aim at optimum utilisation of funds collected in the Chit Fund business.

Collection of subscription in advance

3.43 The subscribers sometimes pay the future instalments in advance. The consolidated payment of future subscriptions realised by a Foreman should be deposited by him in an approved bank mentioned in the Chit agreement before the due date of the succeeding instalment and the amount so deposited should not be withdrawn except for adjustment of subsequent subscriptions.

Payment of prize money

3.44 According to section 22(1) of the Chit Funds Act, 1982, the Foreman shall, on the prized subscriber furnishing sufficient security for the due payment of future subscriptions, be bound to pay to him the prize amount. An internal control for disbursement of prize money includes, *inter alia*, the following:

- The payment of prize money is authorised by the appropriate authority. The sanction specifies the amount of payment, nature of security, etc.
- All the necessary documents should be executed before disbursements are made.
- Securities like shares, debentures, Indira Vikas Patras, Kisan Vikas Patras, etc., are received and retained by responsible officers and the securities should be kept in the joint custody of at least two officers.
- All securities requiring registration are registered in favour of the Chit Fund enterprise or otherwise accompanied by documents sufficient to give title to the enterprise.
- As soon as documents are executed, entries are made in the document register and these entries are checked by an official.

4

Audit Aspects

4.1 The audit of a Chit Fund business assumes great significance as it involves large amounts of public money. Section 24 of the Chit Funds Act, 1982, contains provisions relating to the formats of Balance Sheet and Profit and Loss Account of a Chit Fund. This section also requires that such statements shall be audited by auditors qualified to act as auditors under the Companies Act, 1956, or by a Chit auditor appointed by the Registrar under section 61 of the Chit Funds Act, 1982. The said section also states that even if the accounts of a company carrying on Chit Fund business are subjected to audit by auditors appointed under the Companies Act, 1956, the Chit auditors appointed by the Registrar under section 61 of the Chit Funds Act, 1982, will still have the right to audit the accounts, if so authorised by the Registrar.

4.2 In carrying out the audit of any Chit Fund business, the auditor has to consider all applicable accounting standards apart from the other generally accepted accounting principles such as the guidance notes on accounting matters issued by the Institute of Chartered Accountants of India. The Auditing and Assurance Standards and other statements and guidance notes issued by the Institute of Chartered Accountants of India provides a basis for the auditors to perform the audit.

4.3 The Institute of Chartered Accountants of India has, from time to time, issued 'Auditing and Assurance Standards (AASs)' [earlier termed as Statements on Standard Auditing Practices (SAPs)] to prescribe audit principles and procedures. The AASs apply whenever an independent audit is carried out. The following is the list of Auditing and Assurance Standards (AASs) issued by the Institute of Chartered Accountants of India as on 30th April, 2004:

1. Auditing and Assurance Standard (AAS 1), 'Basic Principles Governing an Audit'.
2. Auditing and Assurance Standard (AAS 2), 'Objective and Scope of the Audit of Financial Statements'.
3. Auditing and Assurance Standard (AAS 3), 'Documentation'.

4. Auditing and Assurance Standard (AAS 4) (Revised), 'The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements'.

5. Auditing and Assurance Standard (AAS 5), 'Audit Evidence'.

6. Auditing and Assurance Standard (AAS 6) (Revised), 'Risk Assessments and Internal Control'.

7. Auditing and Assurance Standard (AAS 7), 'Relying Upon the Work of an Internal Auditor'.

8. Auditing and Assurance Standard (AAS 8), 'Audit Planning'.

9. Auditing and Assurance Standard (AAS 9), 'Using the Work of An Expert'.

10. Auditing and Assurance Standard (AAS 10) (Revised), 'Using the Work of Another Auditor'.

11. Auditing and Assurance Standard (AAS 11), 'Representations by Management'.

12. Auditing and Assurance Standard (AAS 12), 'Responsibility of Joint Auditors'.

13. Auditing and Assurance Standard (AAS 13), 'Audit Materiality'.

14. Auditing and Assurance Standard (AAS 14)'Analytical Procedures'.

15. Auditing and Assurance Standard (AAS 15), 'Audit Sampling'.

16. Auditing and Assurance Standard (AAS 16), 'Going Concern'.

17. Auditing and Assurance Standard (AAS 17), 'Quality Control for Audit Work'.

18. Auditing and Assurance Standard (AAS 18), 'Auditing of Accounting Estimates'.

19. Auditing and Assurance Standard (AAS 19), 'Subsequent Events'.

20. Auditing and Assurance Standard (AAS 20), 'Knowledge of the Business'.

21. Auditing and Assurance Standard (AAS 21), 'Consideration of Laws and Regulations in an Audit of Financial Statements'.

22. Auditing and Assurance Standard (AAS 22), 'Initial Engagements – Opening Balances'.

23. Auditing and Assurance Standard (AAS 23), 'Related Parties'.

24. Auditing and Assurance Standard (AAS 24), 'Audit Considerations Relating to Entities Using Service Organisations'.

25. Auditing and Assurance Standard (AAS 25), 'Comparatives'.

26. Auditing and Assurance Standard (AAS 26), 'Terms of Audit Engagements'.

27. Auditing and Assurance Standard (AAS 27), 'Communications of Audit Matters with those charged with Governance'.

28. Auditing and Assurance Standard (AAS 28), 'The Auditor's Report on Financial Statements'.

29. Auditing and Assurance Standard (AAS 29), 'Auditing in a Computer Information Systems Environment'.

30. Auditing and Assurance Standard (AAS 30), 'External Confirmations'.

31. Auditing and Assurance Standard (AAS 31), 'Engagements to Compile Financial Information'.

32. Auditing and Assurance Standard (AAS 32), 'Engagements to Perform Agreed- upon Procedures regarding Financial Information'.

4.4 The auditor of a Chit Fund business is required to be conversant with the requirements of all the above AASs. However, in the following sections, some of the key aspects covered by some of the important AASs, as applicable to the audit of a Chit Fund business, keeping in view the special characteristics of such businesses, are discussed in brief. While applying an AAS in a practical situation, reference should be made to the original text of the AAS.

OBJECTIVE OF AUDIT

4.5 Paragraphs 2 and 3 of the Auditing and Assurance Standard (AAS 2), issued by the Institute of Chartered Accountants of India on, 'Objective and Scope of the Audit of Financial Statements', state as below:

"2. The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements.

3. The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise."

4.6 The users of the financial statements of a Chit Fund enterprise are mostly the owners of the business, the subscribers to the Chit and other statutory authorities such as the Reserve Bank of India, Registrar of Chits, Income-tax Department etc. The objective of audit of financial statements is to provide the opinion of the auditors to these users as to whether the financial statements give a true and fair view of financial position and operating results of the enterprise.

PLANNING THE AUDIT

4.7 Paragraphs 12, 13 and 14 of the Auditing and Assurance Standard (AAS) 1, 'Basic Principles Governing an Audit', issued by the Institute of Chartered Accountants of India, state as below:

"12. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on a knowledge of the client's business.

13. Plans should be made to cover, among other things:

(a) acquiring knowledge of the client's accounting system, policies and internal control procedures;

(b) establishing the expected degree of reliance to be placed on internal control;

(c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and

(d) coordinating the work to be performed.

14. Plans should be further developed and revised as necessary during the course of the audit."

4.8 The business of Chit Fund involves handling of money belonging to the public, as stated earlier. Before starting the audit, the auditor should obtain knowledge about the business of the enterprise. As the business of Chit Fund is regulated, it is likely that there is not much diversity in the activities undertaken by different enterprises carrying on Chit Fund business. The work should be planned by the auditor considering the volume of Chits conducted. The knowledge of the business obtained at various stages would be very useful in performing various audit procedures. For detailed guidance on the subject, reference may be made to the Auditing and Assurance Standards (AAS) 8, 'Audit Planning', and AAS 20, 'Knowledge of the Business', issued by the Institute of Chartered Accountants of India.

EVALUATION OF ACCOUNTING SYSTEM AND RELATED INTERNAL CONTROLS

4.9 Paragraph 7 of the Auditing and Assurance Standard (AAS) 2, 'Objective and Scope of the Audit of Financial Statements', issued by the Institute of Chartered Accountants of India, states as below:

> "7. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:
>
> (a) making a study and evaluation of accounting systems and internal controls on which he wishes to rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures; and
>
> (b) carrying out such other tests, enquiries and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances."

4.10 Special consideration should be given to the internal control system operating in a Chit Fund enterprise. It assumes great importance due to the volume of transactions and involvement of monetary items in the case of a Chit Fund. Reference should be made to the section dealing with 'Internal Control Aspects' of Chapter 3 of this Technical Guide and the Auditing and Assurance Standard (AAS) 6 on 'Risk Assessments and Internal Control' (Revised June, 2002), for this purpose.

4.11 In addition to the evaluation of internal control system, an understanding of the accounting system also should be obtained by the auditor. Paragraph

19 of AAS 6 states as below:

> **"19. The auditor should obtain an understanding of the accounting system sufficient to identify and understand:**
>
> **(a) major classes of transactions in the entity's operations;**
>
> **(b) how such transactions are initiated;**
>
> **(c) significant accounting records, supporting documents and specific accounts in the financial statements; and**
>
> **(d) the accounting and financial reporting process, from the initiation of significant transactions and other events to their inclusion in the financial statements."**

4.12 The Chit Fund auditor should acquire knowledge of the accounting system followed by the enterprise before determining the nature, timing and extent of audit procedures. This knowledge can be had from:

- going through the accounting manuals, if any, of the enterprise;
- performing walk-through tests, i.e., tracing a few transactions through the accounting system;
- inspection of documents and records produced by the accounting and internal control systems; and
- inquiries and discussions with management and staff of the enterprise.

4.13 As the business of Chit Fund involves dealing in monetary items in large magnitude, the system is prone to frauds and misappropriations. Frauds and misappropriations occur generally in a Chit Fund in the following forms:

- Misappropriation of cash and negotiable instruments received from the subscribers of the Chit ;
- Misappropriation of securities deposited by prized subscribers with the Chit Fund enterprise as security for future payments of instalments;
- Deposit of fake documents and title deeds with the Chit Fund as security for payment of prize money.

4.14 In most of the above cases, the frauds or misappropriations are the result of collusion and lack of internal controls. Therefore, an understanding of the ways in which controls operate in the Chit Fund enterprise should be obtained by the auditor. With regard to the auditor's duties and responsibilities in respect of fraud and error, reference should be made to Accounting and Assurance Standard (AAS) 4 (Revised), on 'The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements'.

4.15 An audit programme should be prepared in advance before starting the work. The auditor may also be required to amend the audit programme in order to expand the substantive procedures in the light of experience gained during the course of the audit. The audit programme should be reviewed every year.

AUDIT PROCEDURES RELATING TO SPECIFIC AREAS

4.16 The audit procedures which the auditor should perform with respect to items which are specifically related to the business of Chit Funds are dealt with hereinafter.

Foreman's Commission

4.17 As stated earlier, the Foreman's commission is the main source of revenue for a Chit Fund business. Hence, verification of the same assumes greater significance. Foreman's commission is a fixed amount in a Chit and accrues evenly through the period of duration of the Chit. The amount of Foreman's commission is specified in the Chit agreement. The Foreman's commission is recognised as revenue at the time when the prized subscriber is determined by auction or by draw. The auditor should verify the minutes of the proceedings of each draw/auction. The prize amount is paid to the subscriber after deducting discount including foreman's commission and executing the necessary documents. With regard to the verification of the prize amount, reference may be made to the paragraphs 4.31 to 4.36.

4.18 As an overall test, the auditor can verify the total amount of the Foreman's commission recorded in the books of account by multiplying the amount of the Foreman's commission per ticket by the total number of tickets in respect of which prized subscribers have been determined during the year. If the amount arrived at as per this calculation agrees with the amount shown in the books of account, the auditor may not perform detailed audit procedures to verify the same. In addition, the auditor may also perform various analytical review procedures for verification of overall revenue generated from the

Foreman's commission. One of the analytical review procedures applied by the auditor is a comparison of revenue from the Foreman's commission with the previous year's corresponding figures. While applying such procedures, the auditor should consider the details of Chits started and terminated during the year and their impact on the revenue of the enterprise.

Default Interest

4.19 Default interest is the amount of interest realised from the subscribers for default in remitting instalments on time. The rate of interest is mentioned in the Chit agreement. In many cases, the Foreman may, at his discretion, and depending upon the subscriber, waive collection of such interest. To satisfy himself about the correctness of the amount of default interest, the auditor should examine that there is a system to ensure that the receipts are not back-dated. In this regard, the procedure for issue of receipts against the instalment payments should be examined by the auditor to ensure that no receipt is issued without authorisation by at least two persons. In the manual system of accounting, counterfoils of receipts issued may serve as a basis for such verification. In an EDP environment, the auditor should ensure that the system of issuing receipts is designed in such a way that default interest is calculated at specified rates and included in the instalment amount when receipts are issued. He should also ensure that interest is not recognised as revenue until the uncertainty regarding its receipt is removed. In many cases, the uncertainty is removed and revenue is recognised when the interest is actually received.

4.20 The auditor should perform a test check of the calculations of the default interest collected so as to satisfy himself that the system is free from calculation errors. He should satisfy himself that the interest is waived only with proper authorisation. In addition to the above tests, analytical procedures, such as comparison with the previous year's corresponding figures, may be performed so as to form an overall opinion. While conducting such analytical procedures, the auditor should take into account the changes in the rate of interest, if any.

Terminated Chits

4.21 The auditor may carry out the following procedures in respect of the terminated chits:

- Verify whether the termination of the Chit is in accordance with section 40 of the Chit Funds Act, 1982.

- Verify that all transactions in respect of terminated Chits have been recorded in the relevant ledger;
- Verify that all terminated Chits are included in the statement of terminated chits prepared by the management;
- Obtain separate trial balances in respect of all Chits terminated during the year;
- In respect of dues found unrealisable on termination of a Chit, if the said dues are written off, the auditor should verify whether such a write off has been made after obtaining approval of the board of directors or a similar controlling authority. Reference may be made to the minutes book of the board or the other authority, if any, for this purpose;
- Examine whether the amount realised from the securities is properly dealt with.

Interest on Loans & Advances

4.22 The surplus funds with a Foreman may be utilised for granting temporary loans/advances to subscribers on the security of subscriptions paid by them. The Foreman may charge a fixed rate of interest on these loans/advances.

4.23 The auditor should obtain an understanding of the policy of the Chit Fund enterprise regarding charging of interest. The auditor should conduct a test check of the interest calculations to establish their correctness. In addition to the above procedures, the auditor may perform analytical review procedures such as comparison with the corresponding figures for the previous year. While using such procedures, the auditor should take note of changes in the rates of interest, if any, and changes in the amount of loan from the previous year.

Audit of Expenses

4.24 The expenses incurred by a Chit Fund are mostly administrative expenses such as salaries, printing and stationery, rent, postage and telephone, advertisement, travelling, etc. In addition to the aforesaid expenditure, various expenses such as Chit canvassing commission, interest on Chit security deposits, litigation expenses, etc., are also incurred. The auditor should verify these expenses using normal auditing procedures as performed in the case of other entities. Reference may be made to the Guidance Note on Audit of

Expenses, issued by the Institute of Chartered Accountants of India, in this regard.

Liability to Non-prized subscribers

4.25 Non-prized collections represent the instalments collected from non-prized subscribers. As mentioned in Chapter 3, 'Accounting and Control Aspects', every Chit conducted by the Foreman would have separate day book and a ledger. A schedule of balances standing in the accounts of all non-prized subscribers is extracted from the ledger. The auditor should check the accuracy of the schedule by comparing it with the ledger on a sample basis. In case of disagreement between the schedule and the ledger, he should verify the reconciliation prepared by the Foreman in this regard.

Discount

4.26 The auditor should scrutinise the discount account, to satisfy himself that all discounts foregone by the prized subscribers are credited to this account. In the case of fixed discount, the amount of discount foregone by all the prized subscribers would be identical whereas in the case of auction discount, the amount of discount may vary from auction to auction. The amount of fixed discount can be verified from the Chit agreement of the relevant Chit. In the case of auction discount, the discount can be verified from the minutes of the proceedings of each draw/auction. The amount of discounts can also be verified from the Document Register in which, in many cases, the details of auction discount and fixed discount corresponding to the documents executed are recorded. In case the auditor resorts to verifying the credits in these accounts from the Document Register, he should first ensure that entries in the Document Register are properly recorded, by verifying the same with the documents executed in favour of the Foreman.

4.27 The auditor should also ensure that the debits in the discount account representing transfers to the distributable discount account or to the accounts of prized and non-prized subscribers are in respect of those subscribers who are eligible for these discounts as per the Chit agreement. Conventionally, these transfers are normally made by way of a single consolidated entry. The amount of such transfer can be verified from the list of subscribers who are eligible for such discounts. The auditor should satisfy himself that the transfer entries in respect of these discounts from the 'discount account' or the 'distributable discount account' are passed properly by verifying the subscribers' accounts in the ledger on a sample basis.

Chit Security Trust Money/Chit Security Deposit

4.28 The portion of the prize money retained by the Foreman as security against the payment of future instalments before paying the prize money is called Chit Security Trust Money or Chit Security Deposit. This deposit carries interest which may vary from time to time. Generally, a control account is maintained by the Foreman in the ledger in respect of this deposit. Apart from the control account, subsidiary registers/ledgers are also maintained wherein in addition to the details of deposit such as the name of the depositor, amount, etc., details are also provided for interest accrued, paid, etc. The auditor should satisfy himself about the movement of funds in the deposit accounts including interest thereon.

4.29 The auditor should evaluate the internal controls over the deposits, especially examining whether the deposit receipts are issued serially and all of them are recorded in the relevant register. The auditor should satisfy himself that proper control exists over unused forms of deposit receipts.

4.30 The auditor should verify the schedule of deposits with reference to the relevant register. The auditor should also examine, on a sample basis, the register with the counterfoils of the receipts issued and with the discharged receipts returned to the Chit Fund enterprise, if any. The reconciliation of the subsidiary records with the related control account should also be examined by him. The auditor should also examine whether provision has been made for interest accrued on the deposit upto the date of the balance sheet.

Payment of prize money

4.31 In carrying out the audit of the prize amount paid during the year, the auditor may perform the following audit procedures:

- Study and evaluation of internal control system relating to disbursement of prize amounts;
- Examine the validity of recorded amounts;
- Examine the documentation in respect of payment of prize amounts; and
- Examine the existence, enforceability and valuation of the security.

Evaluation of internal controls relating to payment of prize money

4.32 The auditor should evaluate the efficacy of various internal controls over the payment of prize money in order to determine the nature, timing and extent of his audit procedures. Reference may be made to paragraph 3.44 of chapter 3 with regard to aspects of internal control system for disbursement of prize money.

Examining the validity of recorded amounts

4.33 The auditor should obtain a schedule of prized subscribers in each Chit, extracted from the concerned ledger. He should also test check the balances in schedules with the ledgers to ensure the accuracy of schedules.

Examination of documents

4.34 The nature and type of documents relating to payment of prize money would depend upon the legal status of the subscriber and the nature of security offered. Thus, where the subscriber is a company, documents include certificate of incorporation, memorandum and articles of association, copies of board resolution, etc. Where the subscriber is a partnership firm, the documents include a copy of partnership deed. In case the security is in the form of mortgage, the mortgage deed (in the case of English Mortgage), letter of interest to create mortgage (if the mortgage is Equitable Mortgage) should be submitted. If the subscriber is a company, the evidence of registration of charges should also be submitted. In most of the Chit Fund enterprises, there would be a set of rules regarding the documents to be submitted by various kinds of subscribers offering various kinds of securities. Also, there would be pre-printed forms for documents to be executed. The adequacy of the documents should be examined by the auditor in the context of the rules framed by the Chit Fund enterprise in this regard. The auditor should also satisfy himself that the documents executed are complete and in force.

Verification of Securities

4.35 Section 31 of the Chit Funds Act, 1982, requires that a prized subscriber shall furnish sufficient security for the due payment of all future subscriptions to the Foreman before payment of the prize amount. Therefore, the auditor should verify whether the future receivables in respect of the prized Chits are adequately secured by the Chit enterprise. Various types of securities are accepted by a Foreman for the payment of the prize amount. An illustrative list of various securities accepted and the procedure for verifying them is given below:

(a) *Immovable Property:* The auditor should inspect the title deed, no-encumbrance certificate, the solicitor's opinion taken by the Foreman in respect thereof and the mortgage deed. For valuation, the auditor may rely upon the valuer's or the architect's certificate (which should be taken at reasonable intervals) after carrying out appropriate audit procedures to satisfy himself about the adequacy of the architect's/valuer's work for this purpose. In this context, reference should be made to AAS 9, *Using the Work of an Expert,* issued by the Institute of Chartered Accountants of India. Where the prize amount is paid on the security of a property not in the name of the subscriber, the auditor should examine the interest of the subscriber in the mortgaged property. Power of attorney, no objection certificate from the person in whose name the property is presently registered, etc., will serve as evidence for the right of interest of the subscriber in the property mortgaged.

(b) *Life Insurance Policies:* The auditor should inspect the policies and examine whether they are assigned to the Chit Fund enterprise and whether such assignment has been registered with the insurer. The auditor should also examine whether premium has been paid on the policies and whether they are in force. Certificate regarding surrender value obtained from the insurer should be verified. He should particularly satisfy himself that if the surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

(c) *Bank Deposit Receipts, National Savings Certificate, etc.:* The auditor should inspect these documents and examine whether the lien of the Foreman is noted on the face of the document. He should also satisfy himself that the deposits have not matured on the balance sheet date.

(d) *IVP, KVP*: These securities are fully transferable and, hence, the auditor should evaluate the control system in the Chit Fund enterprise for keeping them in safe custody. He should verify these securities in the presence of a responsible official and satisfy himself that they have not matured on the balance sheet date.

(e) *Chit Security Trust Money*: The auditor should inspect the relevant documents and examine whether they have been properly discharged. He should also satisfy himself that the lien of the Foreman is noted on the face of the relevant document as well as in the relevant deposit register.

(f) *Third Party Guarantees:* The auditor should examine the guarantee bonds and the demand promissory notes in order to verify the third party liability. He should verify that the guarantee is in force on the date of the balance sheet. He should satisfy himself that the guarantee is a continuing one.

(g) *Subscriptions to other Chits:* In case where the subscriber is having more than one Chit under the same scheme or other Chits under different schemes, he can offer any of the non-prized Chits on which he has remitted instalments in time, as security towards the prized Chit. In this case, the auditor should satisfy himself with regard to appropriate documentation, such as, whether the pass book issued to subscribers contains endorsements of such security.

4.36 Apart from the above, the auditor may also carry out appropriate analytical review procedures to assess the overall reasonableness.

Loans and Advances

4.37 The Foreman is entitled to utilise the moneys collected in Chit business by way of giving loans or advances to non-prized subscribers based on the payments they have made in a Chit scheme. These loans carry interest as may be determined from time to time by the Foreman. A control account is normally maintained in the general ledger of the Foreman, apart from the relevant registers/subsidiary ledger. The auditor should obtain an understanding of the policy of the Chit Fund in granting loans and advances on this account. The auditor should satisfy himself that all loans have been advanced according to the policy framed by the enterprise in this regard and are disbursed with the sanction of the appropriate authority. He should obtain a schedule drawn from the relevant ledger and verify whether the total of the schedule agrees with the control account in the general ledger. In case of any difference, reconciliation of the same provided by the management should be verified. He should also satisfy himself that payment of prize money, in respect of the Chit pledged and loan availed thereagainst, is made only after adjusting the loan amount.

Default in Chit instalment payment

4.38 With regard to defaults in Chit instalment payments, the auditor has to satisfy himself that the dues have not become time barred. In this context, the auditor may consider the requirements specified in section 65 of the Chit Funds Act, 1982, as reproduced below:

"(1) Notwithstanding anything contained in the Limitation Act, 1963 (36 of 1963), but subject to the specific provisions contained in this Act, the period of limitation in the case of a dispute referred to the Registrar under section 64, shall-

(a) if the dispute relates to the recovery of any sum, including interest thereon due to a foreman from a deceased subscriber, be three years, computed from the date on which such subscriber dies or ceases to be a subscriber; or

(b) if the dispute is between a foreman and a subscriber or a past subscriber or the nominee, heir or legal representative of a deceased subscriber, and the dispute relates to any act or omission on the part of either party to the dispute, be three years from the date on which the act or omission with reference to which the dispute arose, took place.

(2) The period of limitation in the case of any dispute other than those referred to in sub-section (1) which are required to be referred to the Registrar under section 64 shall be regulated by the provisions of the Limitation Act, 1963 (36 of 1963), as if the dispute were a suit, and the Registrar, a civil court.

(3) Notwithstanding anything contained in sub-section (1) and (2), the Registrar may admit a dispute after the expiry of the period of limitation specified therein, if the applicant satisfies the Registrar that he has sufficient cause for not referring the dispute within such period."

REQUIREMENTS UNDER COMPANIES (AUDITORS' REPORT) ORDER, 2003

4.39 The Companies (Auditor's Report) Order, 2003, prescribes the matters to be reported upon by the auditors of companies including the companies carrying on Chit Fund business.

This Order came into force on the 1st day of July, 2003. The auditor should refer to the Statement on the Companies (Auditor's Report) Order, 2003, issued by the Institute of Chartered Accountants of India, for his duties in this regard.

ILLUSTRATIVE AUDIT CHECKLIST

4.40 An illustrative audit checklist has been given in Appendix IV with a view to guide the auditor of a company carrying on Chit Fund business.

Appendix I

List of Accounting Standards Mandatory* in respect of accounting periods commencing on or before March 31, 2004

S.No.	Accounting Standard (AS) No.	Title of the Accounting Standard	Date from which mandatory (accounting periods commencing on or after)	Mandatory[1]
1.	AS 1	Disclosure of Accounting Policies	1-4-1991 – for companies governed by the Companies Act, 1956, as well as for enterprises other than those specified in Note 1. 1-4-1993 – for all enterprises, including those specified in Note 1.	for all enterprises
2.	AS 2 (Revised)	Valuation of Inventories	1-4-1999	for all enterprises
3.	AS 3 (Revised)	Cash Flow Statements	1-4-2001	See Note 2

* The mandatory status of an Accounting Standard implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from an Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

[1] With regard to the applicability of accounting standards with effect from 1-4-2004, refer to Appendix II.

4.	AS 4 (Revised)[2]	Contingencies and Events Occurring after the Balance Sheet Date	1-4-1995	for all enterprises
5.	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	1-4-1996	for all enterprises
6.	AS 6 (Revised)	Depreciation Accounting	1-4-1995	for all enterprises
7.	AS 7 (Revised)	Construction Contracts	(See Note 3)	for all enterprises
8.	AS 8*	Accounting for Research and Development	As in case of AS 1 above	for all enterprises
9.	AS 9	Revenue Recognition	As in case of AS 1 above	for all enterprises
10.	AS 10	Accounting for Fixed Assets	As in case of AS 1 above	for all enterprises
11.	AS 11 (Revised 1994)	Accounting for the Effects of Changes in Foreign Exchange Rates	1-4-1995 (See also Note 4)	for all enterprises

[2]Pursuant to AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', becoming mandatory in respect of accounting periods commencing on after 1-4-2004, all paragraphs of AS 4 that deal with contingencies stand withdrawn to the extent covered by present Indian Accounting Standards including AS 29. Accordingly, these paragraphs of AS 4 are applicable to the extent not covered under present Indian Accounting Standards including AS 29. For example, the impairment of financial assets, such as impairment of receivables (commonly known as provision for bad and doubtful debts), would continue to be governed by AS 4, till the issuance of the proposed Accounting Standard on Financial Instruments: Recognition and Measurement.

*AS 8 stands withdrawn with effect from the date AS 26, 'Intangible Assets', becomes mandatory for the concerned enterprises (See Note 11 to this Table).

12.	AS 12	Accounting for Government Grants	1-4-1994	for all enterprises
13.	AS 13	Accounting for Investments	1-4-1995	for all enterprises
14.	AS 14	Accounting for Amalgamations	1-4-1995	for all enterprises
15.	AS 15	Accounting for Retirement Benefits in the Financial Statements of Employers	1-4-1995	for all enterprises
16.	AS 16	Borrowing Costs	1-4-2000	for all enterprises
17.	AS 17	Segment Reporting	1-4-2001	See Note 2
18.	AS 18	Related Party Disclosures	1-4-2001	See Note 2
19.	AS 19	Leases	In respect of all assets leased during accounting periods commencing on or after 1-4-2001	for all enterprises
20.	AS 20	Earnings Per Share	1-4-2001 (See also Note 5)	See Note 5
21.	AS 21	Consolidated Financial Statements	1-4-2001 (See also Note 6)	See Note 6
22.	AS 22	Accounting for Taxes on Income	See Note 7	See Note 7
23.	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements	1-4-2002 (See also Note 8)	See Note 8
24.	AS 24	Discontinuing Operations	See Note 9	See Note 9

25.	AS 25	Interim Financial Reporting	1-4-2002 (See also Note 10)	See Note 10
26.	AS 26	Intangible Assets	See Note 11	See Note 11
27.	AS 27	Financial Reporting of Interests in Joint Ventures	1-4-2002 (See also Note 12)	See Note 12
28.	AS 28	Impairment of Assets	See Note 13	See Note 13
29.	AS 29	Provisions, Contingent Liabilities and Contingent Assets	1-4-2004	See Appendix II

Note 1: (a) Sole proprietary concerns/individuals

(b) Partnership Firms

(c) Societies registered under the Societies Registration Act

(d) Trusts

(e) Hindu undivided families

(f) Associations of persons.

Note 2: AS 3, AS 17 and AS 18 have been made mandatory in respect of following enterprises:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

Note 3: The revised standard comes into effect in respect of all contracts entered into during accounting periods commencing on or after 1-4-2003 and is mandatory in nature from that date. Accordingly, Accounting Standard

(AS) 7, 'Accounting for Construction Contracts', issued by the Institute in December 1983, will not be applicable in respect of such contracts.

Note 4: This Standard has again been revised in 2003 and titled as Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates'. The revised Standard (2003) would come into effect in respect of accounting periods commencing on or after 1-4-2004 and would be mandatory in nature from that date. The revised Standard (2003) would supersede AS 11 (1994), except that in respect of accounting for transactions in foreign currencies entered into by the reporting enterprise itself or through its branches before the date the revised AS 11 (2003) comes into effect, AS 11 (1994) would continue to be applicable.

Note 5: AS 20 is mandatory in nature in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India. An enterprise which has neither equity shares nor potential equity shares which are so listed but which discloses earnings per share, should calculate and disclose earnings per share in accordance with AS 20. It has been clarified that every company, which is required to give information under Part IV of Schedule VI to the Companies Act, 1956, should calculate and disclose earnings per share in accordance with AS 20, whether its equity shares or potential equity shares are listed on a recognised stock exchange in India or not.

Note 6: AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.

Note 7: AS 22 comes into effect in respect of accounting periods commencing on or after 1-4-2001. It is mandatory in nature for:

(a) All the accounting periods commencing on or after 01.04.2001, in respect of the following:

   (i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All the enterprises of a group, if the parent presents consolidated financial statements and the Accounting Standard is mandatory in nature in respect of any of the enterprises of that group in terms of (i) above.

(b) All the accounting periods commencing on or after 01.04.2002, in respect of companies not covered by (a) above.

(c) All the accounting periods commencing on or after 01.04.2003, in respect of all other enterprises.

Note 8: AS 23 comes into effect in respect of accounting periods commencing on or after 1-4-2002. AS 23 is mandatory if an enterprise presents consolidated financial statements. In other words, if an enterprise presents consolidated financial statements, it should account for investments in associates in the consolidated financial statements in accordance with AS 23 from the date of its coming into effect, i.e., 1-4-2002.

Note 9: AS 24 will be mandatory in nature in respect of accounting periods commencing on or after 1-4-2004 for the following:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

In respect of all other enterprises, the Accounting Standard will be mandatory in nature in respect of accounting periods commencing on or after 01.04.2005.

Note 10: AS 25 comes into effect in respect of accounting periods commencing on or after 1-4-2002. This Accounting Standard does not mandate which enterprises should present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Accounting Standard.

Note 11: AS 26 comes into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2003 and is mandatory in nature from that date for the following:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

In respect of all other enterprises, the Accounting Standard will come into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2004 and will be mandatory in nature from that date.

In respect of intangible items appearing in the balance sheet as on the aforesaid date, i.e., 1-4-2003 or 1-4-2004, as the case may be, AS 26 has limited application as stated in paragraph 99 of this Standard.

Note 12: AS 27 comes into effect in respect of accounting periods commencing on or after 01.04.2002. In respect of separate financial statements of an enterprise, this Accounting Standard is mandatory in nature from that date. In respect of consolidated financial statements of an enterprise, this Standard is mandatory in nature where the enterprise prepares and presents the consolidated financial statements in respect of accounting periods commencing on or after 01.04.2002.

Note 13: AS 28 will come into effect in respect of accounting periods commencing on or after 1-4-2004 and will be mandatory in nature from that date for the following:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

In respect of all other enterprises, the Accounting Standard will come into effect in respect of accounting periods commencing on or after 1-4-2005 and will be mandatory in nature from that date.

Appendix II

List of Accounting Standards Mandatory* in respect of accounting periods commencing on or after April 1, 2004

Sl. No.	Accounting Standard (AS) No.	Title of the Accounting Standard	Applicability to Level I Enterprises (see Note 1)	Applicability to Level II Enterprises (see Note 1)	Applicability to Level III Enterprises (see Note 1)
1.	AS 1	Disclosure of Accounting Policies	Yes	Yes	Yes
2.	AS 2 (Revised)	Valuation of Inventories	Yes	Yes	Yes
3.	AS 3 (Revised)	Cash Flow Statements	Yes	Not required, but encouraged	Not required, but encouraged
4.	AS 4 (Revised)	Contingencies[1] and Events Occurring After the Balance Sheet Date	Yes	Yes	Yes

* The mandatory status of an Accounting Standard implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from an Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

[1]Pursuant to AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', becoming mandatory in respect of accounting periods commencing on after 1-4-2004, all paragraphs of AS 4 that deal with contingencies stand withdrawn to the extent covered by present Indian Accounting Standards including AS 29. Accordingly, these paragraphs of AS 4 are applicable to the extent not covered under present Indian Accounting Standards including AS 29. For example, the impairment of financial assets, such as impairment of receivables (commonly known as provision for bad and doubtful debts), would continue to be governed by AS 4, till the issuance of the proposed Accounting Standard on Financial Instruments: Recognition and Measurement.

5.	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Yes	Yes	Yes
6.	AS 6 (Revised)	Depreciation Accounting	Yes	Yes	Yes
7.	AS 7 (Revised) (See Note 2 also)	Construction Contracts	Yes	Yes	Yes
8.	AS 8 (withdrawn pursuant to AS 26 becoming mandatory)	Accounting for Research and Development	N.A.	N.A.	N.A.
9.	AS 9	Revenue Recognition	Yes	Yes	Yes
10.	AS 10	Accounting for Fixed Assets	Yes	Yes	Yes
11.	AS 11 (Revised 2003) (See Note 3 also)	The Effects of Changes in Foreign Exchange Rates	Yes	Yes	Yes
12.	AS 12	Accounting for Government Grants	Yes	Yes	Yes
13.	AS 13	Accounting for Investments	Yes	Yes	Yes
14.	AS 14	Accounting for Amalgamations	Yes	Yes	Yes

15.	AS 15	Accounting for Retirement Benefits in the Financial Statements of Employers	Yes	Yes	Yes
16.	AS 16	Borrowing Costs	Yes	Yes	Yes
17.	AS 17	Segment Reporting	Yes	N.A.	N.A.
18.	AS 18	Related Party Disclosures	Yes	N.A.	N.A.
19.	AS 19 (See Note 4 also)	Leases	Yes	Yes {Except paragraphs 22(c), (e) and (f); 25(a), (b) and (e); 37(a), (f) and (g); and 46(b), (d) and (e)}	Yes {Except paragraphs 22(c), (e) and (f); 25(a), (b) and (e); 37(a), (f) and (g); and 46(b), (d) and (e)}
20.	AS 20	Earnings Per Share	See Note 5	See Note 5	See Note 5
21.	AS 21 (See Note 6)	Consolidated Financial Statements	Yes	Yes	Yes
22.	AS 22	Accounting for Taxes on Income	Yes	Yes	Yes
23.	AS 23 (See Note 6)	Accounting for Investments in Associates in Consolidated Financial Statements	Yes	Yes	Yes
24.	AS 24	Discontinuing Operations	Yes	N.A.	N.A.

25.	AS 25	Interim Financial Reporting	Yes	N.A. (See Note 7 also)	N.A. (See Note 7 also)
26.	AS 26 (See Note 8 also)	Intangible Assets	Yes	Yes	Yes
27.	AS 27 (See Note 6)	Financial Reporting of Interests in Joint Ventures	Yes	Yes	Yes
28.	AS 28	Impairment of Assets	Yes (w.e.f. 1.4.2004)	Yes (w.e.f. 1.4.2006)	Yes (w.e.f. 1.4.2008)
29.	AS 29	Provisions, Contingent Liabilities and Contingent Assets	Yes	Yes {Except paragraph 67}	Yes {Except paragraphs 66 and 67}

Notes

Note 1:

The Council, at its 236th meeting, held on September 16-18, 2003, considered the matter relating to applicability of Accounting Standards to Small and Medium Sized Enterprises (SMEs). The Council decided the following scheme for applicability of accounting standards to SMEs. This scheme comes into effect in respect of accounting periods commencing on or after 1-4-2004.

1. For the purpose of applicability of Accounting Standards, enterprises are classified into three categories, viz., Level I, Level II and Level III. Level II and Level III enterprises are considered as SMEs. The criteria for different levels are given below.

Level I Enterprises

Enterprises which fall in any one or more of the following categories, at any time during the accounting period, are classified as Level I enterprises:

(i) Enterprises whose equity or debt securities are listed whether in India or outside India.

(ii) Enterprises which are in the process of listing their equity or debt securities as evidenced by the board of directors' resolution in this regard.

(iii) Banks including co-operative banks.

(iv) Financial institutions.

(v) Enterprises carrying on insurance business.

(vi) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 50 crore. Turnover does not include 'other income'.

(vii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 10 crore at any time during the accounting period.

(viii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

Level II Enterprises

Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

(i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crore. Turnover does not include 'other income'.

(ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crore at any time during the accounting period.

(iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

Level III Enterprises

Enterprises which are not covered under Level I and Level II are considered as Level III enterprises.

The following may also be noted in respect of applicability of Accounting Standards to Small and Medium Sized Enterprises (SMEs):

(i) An enterprise, which does not disclose certain information pursuant to the exemptions/relaxations available to an SME, should disclose the fact.

(ii) Where an enterprise has previously qualified for any exemption/relaxation (being under Level II or Level III), but no longer qualifies for the relevant exemption/relaxation in the current accounting period, the relevant standards/requirements become applicable from the current period. However, the corresponding previous period figures need not be disclosed.

(iii) Where an enterprise has been covered in Level I and subsequently, ceases to be so covered, the enterprise will not qualify for exemption/relaxation available to Level II enterprises, until the enterprise ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an enterprise, which has been covered in Level I or Level II and subsequently, gets covered under Level III.

Note 2: AS 7 (revised 2002) is applicable in respect of all contracts entered into during accounting periods commencing on or after 1-4-2003. In respect of all contracts entered into during accounting periods commencing on or before 31-3-2003, AS 7 (issued 1983) is applicable.

Note 3: AS 11 (revised 2003) comes into effect in respect of accounting periods commencing on or after 1-4-2004 and is mandatory in nature from that date. The revised Standard (2003) supersedes AS 11 (1994), except that in respect of accounting for transactions in foreign currencies entered into by the reporting enterprise itself or through its branches before the date the revised AS 11 (2003) comes into effect, AS 11 (1994) continues to be applicable.

It may be noted that the Institute has issued an Announcement titled 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis

Schedule VI to the Companies Act, 1956'. As per the Announcement[2], the requirement with regard to treatment of exchange difference contained in AS 11 (revised 2003), is different from Schedule VI to the Companies Act, 1956, since AS 11 (revised 2003) does not require the adjustment of exchange differences in the carrying amount of the fixed assets, in the situations envisaged in Schedule VI. It has been clarified that pending the amendment, if any, to Schedule VI to the Companies Act, 1956, in respect of the matter, a company adopting the treatment described in Schedule VI will still be considered to be complying with AS 11 (revised 2003) for the purposes of section 211 of the Act. Accordingly, the auditor of the company should not assert non-compliance with AS 11 (2003) under section 227(3)(d) of the Act in such a case and should not qualify his report in this regard on the true and fair view of the state of the company's affairs and profit or loss of the company under section 227(2) of the Act.

Note 4: AS 19, Leases, comes into effect and is mandatory in nature in respect of all assets leased during accounting periods commencing on or after 1-4-2001.

Note 5: AS 20, Earnings Per Share, comes into effect in respect of accounting periods commencing on or after 1-4-2001 and is mandatory in nature, from that date, in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India.

An enterprise which has neither equity shares nor potential equity shares which are so listed but which discloses earnings per share, should calculate and disclose earnings per share in accordance with this Standard from the aforesaid date. However, in respect of accounting periods commencing on or after 1-4-2004[3], if any such enterprise does not fall in any of the following categories, it need not disclose diluted earnings per share (both including and

[2] For full text of the Announcement, reference may be made to 'The Chartered Accountant', November 2003, pp. 497.

[3] Originally, no exemption was available to an enterprise, which had neither equity shares nor potential equity shares which were listed on a recognised stock exchange in India, but which disclosed earnings per share. It is clarified that no exemption is available even in respect of accounting periods commencing on or after 1-4-2004 to enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India. It is also clarified that this Standard is not applicable to an enterprise which has neither equity shares nor potential equity shares which are listed on a recognised stock exchange in India and which also does not disclose earnings per share.

excluding extraordinary items) and information required by paragraph 48 (ii) of this Standard:

(i) Enterprises whose equity securities or potential equity securities are listed outside India and enterprises whose debt securities (other than potential equity securities) are listed whether in India or outside India.

(ii) Enterprises which are in the process of listing their equity or debt securities as evidenced by the board of directors' resolution in this regard.

(iii) Banks including co-operative banks.

(iv) Financial institutions.

(v) Enterprises carrying on insurance business.

(vi) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 50 crore. Turnover does not include 'other income'.

(vii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 10 crore at any time during the accounting period.

(viii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

Note 6: AS 21, AS 23 and AS 27 (relating to consolidated financial statements) are required to be complied with by an enterprise if the enterprise, pursuant to the requirements of a statute/regulator or voluntarily, prepares and presents consolidated financial statements.

Note 7: AS 25, Interim Financial Reporting, does not require any enterprise to present interim financial report. It is applicable only if an enterprise is required or elects to prepare and present an interim financial report. However, the recognition and measurement requirements contained in this Standard are applicable to interim financial results, e.g., quarterly financial results required by the SEBI.

At present, in India, enterprises are not required to present interim financial report within the meaning of AS 25. Therefore, no enterprise in India is required to comply with the disclosure and presentation requirements of AS

25 unless it voluntarily presents interim financial report within the meaning of AS 25. The recognition and measurement principles contained in AS 25 are also applicable only to certain Level I enterprises since only these enterprises are required by the concerned regulators to present interim financial results.

In view of the above, at present, AS 25 is not mandatorily applicable to Level II and Level III enterprises in any case.

Note 8: AS 26 comes into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2003 and is mandatory in nature from that date for the following:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

In respect of all other enterprises, the Accounting Standard comes into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2004 and is mandatory in nature from that date.

In respect of intangible items appearing in the balance sheet as on the aforesaid date, i.e., 1-4-2003 or 1-4-2004, as the case may be, AS 26 has limited application as stated in paragraph 99 of this Standard.

Appendix III

PART I – Form of Balance Sheet

Liabilities			Assets		
1. Capital			1.Cash		Rs.
Authorised	Rs.		2. Balances with banks: (a) Current account (b) Deposit account	 Rs. Rs.	 Rs.
Issued	Rs.		3. Investments (a) In chits (b) In Government securities (c) Others	 Rs. Rs. Rs.	 Rs.
Paid-up	Rs.	Rs.	4. Share amount due from prized subscribers (a) Secured (b) Unsecured	 Rs. Rs.	 Rs.
2. Reserve Fund		Rs.	5. Arrears due from prized subscribers (a) Secured (b) Unsecured	 Rs. Rs.	 Rs.
3. Deposits		Rs.	6. Amount due in terminated chits: (a) Secured (b) Unsecured	 Rs. Rs.	 Rs.
4. Borrowings		Rs.	7. Chit prize amount paid earlier		Rs.
5. Foreman's liability in tickets prized		Rs.	8. Loans and advances to subscribers		Rs.
6. Prize amount payable		Rs.	9. Litigation expenses		Rs.
7. Defaulted subscribers' amount payable		Rs.	10. Premises		Rs.
8. Advance subscription received		Rs.	11. Furniture and fixture		Rs.
9. Liability to non-prized subscribers (Arrears from non-prized subscribers to be indicated)		Rs.	12. Stamps in stock		Rs.
10. Amount payable in terminated chits		Rs.	13. Other assets		Rs.

11. Auction profit payable to non-prized subscribers		Rs.	14. Profit and loss account		Rs.
12. Other liabilities		Rs.			
13. Profit and loss account		Rs.			
		Rs.			
Total			Total		Rs.
Total chit amounts of the chits in force, i.e., running chits.			Particulars to be specified in respect of amounts shown against 4, 5 and 6. (i) Amounts due from directors or officers of the company or any of them either jointly or severally with any other person. (ii) Amounts due by companies or firms in which the directors of the company are interested as directors, partners or in the case of private companies, as members.		

PART II – Form of profit and loss account

Expenditure		Income	
1. To interest paid on deposits, borrowings, etc.	Rs.	1. By foreman's commission	Rs.
2. To salaries, allowances, bonus and provident fund	Rs.	2. By bonus	Rs.
3. To directors' sitting fees	Rs.	3. By interest	Rs.
4. To rent, taxes, insurance, lighting	Rs.	4. By indivisible income in auction profit	Rs.
5. To law charges	Rs.	5. By rent	Rs.
6. To postage, telegrams and stamps	Rs.	6. By net profit on sale of investments	Rs.
7. To auditors' fees	Rs.	7. By other receipts	Rs.
8. To filing fees	Rs.	8. By loss	Rs.
9. To depreciation and repairs	Rs.		
10. To stationery, printing and advertisement	Rs.		
11. To other expenditure	Rs.		
12. To balance of profit	Rs.		
Total	Rs.	Total	Rs.

Appendix IV

Illustrative Audit Checklist

The following illustrative checklist is suggested in respect of conduct of audit of a company carrying on a Chit Fund business. The suggestions may be considered *mutatis mutandis* by the auditor in the conduct of audit of a Chit Fund enterprise other than a company.

Share Capital

1. Examine whether the authorised and issued share capital stated in the balance sheet are correctly disclosed. For any changes in the amount of share capital, relevant amendments to Memorandum of Association as well as the minutes of the relevant meetings of the shareholders/ board should be examined.
2. Verify that the company carrying on Chit Fund business has not commenced or does not carry on Chit business unless it has a paid-up capital of not less than rupees one lakh.
3. Examine whether all formalities regarding further issue of capital have been complied with.
4. Obtain a schedule of shareholders as contained in the Shareholders Register and examine whether the amount of capital contained in the Register tallies with the share capital amount as disclosed in the balance sheet.
5. Ascertain whether the returns of allotment have been filed with the Registrar of Companies.
6. Verify in respect of calls made during the year that proper resolutions were passed by the board.
7. Examine whether transfers and transmissions have been properly executed and also examine the resolutions of the board in this regard.
8. If any forfeiture of shares is made during the year, verify whether proper accounting treatment and authorisation for the same has been effected. The minutes of the board meeting should be examined in this regard.

Reserves & Surplus

1. Examine whether the company has created and maintained a reserve fund and has transferred, out of the balance of profit of each year as disclosed in its profit and loss account and before any dividend on its shares is declared, a sum equal to not less than ten percent, of such profit, to such reserve.
2. Compare the figures of reserves with the previous year's closing balances. Any additions to the reserves other than from the profit of the current year should be enquired into and got properly explained. Likewise, verify that the company has not appropriated any sum or sums from the reserve fund except with the prior approval of the Registrar.
3. In case of utilisation of reserves for the purpose of issue of capital as bonus shares, proper authorisation of the relevant authority should be verified with reference to the minutes books.
4. Examine whether the share premium account has been utilised only in accordance with the provisions of section 78 of the Companies Act, 1956.
5. Examine whether all additions to and withdrawals from reserves are properly disclosed and authorised by the board.

Dividends – Distribution of Profits

1. Examine whether declaration of dividend is made in compliance with the provisions of section 205 of the Companies Act, 1956.
2. Examine whether proper transfer to reserve fund has been made before declaration of dividend as per the provisions of section 8(3) of the Chit Funds Act, 1982.
3. Verify that capital reserves have not been used for distribution among shareholders as dividend.
4. Examine whether proper transfer to reserves as per the Companies (Transfer of Profit to Reserves) Rules, 1975, has been made before declaring dividend.
5. Verify that the relevant provisions of the Companies Act, 1956, have been complied with in respect of unclaimed dividend.

Non-Prized Collections

1. Obtain a schedule of non-prized collections in respect of each Chit.
2. Test check the schedule with the relevant register.
3. Verify that the prized/auctioned subscribers are not included in the schedule.
4. Examine whether the schedule agrees with the relevant control account in the ledger. In case of any disagreement, obtain proper reconciliation.

Discount

1. Verify the credits to the discount accounts from the respective Chit agreements, documents executed and document registers.
2. Verify whether the amount of discount distributable to subscribers on each instalment has been debited to the discount accounts.
3. Test check the calculations of discount distributed considering the terms and conditions of the concerned Chit agreement.
4. Verify whether any unusual debits are seen in the discount accounts. If any such entries are noticed, obtain proper explanations from the management.

Chit Security Deposits

1. Obtain a schedule of Chit Security Deposits outstanding as on the date of the balance sheet.
2. Test check the schedule with the Security/Trust Money Deposit Register maintained by the company.
3. Verify that the schedule of deposits agrees with the relevant control account in the ledger.
4. Test check the calculations of interest.
5. Examine whether the interest upto the date of the balance sheet has been accounted for properly.
6. Examine whether proper control exists over the issue and discharge of deposit receipts.

7. Verify that the security deposits on auctioned prized Chits are not in excess of future instalments.

8. Verify that the rate of interest on these deposits has not exceeded the restrictions imposed, if any, by the regulating authority, in this behalf.

9 Calculate the overall cost of deposits and compare it with that of the previous years. Enquire material divergence, if any.

Provisions

1. Examine whether in respect of the instalments which have become due on the balance sheet date but not paid by the prized subscribers as well as the instalments which have not become due on the balance sheet date but the prized subscriber has defaulted in respect of the instalments which have become due, a provision has been created or a contingent liability has been disclosed keeping in view the requirements of AS 4.

2. Examine whether all expenses payable as on the date of the balance sheet are fully provided for.

3. Verify the computation of provisions in respect of income tax, employee benefits, etc.

4. In case the provisions are made on the basis of external evidence such as actuarial valuation, bills for expenses etc., examine the relevant supporting documents.

5. Compare the provisions pertaining to the previous year with those of the current year with a view to ascertaining the adequacy of provisions made during the year.

6. Go through the files of income tax, wealth tax, etc., to verify whether the provision is adequate keeping in view the matters pending assessment or dispute.

7. Obtain management representations in respect of adequacy of provisions.

Fixed Assets

1. Obtain a schedule of all assets extracted from the register of fixed assets and verify that the schedule agrees with the relevant control account in the ledger.

2. Examine whether additions/deletions have been properly entered in the register and are supported by proper authorisations.
3. Examine the supporting evidence in respect of all additions and deletions.
4. Examine whether proper accounting treatment has been made in respect of booking of profit/loss on sale/disposal.
5. Examine whether physical verification of fixed assets is conducted at reasonable intervals and necessary adjustments are made in the books in respect thereof. Test check the records of physical verification with the books of account/registers.
6. In case of revaluation, examine whether proper accounting entries have been passed to adjust the value of fixed assets.
7. Check the calculations of depreciation on fixed assets and examine whether the accounting policy followed by the company is followed consistently.
8. Examine whether the rates of depreciation agree with those provided in Schedule XIV to the Companies Act, 1956. In case rates higher than those prescribed in the Schedule have been applied on the basis of bona fide technological evaluation, examine the evidence in this regard.

Investments

1. Obtain a list of investments as on the balance sheet date and compare the same with the register of investments.
2. Verify that the investments made are within the authority of the company, as prescribed in Section 14 of the Chit Funds Act, 1982.
3. Verify whether the transactions for purchase/sale of investments have been effected with the due approval of the relevant authority.
4. Examine whether dividend/interest have been properly accounted for in case of investments purchased or sold ex-dividend/cum-dividend, or cum-interest/ex-interest, as the case may be.
5. Check the calculation of interest income from investments and examine whether all interest income receivable as on the date of balance sheet is correctly reflected in the profit and loss account.

6. Physically verify the investments held in physical form and obtain evidence for investments held in other forms.

7. Obtain representations from the management regarding classification and valuation of investments.

8. Verify whether any investments consisting of shares, debentures and other securities have been sold at a price less than that at which they are purchased for the purpose of reporting under Section 227(1A) (c) of the Companies Act, 1956.

Loans & Advances

1. Obtain a schedule of balances outstanding in this account as on the date of the balance sheet.

2. Test check the entries in the schedule with the relevant register/ledger.

3. Examine whether the balances agree with the relevant control account in the ledger.

4. Examine whether the disbursements of loans are made according to the rules framed by the company in this regard.

5. Verify whether the application form was received, proper documents were executed, and the fact of the lien in favour of the company has been noted.

6. Examine whether proper sanction is obtained for these disbursements.

7. Examine whether a system exists whereby the prize amounts in respect of a Chit is paid only after adjusting the amount of the loan.

8. Test check the calculations of interest. Examine whether the interest receivable upto the date of the balance sheet is duly accounted for.

Cash Balance/Stamps

1. Physically verify cash-in-hand on the balance sheet date. If it is not possible, verify cash at a date closer to the balance sheet date, and examine whether cash in hand on the date of physical verification agrees with the balance on the date of the balance sheet after taking into account subsequent receipts and payments.

2. If it is found that heavy cash balance is maintained, carry out surprise checks during the course of audit to verify that the cash-in-hand agrees with the balance as per the books of account.

3. Ensure that stamps in hand are properly disclosed in the financial statements.

Bank Balance

1. Obtain balance confirmation letters from all banks with which the company is maintaining accounts including the dormant accounts as well as accounts closed during the year.

2. Examine bank reconciliation statements prepared as on the last day of the year. Also examine whether the reconciliation statements are prepared periodically.

3. Verify that post-dated cheques issued by the company for subsequent periods are not accounted for during the year.

4. Examine whether adjustments have been made in respect of cheques that have become stale as at the date of the balance sheet.

5. Ascertain the reasons for long outstanding entries, if any, in the reconciliation statement and examine whether any such items require adjustment/write-off.

6. In case of fixed deposits with banks, verify all deposit receipts/ certificates of fixed deposits with banks, supported by bank advice.

7. Obtain a schedule of deposits and verify that the schedule agrees with the ledger.

8. Verify that the interest receivable on fixed deposits is properly accounted for.

9. Examine whether, in case any temporary overdraft is availed of by pledging the deposit receipts, proper disclosure of the same is made in the financial statements.

Foreman's Commission

1. Review the revenue recognition policy followed by the company with regard to the Foreman's commission.

2. Verify that the Foreman's commission account is credited with the amount of commission in respect of all prizes given during the year.

3. Verify the total amount of the Foreman's Commission recorded in the books of account by multiplying the amount of the Foreman's Commission per ticket by the total number of tickets in respect of which prized subscribers have been determined during the year. Where the two do not tally, the auditor should perform further audit procedures to verify the same.

4. In cases of defaults by non-prized subscribers in the payment of subscription, examine whether the amount due as Foreman's commission has been properly dealt with.

5. Compare the amount of the Foreman's commission with the previous year's figure. If any material difference exists, call for appropriate explanation along with the relevant documents.

Default Interest

1. Verify the counterfoils of receipts issued to subscribers and trace the amount of interest collected to the Chit default interest account.

2. If the system is computerised, check whether the system automatically calculates default interest while issuing receipts.

3. Test check the calculations of interest to verify that interest is calculated properly.

4. In case of waiver of interest, verify that such waiver has proper authorisation.

Terminated Chits

1. Verify whether the termination of the Chit is in accordance with section 40 of the Chit Funds Act, 1982.

2. Examine whether the ledgers in respect of terminated Chits have been updated with transactions executed during the year.

3. Verify that all terminated chits are included in the statement of terminated chits prepared by the management.

4. Obtain separate trial balances in respect of all Chits terminated during the year.

5. Examine in respect of dues found unrealisable on termination of a Chit, if the said dues are written off, whether the write-off has been made after proper authorisation of the controlling authority.

6. In case of any realisation of security, examine whether the amount recovered is properly dealt with.

Administration and Other General Expenses

1. Verify the vouchers of all transactions passed in cash book, day book and journal.

2. Verify that all vouchers are properly authorised and supported by external evidence, to the extent possible.

3. In case of expenses of unusual nature, verify whether adequate authorisation is obtained from the controlling authority.

4. Verify that no expenditure of a capital nature has been debited to an expense account.

5. Examine the expense accounts to ensure that no expenses of personal nature are debited to revenue.

6. Examine whether all expenses payable as on the date of the balance sheet have been properly accounted for and disclosed as liabilities in the balance sheet.

7. Compare the expenses with the corresponding figures of the previous year and examine whether there is any material divergence from the previous year's figures. In case of such divergence, call for necessary explanation and documentation.

8. Compare the expenditure with the budgeted figures and in case of deviations from the budgeted/projected figures, call for necessary explanation and documentation.

Payment of prize money

1. Verify that the prize money is paid after executing necessary documents and that proper entries have been made in the document register. While

verifying the documents executed against the prize money payment, the following points may be verified:

(a) The documents are complete in all respects.

(b) The securities provided by the subscriber are adequate and properly discharged in favour of the company.

(c) Proper sanction is received from the controlling authority in respect of the prize amount payments.

(d) The securities, other than immovable property provided by the subscribers, are kept under joint custody of two officials.

(e) The rules framed by the company in respect of documentation are followed.

(f) Securities are properly valued before execution of documents and at periodic intervals after execution.

General

1. Obtain a list of all Chits conducted by the company till the end of the financial year.

2. Conduct an overall scrutiny of the ledger and verify that (a) no transactions of extraordinary nature have been executed; (b) all items of expenses, income, assets and liabilities have been properly classified; and (c) the accounting entries passed in respect of transactions have been properly recorded.

3. Obtain trial balances in respect of all Chits, both running as well as terminated, as on the date of balance sheet.

4. Trace the Chit trial balances to the consolidated Chit trial balance prepared by the company to verify that balances of all Chits have been included in the consolidation.

5. Examine whether proper returns from branches have been received and incorporated in the financial statements.

6. Examine whether the branch balances have been reconciled with the head office books.

7. Conduct an overall analysis of financial statements with the previous

year's corresponding figures. Enquire into any material divergence and obtain necessary explanation. Verify the documentation of the explanations received.

8. Verify compliance with the accounting standards issued by the Institute of Chartered Accountants of India, wherever applicable.