

---

## **Audit Amendments for IPCC May '15**

---

**Dear Students,**

Due to introduction of Companies Act, 2013, the following chapters of Auditing Subject have changed:

- 1) Company Audit I
- 2) Company Audit II
- 3) Vouching and Verification

Company Audit I and II has changed majorly due to new provisions of Companies Act, 2013 being applicable for Appointment of Auditor, Qualifications and Disqualifications of Auditor, Rights and Duties of Auditor, Books of Account, Financial Statements, Issue of Shares, Board Report etc. Also, reporting requirement of CARO is NOT Applicable under Companies Act, 2013. Chapter IX of Companies Act, 2013 containing Sections from 128 to 138 deals with provision of Accounts of Companies. Chapter X of Companies Act, 2013 containing Sections from 139 to 148 deals with provision of Audit & Auditors.

In Vouching and Verification, the references of Companies Act and e-Forms to be filed with Registrar of Companies have changed.

This Amendment Sheet covers the above three chapters COMPLETELY (not just the changes), revised as per requirements of Companies Act, 2013.

Enjoy Studying. ALL THE BEST

**Regards,  
Niket**

## COMPANY AUDIT - I

### Chapter X of Companies Act, 2013: Audit & Auditors

#### Section Summary

Section of Companies Act, 2013 [Section 139 to Section 148]	
139	Appointment of Auditors
140	Removal, Resignation of auditor and giving of Special Notice [except 2nd proviso to subsection (4) & subsection (5)]
141	Eligibility, Qualifications and Disqualifications of Auditors
142	Remuneration of Auditors
143	Powers and Duties of Auditors and Auditing Standards
144	Auditor not to render certain services
145	Auditors to sign Audit Reports, etc.
146	Auditors to attend General Meeting
147	Punishment for contravention
148	Central Government to specify audit of items of Cost in respect of certain Companies

#### Qualifications and Disqualifications of Auditor [Section 141]

##### Qualifications of an auditor [Section 141(1) & (2)]

- A person shall be eligible for appointment as an auditor of a company **only if he is a chartered accountant** within the meaning of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, only a Chartered Accountant holding the **Certificate of Practice** can engage in public practice.

A firm whereof **majority of partners practising in India are qualified** for appointment as aforesaid may be appointed by its firm name to be auditor of a company. **[Section 141(1)]**

- Where a firm including a limited liability partnership is appointed as an auditor of a company, **only the partners who are chartered accountants shall be authorised to act and sign** on behalf of the firm. **[Section 141(2)]**

#### Illustration 1

Preksha, a member of the ICAI, does not hold a Certificate of practice. Is her appointment as an auditor valid?

#### Answer

**Not Qualified** as per Section 141(1)

**Illustration 2**

State whether appointment can be made in name of firm ABC & Co:

- (i) Partner A & B are CA in Practice but Partner C does not hold COP.
- (ii) Partner A & B are CA in Practice but Partner C is CS.

**Answer**

**Yes**, for both cases as per Section 141(1).

As per Section 141(1), appointment can be made in firm's name when **majority of its partners are qualified** for appointment.

**Illustration 3**

Arulraj is the Sole Proprietor of Arulraj & Co, CA's. Can he be appointed by his Firm Name?

**Answer**

**No** – When Individual CA is appointed as Auditor, appointment should be in his Personal Name.

**Disqualifications of auditors****[Section 141(3) and Rule 10 of Companies (Audit and Auditors) Rules, 2014]:**

The following persons **shall not be eligible for appointment** as an auditor of a company, namely:

**a) a body corporate other than a limited liability partnership** registered under the Limited Liability Partnership Act, 2008;

**b) an officer or employee** of the company;

As per Section 2(59) of Companies Act, 2013, 'Officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

As per Section 2(51) of Companies Act, 2013, 'Key Managerial Personnel', in relation to a company, means:

- the chief executive officer or the managing director or the manager;
- the company secretary;
- the whole-time director;
- the chief financial officer; and
- such other officer as may be prescribed.

**c) a person who is a partner, or who is in the employment (employee), of an officer or employee** of the company;

**d) a person who, or his relative or partner:**

**(i) is holding any security** of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

However, as per Rule 10 of the Company (Audit and Auditors) Rules, 2014, the **relative may hold security** or interest in the company of **face value not exceeding Rs.1,00,000;**

If the relative acquires any security or interest above the prescribed threshold i.e. Rs. 1 Lac, the corrective action to maintain the limits shall be taken by the auditor within 60 days of such acquisition or interest.

In short, person is disqualified if;

- he or his partner holds **any security** of company; **or**
- his relative holds security of **face value exceeding Rs.1,00,000.**

**Example:** Mr. A, a practicing Chartered Accountant, is holding securities of XYZ Ltd. having face value of Rs. 900/-. Whether Mr. A is qualified for appointment as an Auditor of XYZ Ltd.?

**Answer:** Disqualified

**Example:** Mr. P is a practicing Chartered Accountant and Mr. Q, the relative of Mr. P, is holding securities of ABC Ltd. having face value of Rs. 90,000/-. Whether Mr. P is Qualified from being appointed as an Auditor of ABC Ltd.?

**Answer:** Qualified

**Example:** BC & Co. is an Audit Firm having partners Mr. B and Mr. C, and Mr. A the relative of Mr. C, is holding securities of MWF Ltd. having face value of Rs. 1,01,000. Whether BC & Co. is qualified from being appointed as an Auditor of MWF Ltd.?

**Answer:** Disqualified. If Partner is disqualified, then Firm is also disqualified.

- (ii) is **indebted** to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, **in excess of Rs.5 Lacs**; or
- (iii) has **given a guarantee or provided any security** in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, **in excess of Rs.1 Lac**;

#### **Illustration 4**

A, B & C are Partner of Firm ABC & Co. All are CA holding COP. Mr. A holds 100 equity shares of having FV Rs. 1,000.

- 1) Can appointment be made in name of Firm?
- 2) Can appointment be made in personal name of Mr. B & C?
- 3) Mr. B is Partner in BDF & Co. Can BDF & Co be appointed?
- 4) Can appointment be made in personal name of Mr. D.

**Answer**

- 1) No. If Partner is disqualified, then Firm is also disqualified.
- 2) No. As their Partner A is holding shares, B & C are disqualified. (limit to hold upto face value Rs. 1,00,000 is only for relative, not the partner)
- 3) No – As Mr. B is disqualified, Firm is also disqualified.
- 4) Yes. Mr. D's Partner is NOT holding shares, so he is qualified.

#### **Illustration 5**

A, B & C are Partner of Firm ABC & Co. All are CA holding COP. Mr. A's Relative holds 100 equity shares of having face value Rs. 1,01,000.

- 1) Can appointment be made in name of Firm?
- 2) Can appointment be made in personal name of Mr. B & C?
- 3) Mr. B is Partner in BDF & Co. Can BDF & Co be appointed?

**Answer**

- 1) No. As A's relative holds shares of face value more than Rs. 1,00,000, Mr. A is disqualified. So, Firm ABC & Co is also disqualified.
- 2) Yes. Mr. B or his Partner or his Relative does not hold any shares. So, he is qualified.
- 3) Yes. Mr. B is qualified, so in BDF & Co all the Partners are qualified for appointment. So, appointment in name of BDF & Co is valid.

- e) a person or a firm who, whether directly or indirectly, **has business relationship** with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company;

According to Rule 10 of the Companies (Audit and Auditors) Rules, 2014, the term 'business relationship' shall be construed as any transaction entered into for a commercial purpose, **except:**

- (i) commercial transactions **which are in the nature of professional services permitted** to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- (ii) commercial transactions **which are in the ordinary course of business of the company at arm's length price** - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

- f) a person **whose relative is a director or** is in the employment (**employee**) of the **company as a director or key managerial personnel**; (in simple words, person whose relative is a director or key managerial person of the company is disqualified)

- g) a person who is in **full time employment elsewhere**

or

a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment **holding appointment as auditor of more than 20 companies**;

In computing the specified number of audit assignments.

- the number of such assignments, which he or any partner of his firm has accepted whether **singly or in combination** with any other CA in practice or firm of such CAs, shall be taken into account.
- the number of partners of a firm **on the date of acceptance** of audit assignment shall be taken into account.
- a CA in **full time employment elsewhere shall not be taken** into account.

**Note: Ceiling on Tax Audit Assignments:** 60 Tax Audits.

**Example:** ABC & Co. is an Audit Firm having partners Mr. A, Mr. B and Mr. C, Chartered Accountants. Mr. A, Mr. B and Mr. C are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

- (i) Provide the maximum number of Audits remaining in the name of 'ABC & Co.'

**Answer:** 40

- (ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.

**Answer:** Mr. A – 16, Mr. B – 14 and Mr. C – 10.

- h) a person who has been **convicted by a court** of an offence **involving fraud** and a **period of ten years has not elapsed** from the date of such conviction;
- i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in **consulting and specialised services as provided in section 144** (section 144 deals with certain services not to be tendered by auditor).

**Vacation of office by an auditor [Section 141(4)]**

If a person appointed as an auditor of a company incurs any of the disqualifications specified in Section 141(3), he shall be **deemed to have vacated his office**. Such vacation shall be **deemed to be a casual vacancy** in the office of the auditor.

**Auditor not to Render Certain Services [Section 144] (Newly Inserted)**

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be.

But such services **shall not include any of the following services** (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company) namely:

- a) accounting and book keeping services;
- b) internal audit;
- c) design and implementation of any financial information system;
- d) actuarial services;
- e) investment advisory services;
- f) investment banking services;
- g) rendering of outsourced financial services;
- h) management services; and
- i) any other kind of services as may be prescribed **(no services prescribed so far)**.

Explanation: For the purposes of this sub-section, the term 'directly or indirectly' shall include rendering of services by the auditor,

- (i) in case of auditor being an individual,
  - either himself or
  - through his relative or
  - any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;
- (ii) in case of auditor being a firm,
  - either itself or
  - through any of its partners or
  - through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

However, an **auditor** or audit firm **who or which has been performing any non-audit services** on or before the commencement of this Act **shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.**

**We must note that:**

**Whether a Former Employee of the Company be appointed as Auditor?**

Yes. But as per ICAI notification there is a Cooling Period of 2 years required. In simple words, after he leaves the company as an employee, he cannot be auditor of **that company** for 2 years.

**Whether a Non-Executive Director of the Company be appointed as Auditor?**

No. Non-Executive Director is covered under the term Officer.

**Whether a Person who is Relative of Director or Employee of the Company be Appointed as Auditor?**

If Relative is Director - No;

If Relative is Employee other than KMP - Yes.

**Can a Chartered Accountant be given a Normal Credit Period for Goods from Company in which he is Auditor?**

No. Purchase of goods / services on credit (which is normally allowed by company to everyone) from company will be **regarded as indebtness.**

**Can an Auditor be said to be Indebted if he recovers his Fees in Advance?**

Yes, Indebted

**Can an Auditor be said to be Indebted if he recovers travelling and other expenses in Advance?**

Yes, Indebted

**Can he Recover Fees on Progressive Basis?**

Yes. If Auditor collects Fees on Progressive Basis, he is NOT considered as Indebted.

**Can an Statutory Auditor act as a) Internal Auditor; b) Tax Auditor; c) Consultant; d) Liquidator of the same Company?**

- |  |       |
|--|-------|
| a) Internal Auditor                    | - No  |
| b) Tax Auditor                         | - Yes |
| c) Consultant (other than Section 144) | - Yes |
| d) Liquidator                          | - No  |

Regulation 191 of Chartered Accountants Regulations, 1988 allows a CA in practice to be a Liquidator, but he cannot act as Liquidator and Auditor of Company at the same time.



**Illustration 6**

Anurag, a practicing CA, is attending to the tax matters of XYZ Ltd, and for that purpose has to regularly attend to the Company from 10.00 A.M. to 2.00 P.M. on all working days. He is paid Rs. 25,000 p.m. for the same. XYZ Ltd intends to appoint Anurag as its Auditor at the ensuing General Meeting. Advice whether Anurag can accept the appointment.

**Answer**

**Mr. Anurag CAN accept the Appointment if attending Tax Matters is Contract for Services** - An Auditor may render services to the Company in matters relating to Taxation, Finance, Management Consultancy or other related area as long as his contract is a 'contract for services' (retainership) and not a 'contract of service' (employment). There is no prohibition for charging fee on monthly basis towards other services rendered. In the given case, Anurag attends office regularly from 10.00 A.M. to 2.00 P.M. on all working days. It should be seen that he is not bound by the office timings but is attending to tax matters regularly during office working hours according to his own convenience.

**Illustration 7**

'B' owes Rs. 5,01,000 to 'C' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses?

**Answer**

**Disqualified as per Section 141(3)(d)(ii) – Indebted for amount exceeding Rs. 5 Lakh.**

Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not valid because in such a case also the auditor shall be indebted to the company. Either he should tell the company to meet the travelling expenses or should claim reimbursement of the same afterwards. The auditor is entitled to recover fees on a progressive basis only.

**Illustration 8**

Mr. A was appointed as an auditor of X Ltd. to audit the accounts for the five years from 01/04/07 to 31/03/12 in the AGM held on 16.8.2007. Mr. A had indebted to the company for a sum of Rs.6 Lakh as on 1.4.2007, the opening date of the accounting year which had been the subject to his audit. Upon learning that he might be appointed as the auditor, he repaid the amount on 14.8.2007. Is his appointment valid

**Answer**

**Valid** - The relevant date for reckoning disqualification is the date of appointment. Where the person has paid his debt before appointment date, there is no disqualifications.

**Illustration 9**

X, a CA in practice is a Statutory Auditor of MNO Ltd. He purchased a car from the Company under the Hire Purchase Scheme run by the Company on the same terms and conditions as applicable to all other customers, The cash down price of the car is Rs. 8 Lakh. The initial payment of 25% was made on signing the Hire Purchase Agreement and the balance is payable in 24 monthly instalments. Is X disqualified to act as Auditor?

**Answer**

**Disqualified as per Section 141(3)(d)(ii) – Indebted for amount exceeding Rs. 5 Lakh.**



**Illustration 10**

KBC & Co. a firm of Chartered Accountants has three partners, K, B & C; K is also in whole time employment elsewhere. The firm is offered the audit of ABC Ltd. and is already holding audit of 40 companies.

**Answer****Cannot accept as per Section 141(3)(g)**

K is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, and in the given case company is already holding forty audits, therefore, KBC & Co. can't accept the offer for audit of ABC Ltd.

**Illustration 11**

A, a chartered accountant has been appointed as auditor of Laxman Ltd. In the AGM of the company held in September, 2013, which assignment he accepted. Subsequently in January, 2014 he joined B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner.

**Answer****Disqualified as per Section 141(3)(c) – Partner of an Employee**

Section 141(4) provides that an auditor who incurs any of the disqualifications after his appointment, he shall vacate his office as such auditor.

**Illustration 12**

Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2013-2014. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.

**Answer****Disqualified as per Section 141(3)(d)(i) and 141(4)**

Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partner Mr. Hanuman is holding equity shares of its subsidiary.

**Illustration 13**

Mr. Aditya, a practising chartered accountant is appointed as a 'Tax Consultant' of ABC Ltd., in which his father Mr. Singhvi is the Managing Director.

**Answer**

**Qualified** - Mr. Aditya is a 'Tax Consultant' and not a 'Statutory Auditor' or 'Tax Auditor'.

**Illustration 14**

Mr. Fat, auditor of Thin Ltd., has his office and residence in the building owned by Thin Ltd. Mr. Fat has been given 10% concession in rent by the company as compared to other tenants.

**Answer**

**Qualified as per Companies Act, 2013**

As per SA 200, ‘Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing’, In the case of an audit engagement it is in the public interest and, therefore, required by the Code of Ethics, that the auditor be independent of the entity subject to the audit. Unless and until there is direct proof, giving 10% concession in rent does not affect independence of the auditor in expressing his opinion on the audit of Thin Ltd.

**Illustration 15**

Mr. Amar, a Chartered Accountant, bought a car financed at Rs. 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be to even after taking the loan.

**Answer**

**Disqualified as per Section 141(3)(d)(ii) – Indebted for amount exceeding Rs. 5 Lakh.**

**Appointment of Auditors [Section 139]****Appointment of the First Auditor [Sec 139(6)]**

- **The first auditor** of a company, **other than a Government company**, shall be **appointed by the Board of Directors within 30 days from the date of registration** of the company.
- In the case of **failure of the Board** to appoint such auditor, it shall **inform the members** of the company, **who shall within 90 days at an extraordinary general meeting (EGM) appoint such auditor.**
- The first auditor shall hold office till the conclusion of the 1<sup>st</sup> AGM.

**Illustration 16**

Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company.

**Answer**

**Not Valid** – As per Section 139(6) the first auditor or auditors of a company shall be appointed by the Board of Directors and not the Managing Director.

**Illustration 17**

White Star Ltd. was incorporated on 1.8.2009 and Mr. T who is related to the Chairman of the Company appointed as auditor by the Board of Directors in their meeting on 4.9.2009.

**Answer**

**Not Valid** - As per Section 139(6) the first auditor or auditors of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. The question of relative becomes redundant.

**Illustration 18**

M/s Verma & Sharma, Chartered Accountants were appointed as the first auditors of Good Luck Ltd., by virtue of their name being included as auditors in the Articles of Association.

**Answer**

**Not Valid** - As per Section 139(6) the first auditor or auditors of a company shall be appointed by the Board of Directors.

**Appointment of the First Auditor for Government Company [Sec 139(7)]**

- For a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the **CAG within 60 days from the date of registration** of the company.
- In case the **CAG does not appoint** such auditor within the said period, **the Board of Directors** of the company **shall appoint** such auditor **within the next 30 days**.
- In the case of **failure of the Board to appoint** such auditor within the next 30 days, it shall **inform the members** of the company **who shall appoint** such auditor **within the 60 days at an EGM**.
- The auditor so appointed shall hold office till the conclusion of the 1<sup>st</sup> AGM.

**Illustration 19**

The first auditors of Health and Wealth Ltd., a Government company, was appointed by the Board of Directors.

**Answer**

**Not Valid** – As per Section 139(6), it should be appointed by CAG

**Appointment of Subsequent Auditor / Reappointment of Auditor****[Section 139(1) & Rule 3 and 4 of Companies (Audit and Auditors) Rules, 2014]**

- Every company **shall**, at the 1<sup>st</sup> AGM, appoint an individual or a firm (includes LLP) as an auditor of the company.
- The auditor shall hold office from the **conclusion of 1<sup>st</sup> AGM till the conclusion of its 6<sup>th</sup> AGM** (i.e. for 5 years).
- **After** the 1<sup>st</sup> AGM, when any appointment of auditor is made at any AGM, the auditor so appointed shall hold the office till the conclusion of every 6th AGM, with the AGM where he is appointed is count as 1<sup>st</sup> AGM. **(i.e. appointed for 5 years)**.

**Manner and Procedure for Appointment****(Rule 3 of Companies (Audit and Auditor's) Rules, 2014**

- The **competent authority** shall **take into consideration the qualifications and experience** of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

**Competent Authority means:**

- a) A Company which is required to constitute an Audit Committee u/s 177 – Audit Committee
- b) A Company which is not required to constitute an Audit Committee u/s 177 – Board

- It shall have also consider, any order or pending proceeding relating to **professional matters of conduct** against the proposed auditor before the ICAI or any competent authority or any Court.
- It **may call** for such other **information** from the proposed auditor as it may deem fit.
- The **Audit Committee shall recommend the name** of an individual or a firm as auditor **to the Board** for consideration
- If the **Board agrees** with the recommendation of the Audit Committee, it shall further **recommend** the appointment of an individual or a firm as auditor **to the members** in the AGM.
- If the **Board disagrees** with the recommendation of the Audit Committee, it shall **refer back** the recommendation to the committee for reconsideration citing reasons for such disagreement.
- If the **Audit Committee**, after considering the reasons given by the Board, **decides not to reconsider its original recommendation** (continues with the same recommendation and no considering new name),
  - a) If the Board disagrees, it **shall record reasons for its disagreement with the committee and send its own recommendation** for consideration of the members in the AGM; and
  - b) If the **Board agrees** with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.
- The appointment shall be subject to **ratification in every AGM** (i.e. 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup> and 5<sup>th</sup> AGM) by way of passing of an **ordinary resolution**.
- If the appointment is **not ratified** by the members of the company, the **Board of Directors shall appoint another** individual or firm as its auditor or auditors.

[In simple words, if the appointment is not ratified by the members it would amount to casual vacancy, which would be filled by BoD as per section 139(8)].
- **Before the appointment is made, the written consent** of the auditor to such appointment, **and a certificate** from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, **shall be obtained from the auditor**.
- The **Rule 4** of Companies (Audit and Auditors) Rules, 2014 provides the content of the Certificate. According to this, the auditor appointed shall submit a certificate that :
  - a) the individual or the firm, as the case may be, **is eligible for appointment and is not disqualified** for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
  - b) the proposed appointment is **as per the term** provided under the Act;
  - c) the proposed appointment is **within the limits** laid down by or under the authority of the Act;
  - d) the **list of proceedings** against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, **as disclosed in the certificate, is true and correct**.
- The certificate shall also indicate whether the auditor **satisfies the criteria provided in section 141** [section 141 provides provisions on eligibility, qualification and disqualification of Auditor].

- Further, the **company shall inform the auditor** concerned of his or its appointment, **and also file a notice (in the Form ADT-1)** of such appointment **with the Registrar within 15 days** of the meeting in which the auditor is appointed.

**We must note that:**

Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

It is important to know that **in addition to listed companies**, following classes of companies shall constitute an Audit Committee -

- (i) all public companies with a paid up capital of ten crore rupees or more;**
- (ii) all public companies having turnover of one hundred crore rupees or more;**
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.**

Explanation.- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

**Illustration 20**

No AGM was held for the year ended 31st March, 2014, in XYZ Ltd., Ninu is the auditor for the previous 3 years, whether she is continuing to hold office for current year or not.

**Answer**

**Continue as Auditor** – As per Section 139(1), the auditor shall hold office from the conclusion of 1<sup>st</sup> AGM till the conclusion of its 6<sup>th</sup> AGM (i.e. for 5 years). In case the AGM is not held within the period prescribed, the auditor will continue in office till the AGM is actually held and concluded.

**Appointment of Subsequent Auditors in case of Government Company [Sec 139(5)]**

- For:
  - a) a Government company; or
  - b) any other company owned or controlled, directly or indirectly, by the Central Government (CG), or by any State Government (SG) or Governments, or partly by the CG and partly by one or more SG(s),
 the Comptroller and Auditor General of India **(CAG) shall appoint** an auditor duly qualified to be appointed as an auditor of companies under this Act
- The auditor shall be appointed **within a period of 180 days** from the commencement of the financial year. The auditor appointed shall hold office till the conclusion of the AGM. **(i.e. appointed NOT for 5 years)**
- As per section 2(45) of the Companies Act, 2013, a 'Government Company' means a company in which
  - a) not less than 51% of the paid-up share capital is held by the CG or by any SG(s) or partly by the CG and partly by one or more SG(s); **and**
  - b) includes a company which is a subsidiary of a Government company.

**Illustration 21**

Nickson Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nickson Ltd. appointed Mr. P as statutory auditor for the year.

**Answer**

**Not Valid** – As per Section 139 (5), appointment shall be done by CAG.

Ajanta Ltd is a government company as its 20% shares have been held by Central Govt, 25% by U.P. State Government and 10% by M.P. State Govt. Total 55% shares have been held by Central and State governments. Nickson Ltd. is a subsidiary company of Ajanta Ltd. Hence Nickson Ltd. covers in the definition of a government company. Hence the Auditor of Nickson Ltd. can be appointed only by C & AG.

**Filling up casual vacancy [Section 139(8)]:**

- Any **casual vacancy** in the office of an auditor shall:
  - a) in the case of a company **other than** a company whose accounts are subject to audit by an auditor appointed by the CAG, be **filled by the Board of Directors within 30 days**, but if such **casual vacancy** is as a **result of the resignation of an auditor**, such **appointment** shall also be **approved by the company** at a general meeting convened **within three months of the recommendation of the Board** (appointed by Board but approved by shareholders in 3 months).
  - b) in the case of a company whose accounts are subject to audit by an auditor appointed by the CAG, **be filled by the CAG within 30 days**:  
If **CAG does not fill** the vacancy within the said period, **the Board of Directors shall fill the vacancy within next 30 days**.
  - c) The auditor appointed to fill casual vacancy shall hold the office till the conclusion of the next AGM.

**We must note that:**

- 1) The expression 'casual vacancy' has not been defined in the Act. Taking its natural meaning, it stands for a vacancy created by the auditor **ceasing to act after he was validly appointed and the appointment was accepted**.
- 2) When the auditor appointed to fill up a casual vacancy, refuses to accept, the appointment is not fully complete. It shall be deemed that the casual vacancy continues and has not been filled up.
- 3) If the Firm is appointed as Auditor, any reconstitution of the Firm due to admission, retirement, death etc. including change of name of the Firm, will not affect the appointment as Auditor. However, when there is a total reconstruction of the Firm i.e. all the existing partners retire and new partners are admitted such reconstitution would result in casual vacancy amounting other than resignation and the Board can appoint the new reconstituted Firm.

**Illustration 22**

Balu and Vaidya have been carrying on the profession of CA's under the name and style of M/s BV & Co, since 2003 under a deed of Partnership. On 1<sup>st</sup> May 2003 Ramu was introduced as a Partner in M/s BV & Co, on 09.09.2009 under an agreement introducing a new Partner was made and under an agreement dated 12.10.2009 name was changed to M/s BVR & Co. Due to change in name, it is contended by a company X Ltd that the Old Firm ceases to be the Auditors of the company.



**Answer**

**Contention of X Ltd is Not Valid** - Admission of a Partner amounts to Reconstitution of the Firm and it doesn't affect the appointment of Auditor. The Audit Firm should communicate the change in its name to the Company under audit.

**Illustration 23**

M/s Young & Co., a Chartered Accountant firm, and Statutory Auditors of Old Ltd., is dissolved on 1.4.2014 due to differences of opinion among the partners. The Board of Directors of Old Ltd. in its meeting on 6.4.2014 appointed another firm M/s Sharp & Co. as their new auditors for one year.

**Answer**

**Appointment by Board of Directors is Valid but for one year is Not Valid** - As per Section 139(8) stipulates that any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

**Illustration 24**

Mr. A was appointed auditor of AAS Ltd. by Board to fill the casual vacancy that arose due to death of the auditor originally appointed in AGM. Subsequently, Mr. A also resigned on health grounds during the tenure of appointment. The Board filled this vacancy by appointing you through duly passed Board resolution?

**Answer**

**Valid** - Such **appointment** shall be **approved by the company** at a general meeting convened **within three months of the recommendation of the Board**.

**Illustration 25**

At the AGM of ICI Ltd., Mr X was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to give up practice and join industry. State, how the new auditor will be appointed by ICI Ltd.

**Answer**

Section 139(8) of the Companies Act, 2013 deal with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g., death, disqualification, resignation, etc. In the instance case, Mr. X has been validly appointed and thereafter he had resigned.

The law provides that in case a casual vacancy has been created by the resignation of the auditor (as in this case), the Board cannot fill in that vacancy itself, such appointment shall also be approved by the company at general meeting convened within three months of the recommendation of the board and then he shall hold office till the conclusion of the next AGM.

In this case the casual vacancy has been created on account of resignation. Therefore, Board of Directors will have to fill the vacancy within thirty days and such appointment shall be approved by the company at the general meeting within three months of the recommendations of the board. The new auditor so appointed shall hold office only till the conclusion of the next AGM.

The provisions of the Companies Act, 2013 applicable for the appointment of an auditor in place of a retiring auditor would equally applicable in the instant case are given below:



- a) Section 140(4)(i):** Special notice shall be required for a resolution at an AGM appointing as auditor a person other than a retiring auditor.
- b) Section 115:** Special notice is to be given by such number of members:

- (i) holding not less than 1% of total voting power; **or**
- (ii) holding shares on which such an aggregate sum of not exceeding Rs. 5,00,000 has been paid upto the date of the notice.

The notice shall be sent by the members to the company at least seven days before the date of the meeting

- c) Section 140(4)(ii):** On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- d) Section 140(4)(iii):** Representation if any, received from the retiring auditor should be sent to the members of the company.
- e) Section 139:** Before any appointment or reappointment of auditors is made at an AGM, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Section 141(3)(g).
- f)** The incoming auditor should also satisfy himself that the notice provided for under Sections 139 and 140 has been effectively served on the outgoing auditor.

#### **Re-appointment of retiring auditor [Section 139(9)]**

- A retiring auditor may be re-appointed at an AGM, if:
  - a)** he is not disqualified for re-appointment;
  - b)** he has not given the company a notice in writing of his unwillingness to be re-appointed; and
  - c)** a resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

#### **No Auditors appointed at AGM [Section 139(10)]**

**Where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.**

### **Term and Rotation of Auditor [Section 139(2),(3)&(4)]**

#### **Term of Auditor**

#### **[Section 139(2) & Rule 5 of Companies (Audit and Auditors) Rules, 2014]**

- Section 139(2) provides that listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or re-appoint:
  - a)** an **individual** as auditor for more than **one term of five consecutive years**; and
  - b)** an audit **firm** as auditor for more than **two terms of five consecutive years**.
- **Rule 5** of the Companies (Audit and Auditors) Rules, 2014 has prescribed the following classes of companies for the purposes of section 139(2):
  - a)** all **unlisted public companies** having paid up share capital of Rs.10 crore or more;
  - b)** all **private limited companies** having paid up share capital of Rs.20 crore or more;

c) **all companies** having public borrowings from financial institutions, banks or public deposits of Rs.50 crores or more.

**Example :** R Ltd. is a private limited Company, having paid up share capital of rupees 18 crore but having public borrowing from nationalized banks and financial institutions of rupees 72 crore, manner of **rotation of auditor will be applicable**.

- **Cooling off Period:**

a) An **individual** auditor who has completed his term (i.e. one term of five consecutive years) **shall not be eligible for re-appointment** as auditor in the same company **for 5 years from the completion of his term**;

b) An audit **firm** which has completed its term (i.e. two terms of five consecutive years) **shall not be eligible for re- appointment** as auditor in the same company **for five years from the completion of such term**.

**Example:** XYZ Ltd. which is a listed company appoints Mr. R as an auditor in its AGM dated 29th September, 2014. Mr. R will hold office of Auditor from the conclusion of this meeting upto conclusion of sixth AGM i.e. AGM to be held in the year 2019. Now as per Section 139(2), Mr. R shall not be re-appointed as Auditor in XYZ Ltd. for further term of five years i.e. he cannot be appointed as Auditor upto year 2024.

**Example:** XYZ Ltd. which is a listed company appoints M/s R & Associates as an audit firm in its AGM dated 29th September, 2014. M/s R & Associates will hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2019. Now as per Section 139(2), M/s R & Associates can be appointed or re-appointed as auditor for one more term of five years i.e. upto year 2024. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years i.e. upto year 2029.

- Further, as on the date of appointment **no audit firm having a common partner or partners** to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, **shall be appointed** as auditor of the same company for a period of five years.

**Example:** M/s XYZ & Co., is an audit firm having partner Mrs. X, Mr. Y and Mr. Z, whose tenure has expired in the company immediately preceding the financial year, M/s ABZ & Co., is another audit firm in which Mr. Z is a common partner, will also be disqualified for the same company along with M/S XYZ & Co. for the period of 5 years.

- **Transitional period:** Every company, existing on or before the commencement of this Act which is required to comply with provisions of section 139(2), shall comply with the requirements of this sub-section **within 3 years** from the date of commencement of this provision.

**Example:** Mr. R, a Chartered Accountant, is an individual auditor of M/s. B Ltd by last 5 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013), here a break in the term for a continuous period of five years will not be considered as fulfilling the requirement of rotation. Thus, Mr. R can continue the audit of M/s. B Ltd. for another 3 years due to transitional effect, i.e. aggregate period in the same company will be 8 years.

- It is also provided that nothing contained in this sub-section shall prejudice (affect) the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

**Rotation of Auditor**
**[Section 139(3) & (4) and Rule 6 of Companies (Audit and Auditors) Rules, 2014]:**

- **Members** of a company may **resolve** to provide that:
  - a) in the **audit firm appointed** by it, **the auditing partner and his team shall be rotated** at such intervals as may be resolved by members; or
  - b) the audit shall be conducted by **more than one auditor**.
- The Central Government has prescribed **Rule 6** of the Companies (Audit and Auditors) Rules, 2014 for the manner in which the companies shall rotate their auditors.
- For the purpose of the rotation of auditors:
  - a) in case of an auditor (whether an individual or audit firm), **the period** for which the individual or the firm has **held office as auditor prior to the commencement** of the Act **shall be taken into account** for calculating the period of 5 consecutive years or 10 consecutive years, as the case may be;
  - b) **the incoming auditor** or audit firm shall **not be eligible** if such auditor or audit firm is associated with the outgoing auditor or audit firm **under the same network** of audit firms. The term ‘same network’ includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.
  - c) For the purpose of rotation of auditors,-
    - a **break** in the term **for a continuous period of 5 years** shall be considered as **fulfilling the requirement** of rotation;
    - if a **partner**, who is in charge of an audit firm and also certifies the financial statements of the company, **retires** from the said firm **and joins another firm** of chartered accountants, **such other firm shall also be ineligible** to be appointed for a period of five years.
- Where a company has appointed two or more individuals or firms or a combination thereof as **joint auditors**, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, **do not complete their term in the same year**.

**Illustration explaining rotation in case of audit firm**

<b>Number of consecutive years for which an audit firm <u>has been functioning</u> as auditor in the same company</b>	<b>Maximum number of Consecutive years for which the firm <u>may be appointed</u> in the same company</b>	<b>Aggregate period which the firm would complete in the same company</b>
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years

3 years	7 years	10 years
2 years	8 years	10 years
1 years	9 years	10 years

**Illustration 26**

At an AGM of a listed company, Mr. R a retiring auditor after completing the tenure of five consecutive years of his service claims that he has been reappointed automatically, as the intended resolution of which a notice had been given to appoint Mr. P, could not be proceeded with, due to Mr. P's death.

**Answer**

Section 139(2) of the Companies Act, 2013 deals with the term of an Auditor which provides that listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or reappoint an individual as auditor for more than one term of five consecutive years.

As per Section 139(10) of the Companies Act, 2013, where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

Thus, considering Section 139(10), as no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. Thus, the claim of Mr. R is Valid.

**Audit committee's recommendation [Section 139(11)]:**

Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

**Summary of Section 139:**

Section 139(1)	Manner of Appointment
Section 139(2)	Term of Auditor
Section 139(3)&(4)	Rotation of Auditor
Section 139(5)	Appointment of Auditors in case of Government Company
Section 139(6)	Appointment of the First Auditor
Section 139(7)	Appointment of the First Auditor for Government Company
Section 139(8)	Filling up Casual Vacancy
Section 139(9)	Re-appointment of Retiring Auditor
Section 139(10)	No Auditors appointed at AGM
Section 139(11)	Audit Committee's Recommendation

**Remuneration of Auditors [Section 142]**

- The **remuneration** of the auditor of a company shall be **fixed in its general meeting or in such manner** as the company in **general meeting may determine**.
- In the case of **first auditor**, remuneration may be fixed by the **Board**.
- The remuneration shall, in addition to the fee payable to an auditor, **include the expenses**, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him **but does not include any remuneration paid to him for any other service rendered by him** at the request of the company.

**Illustration 27**

Liability of Audit Fees of a Company has been outstanding since last two years. This year after completion of audit, the Auditor informs the Secretary of the Company over phone to bring the cheque of all the 3 years and take delivery of the Audit Report. Discuss briefly the above statement in the context of the right of the Auditor to receive remuneration.

**Answer**

Section 142 of Companies Act, 2103 deals with Remuneration of an Auditor, but does not lay down any mode of recovery of remuneration by an Auditor. An Auditor has right to receive his remuneration after completing his work, that is, submission of the Audit Report. However, the Auditor may also recover his fees on progressive basis.

In the given case, the Audit Fee for the past two years is unpaid. Also, the Auditor has linked the delivery of Audit Report to the receipt of his outstanding fees.

Conclusion:

- a) The Auditor's action in linking delivery of his Audit Report conditional upon receipt of audit fees is not proper in the given case since - (i) he would not performing his duties under the Companies Act, and (ii) such action is not considered part of professional ethics.
- b) The Auditor has to enforce his right to receive remuneration through Court of Law only after submitting his Audit Report.

**Removal and Resignation of Auditor [Section 140]**

**Removal of auditor before the expiry of his term**

**[Section 140(1) and Rule 7 of Companies (Audit and Auditors) Rules, 2014]:**

- The auditor appointed under section 139 may be removed from his office **before the expiry of his term only by a special resolution** of the company **and** after obtaining the **previous (prior) approval of the CG** by making an application in **Form ADT-2** and shall be accompanied with the prescribed fees.
- The **application** shall be made **to the CG within 30 days** of the **resolution** passed by the **Board**.
- The Company shall hold the general meeting within 60 days of receipt of approval of the CG for passing the special resolution.
- **Giving opportunity of being heard (Audi Alteram Partem):** Before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

**Illustration 28**

M/s A & Co., Chartered Accountants, were appointed first auditors of KLM Ltd. by its Board of Directors. The shareholders of the company removed M/s A & Co. before the expiry of their term, by an ordinary resolution in an Extraordinary General Meeting and appointed another auditor in their place. M/s A & Co. have objected that without prior approval of Central Government their removal is illegal.

**Answer**

**M/s A & Co.’s objection is Valid** as per Section 140(1) due to 2 reasons:

- a) Special Resolution is required, NOT Ordinary Resolution;
- b) Prior approval of CG is required.

**Resignation by Auditor [Section 140(2) & (3)]**

- If the **Auditor has resigned** from the company, **he shall file within** a period of **30 days** from the date of resignation, a statement in the **form ADT-3 with the company and the Registrar.**
- In case of government companies or company controlled by CG or SG(s), the auditor shall also file such statement with the **CAG also** along with company and the Registrar.
- The auditor shall **indicate the reasons and other facts** as may be relevant with regard to his resignation, in the statement.
- If the auditor does not comply with aforesaid provision, he or it shall be punishable with fine which shall not be less than Rs.50,000 but which may extend to Rs.5 Lacs.

**Appointing Auditor other than the Retiring Auditor [Section 140(4)]**

**Note:** 2<sup>nd</sup> Proviso to Sec 140(4) and Sec 140(5) of Companies Act, 2013 are still NOT Notified, and so Section 225(3) of Companies Act, 1956 is still applicable.

- If the retiring auditor has not completed a consecutive tenure of 5 years or, as the case may be, 10 years, special notice (**notice from shareholder**) shall be required for a resolution at an AGM appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.
- On receipt of notice of such a resolution, the company shall forthwith **send a copy thereof to the retiring auditor.**
- Where notice is given of such a resolution and the retiring auditor makes with respect thereto **representation in writing** to the company (not exceeding a reasonable length) **and requests its circulation to members of the company,**
- The company shall, unless the representation is received by it too late for it to do so:
  - a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
  - b) send a copy of the representation to every member of the company to whom notice of the meeting is sent.
- If a copy of the **representation is not sent** as aforesaid because it was received too late or because of the company’s default, then:
  - a) the auditor may require that the representation shall be read out at the meeting; and
  - b) a copy thereof shall be filed with the Registrar. **[Section 140(4)]**
- If the **Central Government is satisfied**, on an application by company or any other aggrieved person, that the right is being abused to secure needless publicity for a defamatory matter, the Central Government may order that the **representation may not**



**be circularised or read out;** also that the company's costs on such an application should be paid in whole or in part by the auditor even though he is not a party to the application [**Section 225(3) of Companies Act, 1956**] (still applicable).

### **Illustration 29**

You, the Auditor of A Ltd., have been considered for ratification by the members in the 4<sup>th</sup> general meeting as the sole auditor, where you were one of the joint auditors for the immediately preceding three years and the said joint auditors are not re-appointed.

#### **Answer**

When one of the joint auditors of the previous years is considered for ratification by the members as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors. As per Section 140(4) of the Companies Act, 2013, special notice shall be required for a resolution at an AGM appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years.

Accordingly, provisions of the Companies Act, 2013 to be complied with are as under:

- 1) **Section 140(4)(i):** Special notice shall be required **for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment..**
- 2) **Section 115:** Special notice is to be given by such number of members holding not less than one percent of total voting power or holding shares on which such an aggregate sum of not exceeding five lakh rupees has been paid upto the date of the notice. The notice shall be sent by the members to the company **not earlier than three months but at least 14 days before the AGM date. The said notice has to be sent by company to all the members at least 7 days before the date of the AGM.**
- 3) **Section 140(4)(ii):** On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- 4) **Section 140(4)(iii):** Representation if any, received from the retiring auditor should be sent to the members of the company.

As an auditor, you need to verify whether the above provisions are complied with.

### **Illustration 30**

Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term?

#### **Answer**

As per Section 140(1), an auditor may be removed from office before the expiry of his term, by the company in a general meeting, obtaining the prior approval of the Central Government in that behalf.

**Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence.** Further, in case of conflict of interest the shareholders may remove the auditors in their own interest.

Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval.



On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention.

In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not reappointed after expiry of their term.

### **Powers of Auditors**

- **Access to books of accounts and vouchers:**

- Every auditor of a company shall have a right of access at all times to the books of accounts and vouchers of the company, whether kept at the registered office of the company or at any other place.
- Books and Accounts includes all books, which have any bearing or are likely to have any bearing on the accounts i.e. Financial Books, Statutory Books, Statistical Books, Memoranda Books, etc.
- ‘Voucher’ includes any correspondence, which may in any way serve to vouch the accuracy of accounts.
- The right of access ‘at all times’ implies that an Auditor can inspect the books, accounts and vouchers usually during the normal working hours of the business of the Companies while holding the office of the Auditor.
- The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto. [Section 143(8)]

- **Entitled to have necessary information and explanation:** He shall be entitled to require from the officers of the company such information and explanations as the auditor may consider necessary for the performance of his duties as auditor.

- **Access to record of all its subsidiaries:** The auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

- **Right to report to the members of the company on the accounts examined by him:** The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under

### **Other Powers of Auditor not contained under Section 143(1)**

- **Right to receive notices and to attend general meeting:** The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors [Section 146].

- **Right of Lien**

In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for nonpayment of his dues on account of the work done on the property. On this premise, **auditor can exercise lien on books and documents placed at his possession by the client for non payment of fees, for work done on the books and documents.**

The Institute of Chartered Accountants in England and Wales has expressed a similar view on the **following conditions**:

- a) Documents retained must belong to the client who owes the money.
- b) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
- c) The auditor can retain the documents only if he has done work on the documents assigned to him.
- d) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under **section 128** of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily **make it impracticable** for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act.

**Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.**

### **Illustration 31**

While conducting the audit of a limited company for the year ended 31st March, 2014, the auditor wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor.

#### **Answer**

**Not Valid** - Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit.

### **Illustration 32**

At the AGM of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?

#### **Answer**

Section 143 of the Companies Act, 2013 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the

statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner.

As decided in the famous case of *Newton v. Birmingham Small Arms Co. Ltd*, the statutory duties of the auditor cannot be limited in any way either by the Articles or by the directors or members but a company may extend them by passing a resolution at the general meeting or making a provision in the articles.

Hence any such resolution even if passed by entire body of shareholders is ultra vires and therefore void.

### **Illustration 33**

M/s. Seeman & Co. had been the company auditor for Amudhan Company Limited for the year 2013-14. The company had three branches located at Chennai, Delhi and Mumbai. The audits of branches-Chennai, Delhi were looked after by the company auditors themselves. The audit of Mumbai branch had been done by another auditor M/s Vasan & Co., a local auditor situated at Mumbai. The branch auditor had completed the audit and had given his report too. After this, but before finalization, the company auditor wanted to visit the Mumbai branch and have access to the inventory records maintained at the branch. The management objects to this on the grounds of the company auditor is transgressing the scope of audit areas agreed. Comment.

#### **Answer**

#### **Objection of Management is Not Valid**

Even where the branch accounts are audited by another local auditor, the company auditor has right to visit the branch and can have access to the books and vouchers of the company maintained at the branch office.

### **Duties of Auditors**

#### **Duty of Inquiry [Section 143(1)]:**

The auditor may also inquire into the following matters, namely:

- a) Whether **loans and advances made by the company on the basis of security** have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members;

For example, if the company under audit borrows Rs. 100,000 from a bank @ 15% interest per annum and advances Rs. 90,000 @ 9% interest per annum to a concern in which a director is interested auditor may find this to be prejudicial to the interests of the company

- b) Whether **transactions of the company which are represented merely by book entries** are not prejudicial to the interests of the company;

For example, purchase of a certain quantity of raw materials at a particular rate from its subsidiary company just before its closing of accounts and showing the sale of the same raw materials back to the subsidiary company at a lower rate in next financial year.

- c) Where the **company is not an investment company or a banking company**, whether, so much of the assets of the company, as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company.

- d) Whether **loans and advances made by the company have been shown as deposits**;

- e) Whether **personal expenses** have been charged to revenue account;

For example, if the expenses incurred on marriage of the daughter of director have been charged to the entertainment account in the books of the company, the auditor will have to report this fact.

- f) Where it is stated in the books and papers of the company that **any shares have been allotted for cash**, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading. **[Section 143(1)]**

**We must note that, the auditor is not required to report on the matters specified above unless he has any special comments** to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied.

**Duty to Report [Section 143(2) and (3)]:**

The auditor shall make a report to the members of the company on the following:

- a) On the **accounts** examined by him; and  
b) On every **financial statements** which are required by or under this Act to be laid before the company in general meeting.

The auditor while making the report shall take into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act.

The auditor shall express his opinion of the accounts and financial statements examined by him. He shall express the opinion which according to him and **to the best of his information and knowledge, the said accounts, financial statements give a true and fair view** of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed. **[Section 143(2)]**

**Reporting as per Section 143(3) and Rule 11 of Companies (Audit and Auditors) Rules, 2013**

The **auditor's report shall also state:**

- a) whether he has sought and **obtained all the information and explanations** which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;  
b) whether, in his opinion, **proper books of account as required by law** have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;  
c) whether the **report** on the accounts of any **branch office** of the company audited by a person other than the company's auditor has been **sent to him** and the manner in which he has dealt with it in preparing his report;  
d) whether the company's balance sheet and profit and loss account dealt with in the report are in **agreement with the books** of account and returns;  
e) whether, in his opinion, the financial statements **comply with the accounting standards**;  
f) the **observations or comments** of the auditors on financial transactions or matters **which have any adverse effect** on the functioning of the company;

**g) whether any director is disqualified** from being appointed as a director under **section 164(2)**;

As per provisions of Section 164(2), no person who is or has been a director of a company which:

- has not filed financial statements or annual returns for any continuous period of three financial years; or
- has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

**h) any qualification, reservation or adverse remark relating to the maintenance of accounts** and other matters connected therewith;**i) whether the company has adequate internal financial controls system** in place and the operating effectiveness of such controls;**j) such other matters as may be prescribed.**

Rule 11 of the Companies (Audit and Auditors) Rules, 2014 provides that the auditor's report shall also include their views and comments on the following matters, namely:-

**a) whether the company has disclosed** the impact, if any, of **pending litigations** on its financial position in its financial statement;**b) whether the company has made provision**, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;**c) whether there has been any delay in transferring amounts**, required to be transferred, **to the Investor Education and Protection Fund** by the company.**Duty to State the Reason for Qualification or Negative Report [Section 143(4)]:**

Where any of the matters is **answered in the negative** or with a qualification, the auditor's report shall **state the reason** for the answer.

**Illustration 34**

Y is the auditor of X Pvt. Ltd. In which there are four shareholders only, who are also the Directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Y to accept a reduced fee and for that he has been offered not to carry out such full audit as he has done in the past. Y accepted the suggestions of the directors.

**Answer**

**Not Valid** - There is no concept of full or part audit under Section 143 of the Companies Act, 2013. Further, remuneration is a matter of arrangement between the auditor and the shareholders. Section 142 specifies the remuneration of an auditor, shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

His duties may not necessarily commensurate with his remuneration. Y, therefore, should not accept the suggestions of the directors regarding the scope of the work to be done. Even if Y accepts the suggestions of the directors regarding the scope of work to be done, it



would not reduce his responsibility as an auditor under the law. Under the circumstances, Y is violating the provisions of the Companies Act, 2013.

**Illustration 35**

The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1) of Section 143 of the Companies Act, 2013, as he was satisfied that no comment is required.

**Answer**

**Valid** – As per Section 143(1), if the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied.

**Illustration 36**

The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the auditors report to them.

**Answer**

**Not Valid** – As per Section 143, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. (Allen Graig and Company (London) Ltd. Case)

**Illustration 37**

You are the auditor of Irregular Ltd. during the course of your audit of the accounts of the company for the year ended 31<sup>st</sup> December you come across the following transactions:

- a) The Company has given a loan of Rs.3,00,000 to X, a Supplier of the Company on the security of a Life insurance policy of the Face Value of Rs.6,00,000 and whose Surrender Value as on 31<sup>st</sup> Dec. was Rs.50,000. The Company is in possession of the policy. However, an assignment in favour of Irregular Ltd has not been registered with LIC.
- b) The Company recorded on 31<sup>st</sup> Dec, a sale of goods to the tune Rs.1,00,000 to A & Co. Ltd, a sister concern and recognised a profit of Rs.20,000 for the year ended 31<sup>st</sup> Dec. On 1st January, a purchase of the goods of the same description amounting to Rs.1,00,000 from A & Co. Ltd was found to be recorded.
- c) The Company has sold during the year 200 Shares of Sinking Horizon Ltd, for Rs.20,000. The cost of shares at the time of acquisition was Rs.40,000. It is also noted that during the year, Sinking Horizon Ltd had lost 3 out of 4 ships owned by it in a storm near Alaska. There are definite indications that the Company might go into liquidation.
- d) The Company has given Rs.50,000 to A & Co, a Partnership Firm very remotely connected with one of its senior employees. A & Co. does not customarily accept Deposits. Irregular Ltd does not owe any obligation in respect of A & Co. The above amount of Rs.50,000 has been classified as 'Deposits' in the Company's accounts.
- e) One of the Directors of the Company celebrated the marriage his daughter during the year. Two cars of the Company held been lent to the Director and the Petrol Bills amounting to Rs.12,500 have been paid by the Company.
- f) The Company was owing Rs.50,000 to Mr. R. It issued Equity Shares amounting to Rs.50,000 in liquidation of the above debt.

What are the reporting considerations involved in the above transactions?

**Answer**

The transactions mentioned above are within the scope of enquiry u/s 143(1). The reporting considerations therein are discussed below:

<b>Clauses</b>	<b>Reporting considerations</b>
Loans on inadequate security	<p><b>a)</b> The auditor should ascertain whether the company holds a legally enforceable security and the value of the security fully covers the amount lent.</p> <p><b>b)</b> In this case, the loan of Rs.300000 has been made on the basis of security having a surrender value of Rs.50000 only. Hence the loan is not adequately secured. Also the security cannot be legally enforced since the company has not registered the assignment in its favour</p> <p><b>c)</b> The auditor should report this matter to the members.</p>
Book entry transactions	<p><b>a)</b> In this case, the sale and purchase transactions represented by book entries only (without actual movement of goods) are intended to boost the profits of the company. This causes fictitious profits and is not a genuine transaction.</p> <p><b>b)</b> The auditor should report this matter to the member and also qualify his report since true and fair view of the accounts is affected</p>
Sale of investments below cost	<p><b>a)</b> There is no prohibition for sale of investments below cost. The Auditor should only ascertain that the sale is bonafide and the price realised is reasonable having regard to the Circumstances of the case.</p> <p><b>b)</b> In the given Circumstances, the sale of investments seems to be bonafide as Sinking Horizon Ltd is not in a sound financial position.</p> <p><b>c)</b> Hence, the Auditor shall report this matter to the Members, but it does not attract a qualification, if the Sale/Cost/ Loss on Sale have been accounted for, and disclosed properly.</p>
Classification of deposits	<p><b>a)</b> In this case, A &amp; Co dose not accepts deposits, and also the company has no obligation against A &amp; Co. the amount given to A &amp; Co. should be shown only as 'Loans and Advances'.</p> <p><b>b)</b> The auditor should instruct the company to show the amount as 'Loans and Advances'. If the company refuses a re-classification and continues to show them as 'Deposits', the auditor should report the same to the Members, and also qualify his report due to distortion of 'true and fair view'.</p>
Personal expenses charged to revenue	<p><b>a)</b> In this case, the Personal Expenses of the Director have been clearly charged to the revenue account of the company.</p> <p><b>b)</b> The auditor should report this matter to the Members. Also, if such amount is material, the auditor report should be qualified since true and fair view of profits is affected.</p>
Allotment of shares	<p><b>a)</b> As held in Spargo's Case and confirmed by CLB Circular, the allotment of Shares by a Company to a person in lieu of genuine debt due towards him is regarded as shares issued for cash. The issue of Equity Shares in liquidation of its debt to Mr. R is legal.</p>



	<b>b)</b> Hence, the Auditor has no duty to report in this instance.
--	--

**Illustration 38**

One of the directors of Hitech Ltd. is attracted by the disqualification under Section 164(2) of the Companies Act, 2013.

**Answer**

**Report as per Section 143(3)(g)** - The auditor has to ensure that written representation have been obtained by the Board from each director that one is not hit by Section 164(2).

**Illustration 39**

Mr. X, a Director of M/s KP Private Ltd., is also a Director of another company viz., M/s GP Private Ltd., which has not filed the financial statements and annual return for last three years 2010-11 to 2012-13. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the Companies Act, 2013, and auditor should not mention disqualification remark in his audit report.

**Answer**

**Not Valid** – Section 164(2) applies to all companies, so Auditor should Report as per Section 143(3)(g).

**Illustration 40**

The Statutory Auditors of a Public Limited Company received letters from Shareholders either directly or through the Company seeking information like details of expenses, explanation for not qualifying the report for one reasons or the other, etc. You are required to advise the Statutory Auditor whether under any circumstances they are bound to entertain such letters and give detailed reply to individual Shareholders.

**Answer**

**No.** The Statutory Auditors are appointed by the 'Company', i.e. Body of Shareholders and not by individual Shareholders. The Statutory Auditors are not required to provide any information / explanations to individual Shareholders.

**Duty to Comply with Auditing Standards [Section 143(9), (10)]:**

Every auditor shall comply with the auditing standards. The **CG may prescribe the standards of auditing**, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA):

However, until any auditing standards are notified, any standard or standards of auditing specified by the ICAI shall be deemed to be the auditing standards.

**Illustration 41**

M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised nonprofit organisation feels that the standards on auditing need not to be applied as Goodwill Education Foundation is a non-profit making concern.

**Answer**

As per Section 143(9) of the Companies Act, 2013, every auditor shall comply with the auditing standards. Further as per Section 143(10) of the Act, the CG may prescribe the standards of auditing, as recommended by the ICAI, in consultation with and after

examination of the recommendations made by the National Financial Reporting Authority (NFRA):

However, until any auditing standards are notified, any standard or standards of auditing specified by the ICAI shall be deemed to be the auditing standards.

Further, the Preface to Standards on Auditing gives the scope of the Standards on Auditing. As per the Preface, the SAs will apply whenever an independent audit is carried out; that is, in the independent examination of financial statements/information of any entity; whether profit oriented or not and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.

Also while discharging their attest function; it is the duty of the Chartered Accountant to ensure that SAs are followed in the audit of financial information covered by their audit reports.

In the given case, even though the client is a non-profit oriented entity the SAs shall apply and the auditor shall be guilty of professional misconduct for failing to discharge his duty in case of non-compliance with SAs.

### **Duty to Report on Matters specified by Central Government [Section 143(11)]:**

The **Central Government may**, in consultation with the National Financial Reporting Authority, **by general or special order, direct**, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

### **Duty to Report Frauds**

#### **[Section 143(12) and Rule 13 of Companies (Audit and Auditors) Rule, 2014]:**

- If an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government immediately but not later than 60 days of his knowledge.
- As per Rule 13 of the Companies (Audit and Auditors) Rules, 2014):
  - a) Auditor shall **forward his report to the Board or the Audit Committee**, as the case may be, immediately after he comes to knowledge of the fraud, **seeking their reply** or observations within **45 days**;
  - b) **on receipt of such reply** or observations the **auditor shall forward his report and the reply** or observations of the Board or the Audit Committee alongwith his comments (on such reply or observations of the Board or the Audit Committee) **to the Central Government within 15 days** of receipt of such reply or observations;
  - c) In case the **auditor fails to get any reply** or observations from the Board or the Audit Committee within the stipulated period of 45 days, **he shall forward his report to the Central Government alongwith a note** containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which **he failed to receive any reply** or observations within the stipulated time.
  - d) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.
  - e) The report shall be **on the letter-head of the auditor** containing postal address, e-mail address and contact number and be **signed by the auditor** with his seal and shall **indicate his Membership Number**.

f) The report shall be in the form of a statement as specified in **Form ADT-4**.

- **The provisions of this section i.e. section 143 shall mutatis mutandis apply to:**
  - a) the cost accountant in practice conducting cost audit under section 148; or
  - b) the company secretary in practice conducting secretarial audit under section 204.
- **Penalty for non compliance:** If any auditor, the cost accountant in practice conducting cost audit under section 148 or the company secretary in practice conducting secretarial audit under section 204 do not comply with the provisions of section 143(12) (reporting about the offence to the Central Government), he shall be punishable with fine which shall not be less than Rs.1 Lacs but which may extend to Rs.25 Lacs.

#### **Duty to Sign Audit Report [Section 145]:**

- The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company. If Individual CA is appointed then that Individual should sign and if Firm is appointed then **any Partner of firm who is CA holding COP** should sign.
- The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report **shall be read before the company in general meeting and shall be open to inspection by any member of the company.**

#### **Illustration 42**

Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, working as Manager of Shrivastav and Co., a Chartered Accountant firm, signed the audit report of Om Ltd. on behalf of Shrivastav & Co.

#### **Answer**

**Not Valid** – As per Section 145 only Partner can sign.

#### **Powers / Rights of CAG [Section 143(5), (6) & (7)]**

- The auditor of a Government company is appointed by the CAG under section 139(5) or section 139(7).  
In the case of a Government company, the **CAG shall direct the auditor** appointed by him, the manner in which the accounts of the Government company are required to be audited **and** thereupon the **auditor** so appointed **shall submit a copy** of the audit report **to the CAG**.  
The audit report among other things, include the following:
  - a) the directions, if any, issued by the CAG,
  - b) the action taken thereon and
  - c) its impact on the accounts and financial statement of the company. **[Section 143(5)]**
- The **CAG shall within 60 days** from the date of receipt of audit report have a right to:
  - a) **conduct a supplementary audit** of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or

persons, so authorised, on such matters and in such form, as the CAG may direct; and

**b) comment upon or supplement** such audit report.

Any **comments given by the CAG** upon, or supplement to, the audit report **shall be sent by the company to every person** entitled to copies of audited financial statements under section 136(1) and also be placed before the AGM of the company at the same time and in the same manner as the audit report. **[Section 143(6)]**

- **Test Audit:** For Government Company or Company controlled by CG or SG(s), the CAG may, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company. **[Section 143(7)]**

#### **Audit of Accounts of Branch Office of Company**

**[Section 143(8) and Rule 12 of Companies (Audit and Auditors) Rule, 2014]]**

- **Branch office in India:**  
Where a company has a branch office, the accounts of that office shall be audited either by:
  - a) the company's auditor appointed under section 139, or
  - b) by any other person qualified for appointment as an auditor of the company under section 139.
- **Branch office outside India:**  
If the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by:
  - a) the company's auditor or
  - b) by an accountant or
  - c) by any **other person duly qualified** to act as an auditor of the accounts of the branch office **in accordance with the laws of that country.**
- The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.
- The **branch auditor shall prepare a report** on the accounts of the branch examined by him **and send it to the auditor of the company** who shall deal with it in his report in such manner as he considers necessary.
- As per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.
- Power to appoint Branch Auditor (not main auditor) can be delegated by Shareholders to Board.

**SA 600 on 'Using the Work of Another Auditor', deals with the Principal Auditor's Right and Duties when using the work of Branch Auditor.**

#### **Illustration 43**

XLW has a Branch Office in Malaysia. The Company has appointed Mr. X, who is qualified to audit accounts as per Malaysian Laws. Mr. Z, the Statutory Auditor objects to the same, contending that he alone can audit the Branch Office accounts. Can Mr.Z visit the branch?

**Answer**

**Objection of Statutory Auditor is Not Valid** - Appointment of Mr. X as Branch Auditor is valid. However, Mr. Z can visit the Branch.

**Illustration 44**

Mr. P is the Statutory Auditor of S Ltd which has a branch in Pune. The Company in General Meeting decided to have the accounts of Pune Branch audited by Mr. A who was appointed without Mr. P's knowledge and consent. Comment.

**Answer**

**Appointment is Valid** - Where the Company appoints the Branch Auditor in General Meeting there is no need for consultation with the Statutory Auditor. Need for consultation arises only when the appointment is made by the Board of Directors.

**Illustration 45**

During the year 2013-14, it was decided for the first time that the accounts of the branch office of AAS Company Limited be audited by qualified Chartered Accountants other than the company auditor. Accordingly, the Board had appointed branch auditors for the ensuing year. One of the shareholders complained to the Central Government that the appointments was not valid as the Board of Directors do not have power to appoint auditors, be they Company Auditor or Branch Auditors?

**Answer**

As per Section 143(8) of the Companies Act, 2013, the accounts of a branch office (within India) of a company are required to be audited by either:

- a) The Company's Auditor himself; or
- b) A person qualified for appointment as an auditor under section 139.

When it had been decided that the accounts of the branch may be audited by a person other than company auditor, the shareholders in general meeting should appoint branch auditor. **The shareholders in general meeting, instead of appointing branch auditor, may authorize the board of directors to appoint branch auditors.**

In the present case, the board has appointed branch auditors without obtaining authorization from the shareholders in general meeting. The board had appointed the auditor where it did not have authority to do so. As such, the appointment is invalid. The shareholder's complaint is right.

The branch auditor should ascertain before accepting the audit whether his appointment is valid.

**Summary of Section 143:**

Section 143(1)	Access to Books of Accounts & Duty of Inquiry
Section 143(2),(3) & (4)	Duty to Report
Section 143(5),(6) & (7)	Audit of Government Companies
Section 143(8)	Audit of Accounts of Branch Office of Company
Section 143(9) & (10)	Compliance with Auditing Standards
Section 143(11)	Additional Reporting
Section 143(12)	Reporting of Frauds by Auditors

**Auditor to Attend General Meeting [Section 146]**

- All notices of, and other communications relating to, **any general meeting** shall be forwarded to the auditor of the company.
- The auditor **shall, unless otherwise exempted by company, attend general meeting either by himself or through his authorised representative**, who shall also be qualified to be an auditor. (means authorised representative has to be CA holding COP)
- The auditor shall have **right to be heard** at such meeting on any part of the business which **concerns him** as the auditor.

**Illustration 46**

The Board of Directors of a company have filed a complaint with the Institute of Chartered Accountants of India against their statutory auditors for their failing to attend the AGM of the Shareholders in which audited accounts were considered.

**Answer**

**Valid**, if not exempted by Company – Section 146.

**Illustration 47**

Mr. Budha, Statutory Auditors of Secret Ltd. was not permitted by the Board of Directors to attend general meeting of the company on the ground that his right to attend general meetings is restricted only to those meetings at which the accounts audited by him are to be presented and discussed.

**Answer**

**Action of Board of Directors is Not Valid.**

**Illustration 48**

An auditor became aware of a matter regarding a company, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion.

**Answer**

Section 146 of the Companies Act, 2013 empowers the auditors of a company to attend any general meeting of the company; to receive all the notices and other communications relating to the general meeting, unless otherwise exempted by the company, and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Where the auditor has reason to believe that the directors concealed deliberately a serious fact from the shareholders which came to his note after issuance of the audit report, he should exercise this right. Normally speaking, an auditor considers subsequent events only upto the date of issuance of the audit report.

As per SA 560 on ‘Subsequent Events’, the discovery of a fact after the issuance of the financial statements that existed at the date of the audit report which would have caused the revision of the audit report requires that the auditor may bring this to the notice of shareholders.

Likewise, it may be advisable for the auditor to attend the meeting with a view to bringing to the notice of the shareholders any matter which came to his knowledge subsequent to his signing the report and if it had been known to him at the time of writing his audit report, he



would have drawn up the report differently; or where the accounts have been altered after the report was attached to the accounts.

### **Cost Audit [Section 148 and Rule 14 of Companies (Audit and Auditors) Rule, 2014]**

- The Central Government may, by order,
  - a) in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed;
  - b) direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed;
  - c) shall also be included in the books of account kept under section 128 by that class of companies.
- The Central Government shall, before issuing such order in respect of any class of companies **regulated under a special Act, consult the regulatory body** constituted or established under such special Act.
- If the **Central Government** is of the opinion, that it is necessary to do so, it **may**, by order, **direct that the audit of cost records** of class of companies, which are covered aforesaid and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, **shall be conducted** in the manner specified in the order.
- The cost audit shall be **conducted by a Cost Accountant in practice** who shall be **appointed by the Board** on such remuneration as may be determined by the members in such manner as may be prescribed.
- Rule 14 of the Companies (Audit and Auditors) Rules, 2014 provides that:
  - a) in the case of companies which are required to **constitute an audit committee**:
    - the **Board shall appoint** an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor **on the recommendations of the Audit committee**, which shall also recommend remuneration for such cost auditor;
    - the remuneration recommended by the Audit Committee shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
  - b) in the case of other companies which are **not required to constitute an audit committee**, the **Board shall appoint** an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.
- The auditor appointed under section 139 (i.e. company auditor) shall not be appointed as the Cost Auditor.
- Cost auditor shall **comply with the cost auditing standards**.  
Here, the expression 'cost auditing standards' mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.
- An audit conducted under section 148 shall be **in addition** to the audit conducted under section 143.

- The **qualifications, disqualifications, rights, duties and obligations applicable to auditors** (i.e. applicable to company auditor) **shall, apply to a cost auditor** appointed under section 148 and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.
- The **report** on the audit of cost records shall be **submitted by the cost accountant** in practice **to the Board of Directors (BOD)** of the company.
- A **company shall within 30 days** from the date of receipt of a copy of the cost audit report **furnish the Central Government with** such report along **with full information and explanation on every reservation or qualification** contained therein.
- If, after considering the cost audit report and the information and explanation furnished by the company, the **Central Government** is of the opinion that any further information or explanation is necessary, it **may call for such further information and explanation** and the company shall furnish the same within such time as may be specified by that Government.
- If any **default** is made in complying with the provisions of section 148:
  - a) The company and every officer of the company who is in default shall be punishable in the manner as provided in section 147(1);
  - b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

#### **Punishment for Contravention [Section 147]**

- **Penalty on Company [Section 147(1)]:**

If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than Rs.25,000 but which may extend to Rs.5 Lacs.
- **Penalty on Officers [Section 147(1)]:**

If any of the provisions of sections 139 to 146 (both inclusive) is contravened, every officer of the company who is in default shall be punishable with

  - a) imprisonment upto 1 year or
  - b) With fine which shall not be less than Rs.10,000 but which may extend to Rs.1 Lacs; or
  - c) Both with imprisonment and fine.
- **Penalty on Auditor [Section 147(2) & (3)]:**
  - a) If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than Rs.25,000 but which may extend to Rs.5 Lacs.
  - b) If an **auditor has contravened such provisions knowingly or willfully** with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with
    - **imprisonment** for a term which may extend to 1 year and
    - fine which shall not be less than Rs.1 Lac but which may extend to Rs.25 Lacs.
  - c) Further, where an auditor has been convicted as above, he shall be liable to:
    - **refund the remuneration** received by him to the company; and

- **pay for damages** to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.
  
- The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons. Such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification. **[Section 147(4)]**
  
- **Liability of Audit firm [Section 147(5)]:**  
In case of auditor being an audit firm, the liability, whether civil or criminal shall be of the partner or **partners concerned of the audit firm and of the firm jointly and severally.**

## Audit Report

### Types of Audit Reports

Auditor's Report can be of two types:

- 1) **Unmodified Report** (also known as Clean Report / Unqualified opinion)
- 2) **Modified Report:** Modified Report includes Qualified Report, Adverse Report or Disclaimer of Opinion.

**SA 700** on 'Forming an Opinion and Reporting on Financial Statements' deals with Unqualified Report; while **SA 705** on 'Modifications to the Opinion in Independent Auditor's Report' deals with Modified Report.

#### 1) Clean report/Unqualified opinion:

**An opinion is said to be unqualified when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of financial statements.** The auditor issues a clean report when he does not have any reservation in respect of matters contained in financial statements.

A clean report indicates that-

- a) The financial statements have been prepared using the generally accepted accounting principles.
- b) The financial statements comply with relevant statutory requirements and regulations.
- c) There is adequate disclosure of all material matters relevant to proper presentation of financial information.
- d) Any change in accounting principles or in the method of their application, and the effects there of, have been properly determined and disclosed in the financial statements.

#### 2) Qualified report:

Qualified Opinion is one when an auditor does not give a clean chit about the truthfulness and fairness of the financial statements but makes certain reservations.

The auditor shall express a qualified opinion when:

- a) The auditor, having obtained sufficient appropriate audit evidence, concludes that **misstatements**, individually or in the aggregate, **are material, but not pervasive**, to the financial statements; or
- b) The auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, but the auditor concludes that the **possible effects** on the financial statements of undetected misstatements, if any, **could be material but not pervasive**.

All the qualification should be contained in Auditor's report. The notes to accounts should not contain the opinion of the auditors.

It is also necessary that the auditors should quantify, wherever possible, the effect of individual qualifications as well as the total effect of all qualifications on profit and loss or on the state of affairs. If it is not possible to quantify the effect of qualifications accurately, the auditors may do so, on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on the management estimates.

**Circumstances when qualified report is obligatory (necessary) are as follows:**

- If proper books of accounts have not been kept in accordance with law.
- If there is non compliance with Accounting Standards.
- If auditor is unable to obtain all the required information and explanations.
- If the Balance Sheet and Statement of Profit or Loss are not in agreement with the books of account and returns.
- If information required by law is not furnished.

### **3) Disclaimer of opinion:**

**A disclaimer of opinion is given when the auditor is unable to form an overall opinion about the matters contained in the financial statements.** It may happen in situations such as:

- a) When books of accounts of the company seized by Income tax authorities.
- b) When scope of audit work is restricted.

The auditor shall disclaim an opinion when the auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, and the auditor concludes that the **possible effects** on the financial statements of undetected misstatements, if any, **could be both material and pervasive**.

The auditor will state that he is unable to express an opinion because he has not been able to obtain sufficient audit evidence to form an opinion.

### **4) Adverse or negative opinion:**

**The auditor issues a negative report when he is of the opinion that based on his examination he does not agree with affirmation made in the financial statements.**

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that **misstatements**, individually or in the aggregate, **are both material and pervasive to the financial statements**.

**Note:** Whenever auditor issues qualified opinion, disclaimer of opinion or negative report, he should also state in his report the reasons for the same, so that the reader can assess their significance and effect.

### **Summary**

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

**Illustrative Format of Audit Report** (Changes are Underlined)

**Note:** As per General Circular number 08/2014 issued by MCA, auditor’s report of a company pertaining to any financial year **commencing on or after 1st April 2014**, would be in accordance with the requirements of the Companies Act, 2013.

**But till date** the format of Audit Report as per Companies Act, 2013 is NOT yet issued by ICAI. So, here Other Reporting Responsibilities in audit report is given as per requirements of Companies Act, 1956.

**INDEPENDENT AUDITOR’S REPORT**

**To the Members of ABC Company Limited**

**Report on the Financial Statements**

We have audited the accompanying financial statements of ABC Company Limited (“the Company”), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

**Management’s Responsibility for the Financial Statements**

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 (“the Act”) read with the General Circular 15/2013 dated 13th September, 2013 of the Ministry of Corporate Affairs in respect of Section 133 of the Companies Act, 2013. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

**Auditor’s Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



**Opinion**

In our opinion and to the best of our information and according to the explanations given to us, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and
- (c) in the case of Cash Flow Statement, of the cash flows for the year ended on that date.

**Report on Other Legal and Regulatory Requirements**

- 1) As required by the Companies (Auditor’s Report) Order, 2003 (“the Order”) issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.
- 2) As required by section 227(3) of the Act, we report that:
  - a) we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
  - b) in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us];
  - c) the Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us];
  - d) in our opinion, the Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement comply with the Accounting Standards notified under the Companies Act, 1956 read with the General Circular 15/2013 dated 13th September, 2013 of the Ministry of Corporate Affairs in respect of Section 133 of the Companies Act, 2013;
  - e) on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Companies Act, 1956.

For XYZ and Co.  
Chartered Accountants  
Firm’s Registration Number

Signature  
(Name of the Member Signing the Audit Report)  
(Designation)  
Membership Number

Place of Signature  
Date

## COMPANY AUDIT II

### Chapter IX of Companies Act, 2013: Accounts of Companies

#### Section Summary

Section of Companies Act, 2013 [Section 128 to Section 138]	
128	Books of Account, etc, to be kept by Company
129	Financial Statement
130	Re-opening of Accounts on Court's or Tribunal's Order ( <b>NOT Notified</b> )
131	Voluntary Revision of Financial Statements or Board's Report ( <b>NOT Notified</b> )
132	Constitution of National Financial Reporting Authority ( <b>NOT Notified</b> )
133	Central Government to prescribe Accounting Standards
134	Financial Statements, Board's Report etc.
135	Corporate Social Responsibility
136	Right of Member to copies of Audited Financial Statements
137	Copy of Financial Statement to be filed with Registrar
138	Internal Audit

#### Books of Account [Section 128]

- Every company shall prepare and keep **at its registered office** books of account and other relevant books and papers and financial statement for every financial year:
  - a) which **give a true and fair view** of the state of the affairs of the company, including that of its branch offices; and
  - b) which **explain the transactions** effected both at the registered office and its branches; and
  - c) such books shall be kept **on accrual basis and** according to the **double entry system** of accounting.
  - d) the company **may keep** such books of account or other relevant papers in **electronic mode** in such manner as may be prescribed. **[Section 128(1)]**

#### We should note that:

- 1) As per Section 2(13), '**Books of Account**' includes records maintained in respect of:
  - a) All sums of money received and expended by the company i.e. receipts and expenditure;
  - b) All sales and purchases of goods by the company;
  - c) The assets and liabilities of the company; and
  - d) In case, it is a company engaged in production, processing, manufacturing or mining activities, particulars relating to utilisation of material or labour or other items of cost, **provided that class of companies are notified by CG** to keep costing records (till now 47 types of industries are notified).

- 2) As per Section 2(12) **‘book and paper’** and ‘book or paper’ include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on **paper or in electronic form**.
- 3) As per Section 2(40) **‘financial statement’** in relation to a company, includes:
  - a) a balance sheet as at the end of the financial year;
  - b) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
  - c) cash flow statement for the financial year;
  - d) a statement of changes in equity, if applicable; and
  - e) any explanatory note annexed to, or forming part of, any document referred above
- 4) It is permissible, however, for all or any of the books of account to be kept at **such place in India** as the Board of directors may decide (**i.e other than registered office**) but, when a decision in this regard is taken at board meeting, the company must file a notice in writing with the Registrar of Companies giving full address of the other place within 7 days of the Board Resolution.

**5) Electronic Form of Books of Accounts:**

- a) **Rule 3 of the Companies (Accounts) Rules, 2014** provides that the company may keep its books of account or other relevant papers in electronic mode.
  - b) The books of account maintained in electronic mode shall:
    - **remain accessible in India** so as to be usable for subsequent reference.
    - be **retained completely in the original format** and shall remain complete and unaltered.
    - The information received from **branch offices** shall not be altered and shall be kept in a manner as originally received from the branches.
    - The information in the electronic record of the document shall be **capable of being displayed in a legible (readable) form**.
    - There shall be a **proper system for storage, retrieval, display or printout** of the electronic records and such records shall not be disposed of or rendered unusable, unless permitted by law:
    - The **back-up** of the books of account maintained in electronic mode shall be kept in **servers physically located in India** on a periodic basis.
  - c) The company shall **intimate to the Registrar** on an annual basis at the time of filing of financial statement, the name, internet protocol (IP) address, location of the **service provider** and if books of account are maintained on cloud, such address as provided by the service provider.
- Section 128(1) shall be deemed to be complied, if books of account relating to **branch office are kept at branch and proper summarized returns periodically are sent** by the branch office to the company at its registered office or the other place. [**Section 128(2)**]
  - The books of account maintained by the company within India shall be **open for inspection, by any director (not for shareholders) during business hours**, and in the case of financial information is **maintained outside the country, copies** of such financial information shall be maintained and produced **for inspection by any director** subject to such conditions as may be prescribed:

However, the inspection in respect of **any subsidiary of the company** shall be done only **by the person authorised** in this behalf **by** a resolution of the **Board of Directors**. **[Section 128(3)]**

**We should note that:**

**1) Rule 4** of the Companies (Accounts) Rules, 2014 which provides that:

- The **summarised returns of the books of account** of the company **kept** and maintained **outside India** shall be **sent to the registered office at quarterly intervals** which shall be kept **open to directors** for inspection.
  - Where **any other financial information** maintained outside the country **is required by a director**, the director shall **furnish a request** to the company.
  - The **company shall produce** such financial information to the director **within 15 days** of the date of receipt of the written request.
  - The financial information required shall be sought for by the **director himself** and **not by or through his** power of attorney holder or **agent** or representative.
- Where an inspection is made, the officers and other employees of the company shall **all assistance** in connection with the inspection which the company may reasonably be expected to give. **[Section 128(4)]**
  - The books of account relating to a period of **not less than 8 financial years immediately preceding a financial year**, or where the company had been in existence for a period less than 8 years, in respect of all the preceding years together with the relevant vouchers **shall be kept in good order**:

However, where an **investigation** has been ordered in respect of the company, the **Central Government may direct** that the books of account may be kept **for such longer period** as it may deem fit. **[Section 128(5)]**

- The following persons are responsible for the maintenance of proper books of account:
  - a)** The MD, the WTD in charge of finance, the Chief Financial Officer;
  - b)** Any other person of a company charged by the Board.

If they contravene such provisions, they shall be punishable with:

- a)** Imprisonment upto 1 year; or
- b)** Fine Minimum Rs. 50,000; Maximum Rs. 5 lakh; or
- c)** Both. **[Section 128(6)]**

#### **Illustration 49**

A Ltd. has its Registered Office at New Delhi. During the current accounting year, it has shifted its Corporate Head Office to Indore though it has retained the Registered Office at New Delhi. The Managing Director of the Company wants to shift its books of account to Indore from New Delhi, as he feels that there is no legal bar in doing so.

#### **Answer**

**Not Valid** - As per Section 128(1), the Managing Director is not allowed to shift its books of account to Indore unless decision in this behalf is taken by the Board of Directors and a notice is also given to the Registrar of Companies within the specified time.

#### **Illustration 50**

While conducting the audit of a Limited Company for a financial year, the Auditor called for the ledger for ascertaining the details of a particular account. The Ledger could not be

made available to him as it was destroyed due to space constraint as per the instruction of the Executive Director of the Company. Comment.

**Answer**

**Not Valid** - As per Section 128(5), books of account relating to a period of not less than 8 financial years immediately preceding a financial year are to be kept in good order. Auditor should qualify the report.

**Illustration 51**

The company had borrowed Rs. 100 lacs from ICICI, which it is unable to repay on the due date. The accrued unpaid interest on the same is Rs. 25 lacs. There is a stipulation that on default in repayment, there would be a penal interest payable, which would amount to Rs. 10 lacs. The company has applied to ICICI for rescheduling the repayment and waiver of a part of the accrued interest and the penal interest. As on the date of audit, the said application is still pending.

Based on this application, the management does not wish to provide for the accrued interest and the penal interest.

**Answer**

**Not Valid** - As per Section 128(1), a company has to follow accrual system of accounting. The contention of the management is not tenable simply because application has been made for rescheduling the repayment and waiver of a part of the accrued interest and the penal interest, it is not yet accepted by ICICI.

**Illustration 52**

The register of members of AP Ltd. has not been written up-to-date and as a result, the balances in the register do not agree with the amount of issued Share Capital.

**Answer**

**Not Valid** - Register of members is a statutory book, which should be maintained by every company. The auditor should ascertain whether the company updates the register and then examine whether it is in agreement with the amount of issued capital. Because in the audit of share capital, it constitutes one of the internal documentary evidence. The auditor may also consider applying alternative audit procedures because if the company fails to update the register and the auditor fails to obtain sufficient appropriate audit evidence, the auditor may qualify his report.

**Financial Statements [Section 129]**

- The financial statements shall-
  - a) give a **true and fair view** of the state of affairs of the company,
  - b) **comply with the accounting standards** notified under section 133 and
  - c) shall be in the **form** as may be provided in **Schedule III** (earlier Schedule VI).

However, the above provisions shall not apply to following companies:

- 1) Insurance Companies
- 2) Banking companies
- 3) Company engaged in the generation or supply of electricity
- 4) Any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company. **[Section 129(1)]**

**We should note that:**

1) Any reference to the financial statement shall include any notes annexed to or forming part of such financial statement.

- At every AGM of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year. [Section 129(2)]

We should note that:

- 1) As per Section 2(41), 'Financial year', in relation to any company, means the period ending on the 31<sup>st</sup> day of March every year, and where any company has been incorporated on or after the 1<sup>st</sup> day of January of a year, the period ending on the 31<sup>st</sup> day of March of the following year:

However, on an application made by a company, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:

However, the existing companies, shall, within a period of two years from commencement of this act, align its financial year as per the provisions of this clause.

- Where a company has one or more subsidiaries, it shall, in addition to its own financial statements prepare a consolidated financial statement, and such consolidated financial statements shall also be laid before the AGM of the company.

Also, the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1.

For the purposes of giving information in Form AOC-1, 'subsidiary' shall include associate company and joint venture. [Section 129(3)]

- The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, also apply to the consolidated financial statements. [Section 129(4)]
- If the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements the following namely:
  - a) the deviation from the accounting standards,
  - b) the reasons for such deviation and
  - c) the financial effects, if any, arising out of such deviation. [Section 129(5)]

- The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest.

Such exemption may be granted either unconditionally or subject to such conditions. [Section 129(6)]

- The following persons are responsible for compliance with this section:
  - a) The MD, the WTD in charge of finance, the Chief Financial Officer;
  - b) Any other person of a company charged by the Board;
  - c) All the directors, in the absence of any of the officers mentioned above.

If they contravene such provisions, they shall be punishable with:



- a) Imprisonment upto 1 year; or
- b) Fine Minimum Rs. 50,000; Maximum Rs. 5 lakh; or
- c) Both. **[Section 129(7)]**

**Illustration 53**

A Company has established several plants at different places in India and ends the accounting year on 31<sup>st</sup> March. Recently it has established another Plant, which went into commercial production on 1<sup>st</sup> July and wants to adopt a separate accounting year for the newly established Plant How would you deal with the above situation?

**Answer**

**Not Valid** - As per Section 2(41), 'Financial year', in relation to any company, means the period ending on the 31st day of March every year. Accounting year cannot be different for different plants; it is same for the whole company.

**Illustration 54**

The Management tells you that there is no need for them to follow Accounting Standards specified by the ICAI as these are for the Auditor to follow. Comment.

**Answer**

**Not Valid** - As per Section 129(1), the financial statements shall comply with the accounting standards notified under section 133. As per Section 129(5), if the financial statements of a company **do not comply with the accounting standards**, the company shall disclose in its financial statements the following namely:

- a) the deviation from the accounting standards,
- b) the reasons for such deviation and
- c) the financial effects, if any, arising out of such deviation. **[Section 129(5)]**

**Illustration 55**

Ganga-Kaveri Project Ltd. was incorporated on 1.7.2013. During the year ended 31.3.2014 there was no manufacturing or trading activity except raising of share capital, purchase of land, acquisition of plant and machinery and construction of factory sheds. Therefore the Chief Accountant of the company contends that for the relevant year there was no need to prepare a statement of profit or loss or any other statement except a Balance Sheet as at 31.3.2014. Comment.

**Answer**

**The contention of the Chief Accountant is Not Valid** - Section 129 of the Companies Act, 2013 requires preparation of financial statements for the financial year. Though the company did not carry any manufacturing or trading activity but the company has carried on certain activities like construction of factory shed, acquisition of plant and machinery. etc. In such a case, it is necessary to provide for depreciation and other expenses.

**SCHEDULE III**

- **In case of any conflict between the Accounting Standards and the Schedule, Accounting Standards shall prevail.**
- The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards

prescribed under the Companies Act, 2013. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts.

- **Principle of Rounding-off:** Depending upon the Turnover of the Company, the figures appearing in the Financial Statement; (FS) may be rounded off as below. Once a unit of measurement is used, it should be used uniformly in the FS.

Turnover	Rounding off
< Rs. 100 Crores	To the nearest Hundreds, Thousands, Lakhs or Millions, or Decimals thereof
≥ Rs. 100 Crores	To the nearest, Lakhs, Millions or Crores, or Decimals thereof

- Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.
- All Assets and liabilities classified into current and non-current and presented separately on the face of the Balance Sheet.
- **Important Definitions:**
  - 1) **Current Assets:** An Asset shall classified as Current Asset, when it satisfies **any** of the following criteria
    - a) It is expected to be realized in, or is intended for sale or consumption in the Company's Normal Operating Cycle,
    - b) It is held primarily for the purpose of being traded,
    - c) It is expected to be realized within 12 months after the Reporting Date,
    - d) It is Cash or Cash Equivalent unless it is restricted from being exchange or used to settle a Liability for atleast 12 months after the Reporting Date.
  - 2) **Non-Current Assets:** All other Assets shall be classified as Non-Current Asset.
  - 3) **Current Liabilities:** A Liability shall classified as Current when it satisfies any of the following-
    - a) It is expected to be settled in the Company's Normal Operating Cycle,
    - b) It is held primarily for the purpose of being traded,
    - c) It is due to be settled within 12 months after the Reporting Date, or
    - d) The Company does not have an unconditional right to defer settlement of the Liability for atleast 12 months after the reporting date.
  - 4) **Non-Current Liabilities:** All other Liabilities shall be classifies as Non-Current Liabilities.
  - 5) **Operating Cycle:** An Operating Cycle is the time between the Acquisition of Assets for processing & their realization in Cash or Cash Equivalents. Where the Normal Operating Cycle cannot be identified, it is assumed to have duration of 12 months.

**Part I: Form of Balance Sheet**

<b>Name of the Company</b>				
<b>Balance Sheet as at 31 March, 20X2</b>				
<b>Particulars</b>		<b>Note No.</b>	<b>As at 31 March, 20X2</b>	<b>As at 31 March, 20X1</b>
			<b>Rs.</b>	<b>Rs.</b>
<b>A</b>	<b>EQUITY AND LIABILITIES</b>			
<b>1</b>	<b>Shareholders' funds</b>			
	(a) Share capital			
	(b) Reserves and surplus			
	(c) Money received against share Warrants			
<b>2</b>	<b>Share application money pending allotment</b>			
<b>3</b>	<b>Non-current liabilities</b>			
	(a) Long-term borrowings			
	(b) Deferred tax liabilities (net)			
	(c) Other long-term liabilities			
	(d) Long-term provisions			
<b>4</b>	<b>Current liabilities</b>			
	(a) Short-term borrowings			
	(b) Trade payables			
	(c) Other current liabilities			
	(d) Short-term provisions			
	<b>TOTAL</b>			
<b>B</b>	<b>ASSETS</b>			
<b>1</b>	<b>Non-current assets</b>			
	(a) Fixed assets			
	(i) Tangible assets			
	(ii) Intangible assets			
	(iii) Capital work-in-progress			
	(iv) Intangible assets under development			
	(b) Non-current investments			
	(c) Deferred tax assets (net)			
	(d) Long-term loans and advances			

	(e) Other non-current assets			
<b>2</b>	<b>Current assets</b>			
	(a) Current investments			
	(b) Inventories			
	(c) Trade receivables			
	(d) Cash and cash equivalents			
	(e) Short-term loans and advances			
	(f) Other current assets			
	<b>TOTAL</b>			

**Part II: Form of Statement of Profit & Loss**

Name of the Company				
Profit & Loss Statement for the Year Ended _____				
Particulars		Note No.	For the current reporting period	For the previous reporting period
<b>A</b>	<b>CONTINUING OPERATIONS</b>			
I	Revenue from operations (gross)			
	Less: Excise Duty			
	Revenue from operations (net)			
II	Other Income			
<b>III</b>	<b>Total Revenue (I + II)</b>			
<b>IV</b>	<b>Expenses</b>			
	Cost of Material Consumed			
	Purchases of Stock in trade			
	Changes in Inventories of Finished goods, Work in progress and Stock in trade			
	Employee Benefits expense			
	Finance costs			
	Depreciation and amortisation expenses			
	Other expenses			
	<b>Total Expenses</b>			
<b>V</b>	<b>Profit before exceptional and extraordinary items and tax (III - IV)</b>			

VI	Exceptional items			
<b>VII</b>	<b>Profit before extraordinary items and tax (V - VI)</b>			
VIII	Extraordinary items			
<b>IX</b>	<b>Profit before tax (VII - VIII)</b>			
<b>X</b>	<b>Tax expense:</b>			
	(1) Current tax			
	(2) Deferred tax			
<b>XI</b>	<b>Profit (loss) for the period from continuing operations (VII - VIII)</b>			
<b>B</b>	<b>DISCONTINUING OPERATIONS</b>			
XII	Profit (loss) from discontinuing operations			
XIII	Tax expense of discontinuing operations			
<b>XIV</b>	<b>Profit/(loss) from discontinuing operations (after tax) (XII - XIII)</b>			
<b>XV</b>	<b>Profit (Loss) for the period (XI + XIV)</b>			
<b>XVI</b>	<b>Earnings per Equity Share:</b>			
	(1) Basic			
	(2) Diluted			

### Disclosure Requirements General Instructions for preparation of Balance Sheet

Item	Description
<b>Share Capital</b>	<p>For each Class of Share Capital (different classes of Preference Shares to be treated separately):</p> <ol style="list-style-type: none"> <li>Number and Amount of Shares <b>Authorized</b>,</li> <li>Number of Shares Issued, Subscribed and Fully Paid, and Subscribed but not Fully Paid,</li> <li>Par Value per Share,</li> <li>Reconciliation of Number of Shares Outstanding at the Beginning and at the end of the Reporting Period,</li> <li>Rights, Preferences and Restrictions attaching to each class of Shares including restrictions on the distribution of Dividends and the Repayment of Capital,</li> <li>Shares in respect of each Class in the Company <b>held by its Holding Company or its ultimate Holding Company</b> including Shares held by or by Subsidiaries or Associates of the Holding Company or the ultimate Holding Company in aggregate,</li> <li>Shares in Company held by each <b>Shareholder holding more than 5% Shares</b> specifying number of Shares held,</li> <li>Shares Reserved for issue under Options and Contracts including the</li> </ol>

	<p>Terms and Amounts,</p> <p>i) For the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared</p> <ul style="list-style-type: none"> <li>Aggregate Number &amp; Class of Shares allotted as Fully Paid Up pursuant to Contract(s) without payment being received in Cash (<b>Shares issued for Consideration other than Cash</b>).</li> <li>Aggregate Number and Class of Shares allotted as fully Paid Up by way of <b>Bonus Shares (source of bonus issue not required)</b>.</li> <li>Aggregate Number &amp; Class of Shares <b>Bought Back</b>.</li> </ul> <p>j) Terms of any Securities Convertible into Equity/Preference Shares issued along with the earliest date of conversion,</p> <p>k) Calls Unpaid (showing aggregate value of Calls Unpaid by Directors and Officers),</p> <p>l) Forfeited Shares (amount originally paid up).</p>
<b>Reserve &amp; Surplus</b>	<p>Reserves &amp; Surplus shall be classified as:</p> <ol style="list-style-type: none"> <li>Capital Reserves,</li> <li>Capital Redemption Reserve,</li> <li>Securities Premium Reserve,</li> <li>Debenture Redemption Reserve,</li> <li>Revaluation Reserve,</li> <li>Share Options Outstanding Account,</li> <li>Other Reserves,</li> <li>Surplus, i.e. balance in Statement of P&amp;L disclosing allocations &amp; appropriations such as Dividend, Bonus Shares and Transfer to/from Reserves etc.</li> </ol> <p>(Revised Schedule VI format prescribes such '<b>below the line</b>' adjustments to be presented under '<b>Reserves and Surplus</b>' in the Balance Sheet.</p> <p><b>Notes:</b></p> <ol style="list-style-type: none"> <li><b>Fund:</b> A Reserve specifically represented by Earmarked Investments shall be termed as a 'Fund'.</li> <li><b>Profit and Loss Account (Dr.):</b> Debit balance of Statement of P&amp;L shall be shown as a Negative Figure under the head 'Surplus'. Similarly, the balance of 'Reserves &amp; Surplus', after adjusting Negative balance of Surplus, if any, shall be shown under the head 'Reserves &amp; Surplus' even if the resulting figure is in the negative.</li> </ol>
<b>Long term Borrowings</b>	<p>Long-Term Borrowings shall be classified as:</p> <ol style="list-style-type: none"> <li>Bonds/Debentures,</li> <li>Term loans - (i) from Banks, and (ii) from Other Parties,</li> <li>Deferred Payment Liabilities,</li> <li>Deposits,</li> <li>Loans &amp; Advances from Related Parties,</li> <li>Long-Term Maturities of Finance Lease Obligations,</li> <li>Other Loans and Advances (specify nature).</li> </ol>



	<p>Notes:</p> <ol style="list-style-type: none"> <li><b>1) Security-wise Classification:</b> Borrowings shall further be sub-classified as Secured and Unsecured. Nature of Security shall be specified separately in each case.</li> <li><b>2) Guarantees:</b> Where Loans have been guaranteed by Directors or Others, the aggregate amount of such loans under each head shall be disclosed.</li> <li><b>3) Maturity Date-Wise:</b> Bonds/Debentures along with the Rate of Interest and particulars of Redemption or Conversion shall be stated. Where Bonds/Debentures are redeemable by Installments, the Date of Maturity for this purpose must be reckoned as the Date on which the First Installment becomes due.</li> <li><b>4) Re-issue Powers:</b> Particulars of any redeemed Bonds/Debentures which the Company has power to reissue shall be disclosed.</li> <li><b>5) Terms of Repayment:</b> Terms of Repayment of Term Loans and Other Loans shall be stated.</li> <li><b>6) Default:</b> Period and amount of continuing default as on the Balance Sheet date in repayment of Loans and Interest, shall be specified separately in each case.</li> </ol>
<b>Other Long-term Liabilities</b>	<p>It shall be classified as:</p> <ol style="list-style-type: none"> <li>Trade Payables (payables after 12 months),</li> <li>Others</li> </ol>
<b>Long term Provisions</b>	<p>It shall be classified as:</p> <ol style="list-style-type: none"> <li>Provision for Employee Benefits,</li> <li>Others.</li> </ol>
<b>Short-Term Borrowings</b>	<ol style="list-style-type: none"> <li>Short-Term Borrowings shall be classified as - <ul style="list-style-type: none"> <li>Loans Repayable on demand - (i) from Banks, and (ii) Other Parties,</li> <li>Loans and Advances from Related Parties,</li> <li>Deposits,</li> <li>Other Loans and Advances.</li> </ul> </li> <li><b>2) Security-wise Classification:</b> Borrowings shall further be sub-classified as Secured and Unsecured, Nature of security shall be specified separately in each case. :</li> <li><b>3) Guarantees:</b> Where Loans have been guaranteed by Directors or others, the aggregate amount of such Loans under each head shall be disclosed.</li> <li><b>4) Default:</b> Period and amount of default as on the Balance Sheet Date in repayment of Loans and Interest shall be specified separately in each case.</li> </ol>
<b>Other Current Liabilities</b>	<p>It shall be classified as –</p> <ol style="list-style-type: none"> <li>Current Maturities of Long-Term Debt,</li> <li>Current Maturities of Finance Lease Obligations,</li> </ol>

	<p>c) <b>Interest Accrued but not due on Borrowings,</b>  d) <b>Interest Accrued and due on Borrowings,</b>  e) Income Received in Advance,  f) Unpaid Dividends,  g) <b>Application Money received for allotment of securities and due for Refund</b> and Interest Accrued thereon (Refer note below)  h) Unpaid Matured Deposits and Interest Accrued thereon,  i) Unpaid Matured Debentures and Interest Accrued thereon,  j) Other Payables (specify nature).</p> <p><b>Note:</b>  Share Application Money not exceeding the Issued Capital and to the extent not refundable shall be shown under the head 'Equity'.  Share Application Money to the extent refundable i.e., the amount In excess of subscription or in case the requirements at minimum subscription are not met, shall be separately shown under 'Other Current Liabilities'.</p>
<b>Short Term Provisions</b>	<p>It shall be classified as</p> <p>a) Provision for Employee Benefits,  b) Others.</p>
<b>Tangible Assets</b>	<p>1) Classification shall be given as - (a) Land, (b) Buildings, (c) Plant and Equipment, (d) Furniture Assets &amp; Fixtures, (e) Vehicles, (f) Office Equipment, (g) Others (Specify Nature).</p> <p>2) Assets under Lease shall be separately specified under each class of Asset.</p>
<b>Intangible Assets</b>	<p>Classification shall be given as - (a) Goodwill, (b) Brands/Trademarks, (c) Computer Software, (d) Mastheads and Publishing Titles, (e) Mining Rights, (f) Copyrights, and Patents and Other Intellectual Property Rights, Services and Operating Rights, (g) Recipes, Formulae, Models, Designs and Prototypes, (h) Licenses and Franchise, (i) Others (specify nature).</p> <p><b>Note (for both Tangible Assets and Intangible Assets):</b></p> <p>1) A Reconciliation of the Gross and Net Carrying Amounts of each Class of Assets at the Beginning and End of the reporting period showing Additions, Disposals, Acquisitions through Business Combinations and other Adjustments and the related Depreciation and Impairment Losses / Reversals shall be disclosed separately.</p> <p>2) Where sums have been written off on a Reduction of Capital or Revaluation of Assets or where sums have been added on Revaluation of Assets, every Balance Sheet subsequent to date of such write-off, or addition shall show the Reduced or Increased figures as applicable and shall by way of a Note, the amount of the Reduction or Increase together with the date thereof for the <b>first 5 years subsequent to the date of such Reduction or Increase.</b></p>
<b>Non-Current Investments</b>	<p>Non-Current investments shall be classified as Trade Investments and Other Investments, and further classified as Investments in</p> <p>a) Property,</p>

	<p>b) Equity Instruments, c) Preference Shares, d) Government / Trust Securities, e) Debentures or Bonds, f) Mutual Funds, g) Partnership Firms, and h) Other Non-Current Investments.</p> <p><b>Notes:</b></p> <p>1) Under each classification, details shall be given of Names of Bodies Corporate (indicating separately whether such bodies are Subsidiaries, Associates, Joint Ventures, or Controlled Special Purpose Entities) in whom Investments have been made (showing separately Investments which are partly-paid).</p> <p>2) In regard to Investments in the capital of Partnership Firms, the Names of the Firms (with the Names of all their Partners, Total Capital and the Shares of each Partner) shall be given.</p> <p>3) Investments carried at other than at Cost should be separately stated specifying the basis for valuation thereof,</p> <p>4) The following shall also be disclosed -</p> <ul style="list-style-type: none"> <li>• Aggregate amount of Quoted Investments and Market Value thereof,</li> <li>• Aggregate amount of Unquoted Investments,</li> <li>• Aggregate Provision for Diminution in value of Investments</li> </ul>
<b>Long Term Loans and Advances</b>	<p><b>General Classification:</b> Long Term Loans and Advances shall be classified as:</p> <p>b) Capital Advances (e.g. for purchase of fixed assets), c) Security Deposits, d) Loans and Advances to Related Parties (giving details thereof), e) Other Loans and Advances.</p> <p><b>Security-wise Classification:</b> The above shall be separately sub-classified as:</p> <p>a) Secured, considered Good b) Unsecured, considered Good c) Doubtful.</p> <p>Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately.</p> <p>Loans and Advances due by Directors or Other Officers of the Company or amounts due by Firms or Private Companies respectively in which any Director is a Partner or a Director or a Member should be separately stated.</p>
<b>Other Non-Current Assets</b>	<p><b>Other Non-Current Assets</b> shall be classified as:</p> <p>a) Long-term Trade Receivables (including Trade Receivables on Deferred Credit Terms) b) Others.</p> <p><b>Security-wise Classification:</b> Long-term Receivables shall be separately</p>

	<p>sub-classified as-</p> <ol style="list-style-type: none"> <li>Secured, considered Good</li> <li>Unsecured, considered Good</li> <li>Doubtful.</li> </ol> <p>Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately.</p> <p>Debts due by Directors or Other Officers of the Company or Debts due by Firms or Private Companies respectively in which any Director is a Partner or a Director or a Member should be separately stated.</p>
<b>Current Investments</b>	<p>Current Investments shall be classified as -</p> <ol style="list-style-type: none"> <li>Investments in Equity Instruments,</li> <li>Investment in Preference Shares,</li> <li>Investments in Government or Trust Securities,</li> <li>Investments in Debentures or Bonds,</li> <li>Investments in Mutual Funds,</li> <li>Investments in Partnership Firms,</li> <li>Other Investments (specify nature).</li> </ol> <p><b>Notes:</b></p> <ol style="list-style-type: none"> <li>Under each classification, details shall be given of Names of Bodies Corporate (indicating separately whether such bodies are Subsidiaries, Associates, Joint Ventures, or Controlled Special Purpose Entities) in whom Investments have been made (showing separately Investments which are partly-paid).</li> <li>In regard to Investments in the capital of Partnership Firms, the Names of the Firms (with the Names of all their Partners, Total Capital and the Shares of each Partner) shall be given.</li> <li>The following shall also be disclosed: <ul style="list-style-type: none"> <li>Basis of Valuation of Individual Investments,</li> <li>Aggregate Amount of Quoted Investments and Market Value thereof,</li> <li>Aggregate Amount of Unquoted Investments,</li> <li>Aggregate Provision made for Diminution in Value of Investments.</li> </ul> </li> </ol>
<b>Inventories</b>	<p>Inventories shall be classified as:</p> <ol style="list-style-type: none"> <li>Raw Materials,</li> <li>Work In Progress,</li> <li>Finished Goods,</li> <li>Stock-in-Trade (in respect of goods acquired for Trading),</li> <li>Stores and Spares,</li> <li>Loose Tools,</li> <li>Others.</li> </ol> <p><b>Note:</b></p> <p>Goods-in-Transit shall be disclosed under the relevant sub-head of Inventories.</p> <p>Mode of Valuation shall be stated.</p>

<b>Trade Receivables</b>	<ol style="list-style-type: none"> <li>1) Aggregate amount of Trade Receivables outstanding for a period exceeding 6 months from the <b>date they are due for payment</b> should be separately stated.</li> <li>2) Security-wise Classification: Trade Receivables shall be separately sub-classified as <ol style="list-style-type: none"> <li>a) Secured, considered Good</li> <li>b) Unsecured, considered Good</li> <li>c) Doubtful.</li> </ol> </li> <li>3) Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately.</li> <li>4) Debts due by Directors or Other Officers of the Company or any of them either severally or jointly with any other person or debts due by Firms or Private Companies in which any Director is a Partner or a Director or a Member should be separately stated.</li> </ol>
<b>Cash and Cash Equivalents</b>	<p>Cash and Cash Equivalents shall be classified as -</p> <ol style="list-style-type: none"> <li>a) Balances with Banks,</li> <li>b) Cheques, Drafts on Hand,</li> <li>c) Cash on Hand,</li> <li>d) Others.</li> </ol> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>• Earmarked Balances with Banks (e.g. for Unpaid Dividend) shall be separately stated.</li> <li>• Balances with Banks to the extent held as Margin Money or Security against the Borrowings,</li> <li>• Repatriation restrictions, if any, in respect of Cash and Bank Balances shall be separately stated.</li> <li>• Bank Deposits with more than 12 months Maturity shall be disclosed separately.</li> </ul>
<b>Short Term Loans and Advances</b>	<ol style="list-style-type: none"> <li>1) General Classification: Short-Term Loans and Advances shall be classified as - <ol style="list-style-type: none"> <li>a) Loans and Advances to Related Parties (giving details thereof),</li> <li>b) Others.</li> </ol> </li> <li>2) Security-wise Classification: The above shall also be sub-classified as - <ol style="list-style-type: none"> <li>a) Secured, considered Good,</li> <li>b) Unsecured, considered Good,</li> <li>c) Doubtful.</li> </ol> </li> <li>3) Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately.</li> <li>4) Loans &amp; Advances due by Directors or Other Officers of the Company or amounts due by Firms or Private Companies in which any Director is a Partner or a Director or a Member shall be separately stated.</li> </ol>
<b>Other Current Assets</b>	<p>This is an all-inclusive heading, which incorporates Current Assets that do not fit into any other Asset Categories. Nature of each item should be specified.</p>

<b>Contingent Liabilities and Commitments</b>	<p>Contingent Liabilities and Commitments (to the extent not provided for)</p> <p><b>Contingent Liabilities</b> shall be classified as -</p> <p>a) Claims against the Company not Acknowledged as Debt,</p> <p>b) Guarantees,</p> <p>c) Other Money for which the Company is contingently liable.</p> <p><b>Commitments</b> shall be classified as -</p> <p>a) Estimated amount of Contracts remaining to be executed on Capital Account and not provided for,</p> <p>b) Uncalled Liability on Shares and other Investments partly paid,</p> <p>c) Other Commitments.</p>
<b>Proposed Dividends</b>	The amount of Dividends Proposed to be distributed to Equity and Preference Shareholders for the period and the related amount per Share shall be disclosed separately. Arrears of Fixed Cumulative Dividends on Preference Shares shall also be disclosed separately.
<b>Unutilized Proceeds of Securities</b>	Where in respect of an issue of Securities made for a specific purpose, the whole or part of the amount has not been used for the Specific Purpose at the Balance Sheet Date, there shall be indicated by way of Note how such Unutilized Amounts have been used or invested.
<b>Lower Realisable value of Assets</b>	If in the opinion of the Board, any of the Assets, other than Fixed Assets and Non-Current Investments, do not have realization value equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated.

**Disclosure Requirements: General Instructions for preparation of Statement of P&L**

Item	Description
The provisions of this Part shall apply to the Income and Expenditure Account in the same manner.	
Revenue from Operations	<p><b>For Company other than a Finance Company:</b></p> <p>Revenue from Operations shall disclose separately in the Notes, Revenue from -</p> <p>a) Sale of Products</p> <p>b) Sale of Services</p> <p>c) Other Operating Revenues</p> <p>d) Less: Excise Duty</p> <p><b>For Finance Company:</b></p> <p>Revenue from Operations shall include, Revenue from:</p> <p>a) Interest, and</p> <p>b) Other Financial Services</p> <p>Revenue under each of the above heads shall be disclosed separately by way of Notes to Accounts to the extent applicable,</p>
Finance Costs	<p>a) Interest Expenses,</p> <p>b) Other Borrowing Costs,</p> <p>c) Applicable Net Gain/Loss on Foreign Currency Transactions and Translation.</p>
Other Income	<p>Other Income shall be classified as -</p> <p>a) Interest Income (in case of a Company other than a Finance Company),</p>



	<p><b>b)</b> Dividend Income,</p> <p><b>c)</b> Net Gain/Loss on Sale of Investments,</p> <p><b>d)</b> Other Non-Operating Income (Net of Expenses directly attributable to such income).</p>
Additional Information:	<p>A Company shall disclose by way of Notes following additional information:</p> <p><b>a)</b> Employee Benefits Expense (showing separately Salaries &amp; Wages, Contribution to Provident Fund and other Funds, Expense on Employee Stock Option Plan(ESOP) and Employee Stock Purchase Plan(ESPP), Staff Welfare Expenses)</p> <p><b>b)</b> Depreciation and Amortization Expense,</p> <p><b>c)</b> Any item of Income or Expenditure which exceeds 1% of Revenue from Operations or Rs. 1,00,000 whichever is higher,</p> <p><b>d)</b> Adjustments to the Carrying Amount of Investments,</p> <p><b>e)</b> Net Gain / Loss on Foreign Currency Transaction &amp; Translation (other than considered as Finance Cost),</p> <p><b>f)</b> Payments to the Auditor as - (a) Auditor, (b) For Taxation Matters, (c) For Company Law Matters, (d) For Management Services, (e) For Other Services, (f) For Reimbursement of Expenses,</p> <p><b>g)</b> In case of companies covered u/s 135, amount of expenditure incurred on corporate social responsibility activities. <b>(Newly Inserted)</b></p> <p><b>h)</b> Items of Exceptional and Extraordinary Nature,</p> <p><b>i)</b> Prior Period Items.</p> <p><b>j)</b> Expenditure incurred on each of the following items, separately for each item:-</p> <ul style="list-style-type: none"> <li>- Consumption of stores and spare parts.</li> <li>- Power and fuel.</li> <li>- Rent.</li> <li>- Repairs to buildings.</li> <li>- Repairs to machinery.</li> <li>- Insurance.</li> <li>- Rates and taxes, excluding, taxes on income.</li> <li>- Miscellaneous expenses,</li> </ul> <p><b>k)</b> Value of Imports calculated on CIF basis by the Company during the Financial Year in respect of (i) Raw Materials, (ii) Components and Spare Parts, (iii) Capital Goods,</p> <p><b>l)</b> Expenditure in Foreign Currency during the Financial Year on account of Royalty, Know-How, Professional and Consultation Fees, Interest, and Other Matters,</p> <p><b>m)</b> Amount remitted during the year in Foreign Currencies on account of Dividends with a specific mention of the total number of Non-Resident Shareholders, the Total Number of Shares held by them on which the Dividends were due and the year to which the Dividends related.</p> <p><b>n)</b> Earnings in Foreign Exchange classified under the following heads, namely -</p> <p>Export of Goods calculated on FOB Basis,</p>

	Royalty, Know-How, Professional & Consultation Fees, Interest and Dividend, Other Income, indicating the nature thereof.
--	--

**Illustration 56**

A Company has changed the format relating to items of Income and Expenditure to be disclosed in the Statement of Profit & Loss.

**Answer**

**Not Valid** - As per Part II of Schedule III, a format is prescribed for the Statement of Profit and Loss, which cannot be changed.

**Illustration 57**

A suit for damages of Rs. 1 Lakh for breach of contract of sale (breach occurred in 2010) was decreed in favour of Ajay Ltd in December 2011. The Company has included the amount in its Turnover for the Financial Year 2011-12. Comment.

**Answer**

**Not Valid** - As per Part II of Schedule III, the amount received on account of breach of contract of sales would not form part of Turnover (i.e. by way of Sale of Products or Services). It can be considered as 'Other Operating Revenues'.

**Illustration 58**

A Company has issued 7 years Redeemable Non-convertible Debentures. A portion of such issue is under Cumulative Interest Scheme on which the interest is payable only on redemption of Debentures. The Nominal Value of the Debentures as well as interest accrued thereon have been secured by first charge through equitable mortgage on certain assets of the Company. Interest Accrued but not due on the Debentures issued under the Cumulative Interest Scheme has been shown by the Company separately under the head 'Secured Loans' in the Balance Sheet of the Company. Do you agree?

**Answer**

**Not Valid** - As per Schedule III, Interest accrued but not due as well as Interest accrued and due both are to be shown under Other Current Liabilities.

**Illustration 59**

A Company has purchased Plant & Machinery from a Foreign Supplier, which has allowed the payment of purchase consideration in installments. The liability has been classified as 'Secured Loan' by the Company. Comments.

**Answer**

**Not Valid** - As per Schedule III, it should be disclosed under Long Term Borrowings sub-head Deferred Payment Liabilities.

**Illustration 60**

The Management tells you that WIP is not valued since it is difficult to ascertain the same in view of multiple processes involved and in any case, the value of Opening & Closing WIP would be more or less the same. Comment.

**Answer**

**Not Valid** - As per AS 2 on 'Valuation of Inventories', the value of Opening and Closing Work-in-Process should be disclosed in Financial Statements. Where the Company has difficulties in determining the exact quantity of WIP, proper technical estimates should be obtained. The Auditor should advise the Company to obtain a technical estimate for disclosure of WIP in the Financial Statements. If the Company does not accept to this request, the Auditor should qualify his report

### **Section 130, 131 & 132 are still NOT Notified**

#### **Central Government to Prescribe Accounting Standards [Section 133]**

- The **Central Government may prescribe** the Standards of Accounting, as **recommended by the ICAI, in consultation with** and after examination of the recommendations made by the National Financial Reporting Authority (**NFRA**).
- 'Accounting Standards' means the standards of accounting as recommended by the ICAI and prescribed by the Central Government in consultation with and after examination of the recommendations made by the NFRA constituted under section 132 of the Companies Act, 2013.
- The Ministry of Corporate Affairs (MCA) vide General Circular No. 15/2013 dated 13<sup>th</sup> September, 2013 has clarified that till the Accounting Standards are prescribed by Central Government in consultation with and after examination of the recommendations made by the NFRA, the existing Accounting Standards notified under the Companies Act, 1956 shall continue to apply. The same thing is also said in Rule 7 of Companies (Accounts) Rules, 2014.

#### **Signing of Financial Statements & Board's Report**

##### **[Section 134 & Rule 8 of Companies (Accounts) Rules, 2014]**

- The **financial statement**, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are **signed** on behalf of the Board **at least by the following**:
  - a) **the chairperson** of the company where he is authorised by the Board; **or by two directors** out of which one shall be MD; **and**
  - b) the **Chief Executive Officer**, if he is a director in the company, **and**
  - c) the **Chief Financial Officer and the company secretary** of the company, wherever they are appointed.

In the case of a One Person Company, the financial statement shall be signed by only one director, for submission to the auditor for his report thereon. **[Section 134(1)]**

- The auditors' report shall be attached to every financial statement. **[Section 134(2)]**
- There shall be **attached** to statements laid before a company in general meeting, a **report by its Board of Directors**, which shall **include**:
  - a) The extract of the annual return;
  - b) Number of meetings of the Board;
  - c) Directors' Responsibility Statement;
  - d) A statement on declaration given by independent directors;

- e) When company is required to have Nomination and Remuneration Committee, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under Section 178;
- f) Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made:
  - (i) by the auditor in his report; and
  - (ii) by the company secretary in practice in his secretarial audit report;
- g) Particulars of loans, guarantees or investments under section 186;
- h) Particulars of contracts or arrangements with related parties referred to in section 188. As per Rule 8(2) of Companies (Accounts) Rules, 2014, such particulars shall be given in **Form AOC-2**;
- i) The state of the company's affairs;
- j) The amounts, if any, which it proposes to carry to any reserves;
- k) The amount, if any, which it recommends should be paid by way of dividend;
- l) Material changes and commitments, if any, affecting the financial position of the company which have occurred **between the end of the financial year** of the company to which the financial statements relate **and the date of the report**;
- m) The conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;

Rule 8(3) of Companies (Accounts) Rules, 2014 prescribes the following disclosure:

**Conservation of energy:**

- (i) the steps taken or impact on conservation of energy;
- (ii) the steps taken by the company for utilising alternate sources of energy;
- (iii) the capital investment on energy conservation equipments;

**Technology absorption:**

- (i) the efforts made towards technology absorption;
- (ii) the benefits derived like product improvement, cost reduction, product development or import substitution;
- (iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year):
  - a) the details of technology imported;
  - b) the year of import;
  - c) whether the technology been fully absorbed;
  - d) if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and
- (iv) the expenditure incurred on Research and Development.

**Foreign exchange earnings and Outgo:**

The Foreign Exchange earned in terms of actual inflows during the year and the Foreign Exchange outgo during the year in terms of actual outflows.

- n) A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;
- o) The details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;
- p) In case of a listed company and every other public company having a paid up share capital of Rs.25 crore or more calculated at the end of the preceding financial year shall include (as prescribed by Rule 8(4) of the Companies (Accounts) Rules, 2014), in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.;
- q) The report of the Board shall also contain (as prescribed by Rule 8(5) of the Companies (Accounts) Rules, 2014:
  - (i) the financial summary or highlights;
  - (ii) the change in the nature of business, if any;
  - (iii) the details of directors or key managerial personnel who were appointed or have resigned during the year;
  - (iv) the names of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year;
  - (v) the details relating to deposits like-
    - a) accepted during the year;
    - b) remained unpaid or unclaimed as at the end of the year;
    - c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-
      - a) at the beginning of the year;
      - b) maximum during the year;
      - c) at the end of the year;
  - (vi) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;
  - (vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;
  - (viii) the details in respect of adequacy of internal financial controls with reference to the Financial Statements. **[Section 134(3)]**
- The **report of the Board of Directors to be attached to the financial statement** under this section shall, in case of a One Person Company, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report. **[Section 134(4)]**
- The **Directors' Responsibility Statement shall state** that:
  - a) in the preparation of the annual accounts, the **applicable accounting standards** had been followed along with proper explanation relating to material departures;
  - b) the directors had **selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent** so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

- c) the directors had taken **proper and sufficient care for the maintenance** of adequate accounting records, for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- d) the directors had prepared the annual accounts on a **going concern basis**; and
- e) the directors, in the case of a listed company, had **laid down** internal financial controls to be followed by the company **and that such internal financial controls are adequate and were operating effectively**.

**Explanation:** 'Internal Financial Controls' means the policies and procedures adopted by the company for ensuring:

- the orderly and efficient conduct of its business, including adherence to company's policies,
- the safeguarding of its assets,
- the prevention and detection of frauds and errors,
- the accuracy and completeness of the accounting records, and
- the timely preparation of reliable financial information.

- f) the directors had **devised proper systems to ensure compliance** with the provisions **of all applicable laws** and that such systems were adequate and operating effectively. **[Section 134(5)]**

- The **Board's report** shall be **signed by its chairperson** of the company if he is authorised by the Board **and where he is not so authorised, shall be signed by at least two directors**, one of whom shall be a MD,

In case there is only one director, the Board's report shall be signed by such director. **[Section 134(6)]**

- A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of:

- a) any notes annexed to or forming part of such financial statement;
- b) the auditor's report; and
- c) the Board's report. **[Section 134(7)]**

- If a company **contravenes the provisions** of this section, **the company shall be punishable with fine which shall minimum Rs.50,000; maximum Rs.25,00,000 and every officer** of the company who is in default shall be punishable

- a) Imprisonment upto 3 year; or
- b) Fine Minimum Rs. 50,000 Maximum Rs. 5 lakh; or
- c) Both. **[Section 134(8)]**

#### **We should note that:**

As per section 143(2) of the Act, the duty of the auditor extends to expressing an opinion on balance sheet and statement of profit and loss and all other documents **annexed** thereto. Since section 129(3) requires that particulars of subsidiary company are required to be **attached** to balance sheet of holding company, the same shall not be covered by auditor's report. The Board's Report under section 134 is also **attached** to every balance sheet of a company.

#### **Section 135, 136 and 137 – NOT Covered in IPCC Syllabus**



## **Internal Audit**

### **[Section 138 & Rule 13 of Companies (Accounts) Rules, 2014] (Newly Inserted)**

- According to Section 138 of the Companies Act, 2013 and Rule 13 of the Companies (Accounts) Rules, 2014, the following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:
  - 1) every listed company;
  - 2) every unlisted public company having:
    - a) paid up share capital of Rs.50 crore or more during the preceding financial year; or
    - b) turnover of Rs.200 crore or more during the preceding financial year; or
    - c) outstanding loans or borrowings from banks or public financial institutions Rs.100 crore or more **at any point of time** during the preceding financial year; or
    - d) outstanding deposits of Rs.25 crore or more **at any point of time** during the preceding financial year; and
  - 3) every private company having:
    - a) turnover of Rs.200 crore or more during the preceding financial year; or
    - b) outstanding loans or borrowings from banks or public financial institutions Rs.100 crore or more **at any point of time** during the preceding financial year.

An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

- The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.
- Internal Auditor shall either be a **chartered accountant (who may or may not be in practice)** or a **cost accountant, or such other professional** as may be decided by the Board to conduct internal audit of the functions and activities of the company.
- The internal auditor **may or may not be an employee** of the company.

### **Illustration 61**

JKT Ltd. having Rs. 40 lacs paid up capital, Rs. 9.50 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs. 49 crores, Rs. 145 crores and Rs. 260 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory. Comment.

#### **Answer**

As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014 every private company shall be required to appoint an internal auditor or a firm of internal auditors, having:

- a) turnover of two hundred crore rupees or more during the preceding financial year; or
- b) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

In the instant case, JKT Ltd. is having turnover of Rs. 260 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the Company has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit.

**Special Requirements of Company Audit**

- It is essential that the auditor, prior to starting the audit of a company, shall examine:
  - a) The Memorandum of Association.
  - b) The Articles of Association.
  - c) Contracts entered into with vendors and other persons relating to purchase of property, payment of commission, etc.
- A company cannot enter into a contract before it has been registered. What is more, a public company cannot commence business until the certificate of commencement of business has been granted to it by the Registrar of Companies. It is, therefore, the duty of the auditor to take into account, while examining the transaction entered into by the company, the dates when these were entered into for confirming the validity.
- With a view to carrying out the audit effectively, it is necessary that the auditor should know the authority structure of the company.
- As per **Section 179** of the Act, the Board of Directors of a company are entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to do. However, the **Board shall not exercise any power or do any act or thing which is directed or required by any legislation (including the Companies Act) or by the memorandum or articles of the company, to be exercised or done by the company, in general meeting.**

Section 179 specifies various types of **decisions** that can be taken by way of resolution **by the Board of Directors only in Board's meetings**, namely;

- a) to make calls on shareholders in respect of money unpaid on their shares;
- b) to authorise buy-back of securities under section 68;
- c) to issue securities, including debentures, whether in or outside India;
- d) to borrow monies;
- e) to invest the funds of the company;
- f) to grant loans or give guarantee or provide security in respect of loans;
- g) to approve financial statement and the Board's report;
- h) to diversify the business of the company;
- i) to approve amalgamation, merger or reconstruction;
- j) to take over a company or acquire a controlling or substantial stake in another company;
- k) any other matter which may be prescribed:

Apart from the above, a number of other functions are also carried out by the Board. A few of such functions are stated herein by way of examples:

- a) Adopting of accounts before the same submitted to the auditor for their report - Section 134
- b) Appointment of the first auditors and filling of casual vacancy - Section 139.
- c) Investment in shares of companies within the limits specified in Section 186.
- d) Entering into contracts with persons who are directors of the company or related to or associated with the directors as are specified in Section 188 of the Act.

- As per **Section 180**, the Board of directors of a public company, or of a private company which is a subsidiary of a public company, shall not, except **by an approval of Shareholders by way of Special Resolution is required for following:**
  - a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.
  - b) to invest otherwise in trust securities the amount of compensation received by it as a result of any **merger or amalgamation**;
  - c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, **apart from temporary loans** obtained from the company's bankers in the ordinary course of business:  
Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.
  - d) to remit, or give time for the repayment of, any debt due from a director.

Apart from the above, other matters which only the shareholders can sanction at a general meeting are:

- a) Appointment and fixation of remuneration of auditors in AGM - Section 139 and 142,
- b) Declaration of dividends etc. [Regulation 85, Table A].

### **Special Considerations involved in the Examination of Certain Documents**

#### **Memorandum of Association**

- **MoA is a charter containing particulars of business activities that the company can undertake and the powers it can exercise in regard thereto.** Only on a consideration thereof it is possible for the auditor to determine whether a transaction which has been entered into by the company is intra vires, i.e. the company is authorised to enter into it.
- If a company enters into a transaction which is ultra vires, the shareholders, though entitled to claim the profit arising on such a transaction, may restrain the management from charging the loss, if any, has been suffered thereon, to the company.
- If the auditor fails to detect and report the transaction which are ultra vires the company, he would be guilty of negligence.

#### **Articles of Association**

- **AoA contains the rules and regulations for the internal management of the Company;** and they define the rights of different classes of shareholders, conditions under which calls can be made, the maximum and minimum number of directors the company can have, their qualifications, disqualifications and removal, etc.
- The auditor should study the Articles and include extracts from them in his permanent audit file.
- The auditor, who fails to take note of the provisions in the Articles in the verification of statements of accounts, would be guilty of professional negligence.

**As decided in famous case of Leeds Estate Building and Investment Co. v. Shepherd, Starling J. said, 'It is the duty of the auditor to see that the balance**

**sheet is a true and fair representation of the company's affairs. It was no excuse that the auditor had not seen the articles when he knew of their existence'.**

- The auditor must acquaint himself with the provision of the Articles of the company and should apply this knowledge in the verification of the transactions of the company.

### **Prospectus**

- **It is a formal document which a public company must issue before it makes the allotment of shares.**
- It must contain all the terms and conditions on which subscription to the shares is sought to be obtained from the public.
- If any statement made by the company is ultimately proven to be false, the shareholder has the option to claim refund of the amount paid by him. The auditor should, therefore, study carefully all the conditions and stipulations made in the prospectus and, in case any of them has not been carried out, to draw the attention of shareholders thereto.
- It may be noted that the right to claim refund is restricted to such of the shareholders who subscribed for shares on the basis of prospectus. A shareholder who has purchased the shares from stock exchange or otherwise cannot claim refund.

## **Audit of Share Capital**

### **General Programme for Verification of Share Capital**

#### **Nominal or Authorised or Registered capital**

- This form of capital has been defined in section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. Thus it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty.
- It is usually fixed at the amount, which, it is estimated; the company will need, including the working capital and reserve capital, if any.
- The authorised capital may be verified with reference to the amount shown in the Memorandum of Associations. Previous year audited balance sheet may also be seen.

#### **Issued capital**

- Section 2(50) of the Companies Act, 2013 defines "issued capital" which means such capital as the company issues from time to time for subscription; It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.
- Schedule III of the Companies Act, 2013, makes it obligatory for a company to disclose its issued capital in the balance sheet.
- Verify the amount of issued capital with reference to last year audited balance sheet.
- Also see whether the Central Government has issued any notification for conversion of debenture or loan into equity share under section 62(4).

#### **General points for verification of issue of capital**

- Study the conditions of issue contained in the Memorandum and Articles of Association, Prospectus or Statement in lieu of Prospectus, as the case may be, and see that all of them have fully been complied with.
- Verify that the first allotment was not made until the amount of **minimum subscription** stated in the Prospectus had been subscribed and until then the amount received was kept deposited in a Scheduled bank as required by Section 39 of the Act.
- Confirm that the **brokerage and underwriting commission** was paid only at the rates authorised by the Prospectus or the Articles of Association, having regard to the provisions contained in Section 40 of the Companies Act, 2013.
- Ensure that legal requirements as laid down in section 62 (dealing with **right shares**) have been complied with.
- Verify that **preliminary contracts**, if any, entered into for purchase of a property or business, for creating an organisation for management of the company, etc. have been carried out strictly according to the terms stated in the Prospectus.
- Ensure that the company intending to offer shares to the public for subscription by the issue of a Prospectus has, before such issue, made an application to one or more recognised stock exchanges for **permission** for the shares intending to be so offered within the **stock exchange** or each stock exchange as required by the Companies Act, 2013.
- Confirm that the **guidelines issued by the SEBI** have been followed. Compliance reports submitted by lead managers and reports submitted to SEBI may be examined in this regard.
- Ascertain that there exists an **internal check on receipt** of amounts alongwith the application and that the same throughout has continued to function satisfactorily.
- Verify compliance with legal provision relating to issue of shares at premium (section 52), Prohibition on issue of shares at discount (section 53), and issue of sweat equity shares (section 54).

### **Shares Issued for Cash**

Usually, there are three stages in the issue of shares for cash:

- 1) Receipt of applications for shares along with application money;
- 2) Allotment of shares and receipt of allotment; and
- 3) Making calls and receipt of call money.

### **Applications:**

- Check entries in the **Application and Allotment Book** (or Sheets) with the original applications;
- Check entries in the Application and the Allotment Book as regards deposits of money, received with the applications, with those in the **Cash Book**;
- Vouch amounts refunded to the unsuccessful applicants with copies of **Letters of Regret**;
- Check the totals columns in the Application and Allotment Book and confirm the **journal entry** debiting Share Application Account and crediting Share Capital Account.

### **Allotment:**

As per Section 39 of Companies Act, 2013:

- No allotment of any securities shall be made unless minimum amount has been subscribed **and** application money has been received by the company by cheque or other instrument.
- Application amount on every security shall not be less than 5% of nominal amount or as may be specified SEBI.
- If the stated **minimum amount has not** been subscribed and received **within a period of 30 days from the date of issue of the prospectus**, or as may be specified by SEBI, **the amount shall be returned within a period of 15 days from the closure of the issue**. For late payment directors in default are liable to repay that amount with interest at 15% pa.
- Company shall file with Registrar a **Return of Allotment in e-Form PAS 3**.
- In case of default, the company and its officer in default shall be liable to a penalty, of Rs.1,000 for each day during which such default continues or Rs.1,00,000, whichever is less.

Auditor's duties for Allotment of shares:

- Examine **Director's Minutes Book** to verify approval of allotments.
- Compare copies of **letters of allotment** with entries in the Application and Allotment Book.
- Trace entries in the **Cash book** into the Application and Allotment Book for the verification of amounts collected on allotment.
- Trace the amount collected on application as well as those on allotment from the Application and Allotment Book into the **Share Register**.
- Check whether the amount stated in the prospectus as the **minimum amount** has been subscribed and the sums payable on such application have been received by the company.
- Check that the amount payable on the application on every security is not less than 5% of the nominal amount of security or such other percentage or amount as may be prescribed by the SEBI.
- If the stated **minimum amount has not been subscribed** and the sum payable on subscription is not received within a period of 30 days from the date of issue of the prospectus or such period as may be specified by the SEBI, check that the amount received above is returned within a period of 15 days from the closure of the issue and if in case the amount is not repaid within such period, the directors in default shall jointly and severally be liable to repay that amount with interest at the rate of 15% per annum.
- Check totals of amounts payable on allotment and verify the **journal entry** debiting Share Allotment Account and crediting Share Capital Account.

#### **Calls:**

- Examine the **Director's resolution** making the call.
- Vouch **amounts received** with the counterfoils of receipts.
- Trace postings of the amounts received from the Calls Book (for calls due) and the **Cash Book** (for calls collected) into the Share Register.
- Verify the **journal entry**, debiting the Call Account and crediting Share Capital with totals of the amounts due.
- Note the **calls in arrears**.



**General:**

- Ascertain that the nominal value of shares allotted **does not, exceed the authorised and issued capital** and that allotments were made in accordance with conditions contained in the Prospectus.
- See the **returns of allotment** have been filed with the Registrar of Companies.
- Extract balances of shareholders' accounts contained in the Share Register and tally their total with the balance in the Share Capital Account.
- If the issue was underwritten, examine the contract with the **underwriters** to ensure that all obligations under the contracts have been fully satisfied. Vouch payment of commission and brokerage, the first by reference to the underwriting contract and the second by reference to stamps of brokers on application forms.
- See that the company has **delivered share certificates within three months** after the allotment of any of its shares in accordance with the procedure laid down under Section 53.

**Shares Issued for Consideration other than Cash**

A company can issue shares for consideration other than cash. For example, Shares may be issued to:

- a) Vendors towards payment of purchase consideration;
- b) Underwriters towards payment of underwriting commission;
- c) Promoter for entering the preliminary contracts on behalf of Company etc.

The audit procedure in regard to issue of shares for consideration other than cash would be as follows:

- The **Contract**, on the basis of which shares have been allotted, should be referred.
- The allotment should be confirmed by reference to the **minutes of Board of Directors meetings**.
- Examine the **prospectus for details as to amount payable to vendors, underwriters & promoters & the mode of payment**.
- Shares issued for consideration for consideration other than cash shall be **separately disclosed** in the Balance Sheet under the head Share Capital.

**Note:**

Where allotment is made in adjustment of a bona fide debt payable in money at once, the allotment should be considered as against cash. (Spargo's Case)

**Shares Issued at a Premium [Section 52]**

Where a company has issued shares at a premium (i.e. at amount in excess of the nominal value of the shares), whether for cash or otherwise, Section 52 of the Companies Act, 2013 provides that a company shall transfer the amount received by it as premium to securities premium account and state the means in which the amount in the account can be applied.

**Application of securities premium account:** The securities premium account may be applied by the company:

- a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

- b) in writing off the preliminary expenses of the company;
- c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- e) for the purchase of its own shares or other securities under section 68.

#### **Duties of auditor**

- Examine the minutes of **Board Meeting authorizing** the issue of shares at a premium.
- Ensure that the rate of premium is in accordance with the Board's authorization.
- Premium should be **disclosed** under separate account called 'Securities Premium Account' under the head 'Reserves and Surplus' in the Balance Sheet.
- Ensure the compliance with guidelines issued by SEBI.

#### **Shares Issued at a Discount [Section 53]**

- According to section 53, a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013.
- Any share issued by a company at a discounted price shall be void.
- Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be  $\geq$  Rs. 1,00,000 but  $\leq$  Rs. 5,00,000 and every officer who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be  $\geq$  Rs. 1,00,000 but  $\leq$  Rs. 5,00,000, or with both.

#### **Issue of Sweat Equity Shares (Section 54)**

- As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'. "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.
- The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:
  - a) the issue is authorised by a special resolution passed by the company;
  - b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
  - c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
  - d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by SEBI in this behalf.

**Buy Back of Shares [Section 68 to 70]**

Section 68 to 70 of the Companies Act, 2013 lays down the provisions for a company to buy-back its own equity shares.

**As per Section 68:**

- 1) A company may, purchase its own shares out of:
- a) Its free reserves (it means out of the assets already available with the company); or
  - b) The securities premium account (it can be used only for premium payable on buy back of shares); or
  - c) The proceeds of any shares or other specified securities.

Provided that **no buy-back** of any kind of shares or other specified securities shall be made **out of** the proceeds of an **earlier issue of the same kind of shares**.

- 2) No company shall purchase its own shares unless.

- a) The buy-back is authorised by its articles;
- b) A **special resolution** has been passed in general meeting of the company authorising the buy-back;

However, when the buy back is of less than 10% of the paid up equity capital and free reserves of the company then it can be authorised by the Board by means of resolution passed at its meeting and no special resolution will be required.

- c) The buy-back does not exceed 25% of the total paid-up capital and free reserves of the company (Total Amount of Buyback).

Paid up Capital includes Equity Share Capital and Preference Share Capital.

Provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total **paid-up equity capital** in that financial year (Nominal Value of Buyback).

- d) The ratio of the secured and unsecured debt owned by the company is not more than twice the paid up capital and its free reserves after such buy-back:

Explanation:

The expression 'debt' includes long term and current liabilities.

- e) All the shares or other specified securities for buy-back are fully paid-up;
- f) The buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;

- 3) The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement.
- 4) Every buy-back shall be **completed within twelve months** from the date of passing the special resolution or a resolution passed by board.
- 5) The buy-back may be:
- a) From the existing security holders on a proportionate basis; or

- b) From the open market; or
  - c) By purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.
- 6) Where a company proposes to buy-back its own shares, it shall, before making such buy-back, file with the Registrar and SEBI, a **declaration of solvency** signed by at least two directors of the company, one of whom shall be the managing director in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will **not be rendered insolvent within a period of one year** of the date of declaration adopted by the Board:  
Provided that no declaration of solvency shall be filed with SEBI by a company whose shares are not listed on any recognised stock exchange.
- 7) Where a company buys-back its own securities, it shall extinguish and physically **destroy** the securities so bought-back **within seven days** of the last date of completion of buyback.
- 8) Where a company completes a buy-back of its shares, it shall **not make further issue of same kind of shares** (including allotment of right shares) within a period of **six months** except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.
- 9) Where a company buys back its shares, it shall **maintain a register** of the shares or securities so bought together with other details related to it.
- 10) A company shall, after the completion of the buy-back, file with the Registrar and SEBI, **a return** (namely SH-11) containing such particulars relating to the buy-back within thirty days of such completion  
Provided that no return shall be filed with SEBI by a company whose shares are not listed on any recognised stock exchange.
- 11) If a company makes **default** in complying with the provisions of this section or any regulations made by SEBI in this regard,
- a) the company may be punishable with a fine which shall not be less than Rs One Lakh but which may extend to three lakh rupees; and
  - b) every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but which may extend to three lakh rupees or with both.

Explanation:

- a) For the purpose of this section 'Free reserves' includes Securities Premium A/c.

#### **As per Section 69:**

Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the share so purchased shall be transferred to the Capital Redemption

Reserve Account. The balance of Capital Redemption Reserve Account can be used for issuing fully paid up Bonus Shares.

We must note that Securities Premium Account balance is not available for transfer to Capital Redemption Reserve.

**As per Section 70:**

1) No company shall directly or indirectly purchase its own shares or other specified securities.

a) Through any subsidiary company including its own subsidiary companies; or

b) Through any investment company or group of investment companies; or

c) If a default, by the company,

- in repayment of deposit or interest payable thereon; or
- redemption of debentures or preference shares; or
- payment of dividend to any shareholder; or
- repayment of any term loan or interest payable thereon to any financial institutions or bank,

is subsisting.

**However, company can do buy-back if default is made good and three years has lapsed after the default is made good.**

2) No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92, 123, 127 and section 129. **Section 92 relates to Filing of Annual Return, Section 123 and 127 to Declaration and Payment of Dividend and Section 129 to Financial Statement of Company.**

**As per SEBI (Buy-back of Securities) (Amendment) Regulations, 2013:**

a) No offer of buy-back for 15% or more of the paid up capital and free reserves of the company shall be made from the open market.

b) A company shall not make any offer of buy-back within a period of one year reckoned from the date of closure of the preceding offer of buy-back.

**Calls Paid in Advance**

A Company, if permitted by the articles, may accept from members, either the whole or part of the amount remaining unpaid on any shares held by him as Calls in Advance; but the amount so received cannot be treated as a part of the capital for the purpose of any voting rights.

The auditor should verify the following with regards to Calls in Advance:

- Verify whether **Articles of Association** empower the company to receive calls in advance.
- Ensure that Calls in Advance are **shown separately** in the Balance Sheet, & not shown as the part of Capital.
- **Calls in Advance cannot be treated as a part of the capital for the purpose of any voting right** until the same becomes presently payable and duly appropriated.

- **A Company, if authorized by Articles of Association, may pay dividend** in proportion to the amount paid upon each share, where a larger amount is paid up on some shares than that on others.
- **Unless the company exercises the right as aforementioned, the shareholders who have paid calls in advance would be entitled to receive interest at the rate specified in the AOA.**
- In the event of winding up, Calls in Advance are repayable along with interest accrued there on before any part of the capital is returned to the share holders.

### **Calls in Arrears**

- Verify the amount of Calls in Arrears from the Share Register.
- Examine AOA to ascertain the Company's powers regarding:
  - a) Interest chargeable on calls in arrears.
  - b) Forfeiture of shares for non-payment of calls.
- Verify compliance with AOA for the interest charged. **(Rate as per Table F – 10%)**
- Ensure that Calls in Arrears have been disclosed as a deduction from the total paid up capital on the liabilities side.
- Ensure that Calls in Arrears have been specifically disclosed as Calls in Arrears from:
  - a) Directors and
  - b) Others

### **Issue and Redemption of Preference Shares**

Preference share capital means that part of the issued share capital of the company **which carries** or would carry a **preferential right** with respect to:

- a) payment of dividend; and
- b) repayment, in the case of a winding up.

### **Issue of Preference Shares [Section 55]**

As per Section 55 of the Companies Act, 2013, **no company** limited by shares **shall issue** any **preference shares which are irredeemable**. Whereas a **company** limited by shares **may**, if so authorised by its articles, **issue** preference shares which are liable to be redeemed within a period **not exceeding 20 years** from the date of their issue subject to such conditions are prescribed in rules which are discussed below.

- A company having a share capital may, if so authorised by its articles, issue preference shares subject to the following conditions, namely:
  - a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company
  - b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.
- A company issuing preference shares shall set out in the resolution all the particulars in respect of such shares, namely:
  - a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;
  - b) the participation in surplus fund;



- c) the payment of dividend on cumulative or non-cumulative basis.
- d) the conversion of preference shares into equity shares.
- e) the voting rights;
- f) the redemption of preference shares.
- Where a company issues preference shares, the Register of Members maintained under section 88 shall contain the particulars in respect of such preference share holder(s).
- A company intending to list its preference shares on a recognized stock exchange shall issue such shares in accordance with the regulations made by SEBI in this behalf.
- A company **may issue preference shares for a period exceeding twenty years for infrastructure projects**, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.

### **Redemption of Preference Shares**

- A company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders and the preference shares may be redeemed:
  - a) at a fixed time or on the happening of a particular event;
  - b) any time at the company's option; or
  - c) any time at the shareholder's option.
- The Auditor should ensure that:
  - a) That the shares redeemed were **fully paid up**;
  - b) That the shares were redeemed out of profit available for distribution as dividend or out of proceeds of a fresh issue made for purpose of redemption;
  - c) That the premium if any, on redemption, was provided for either out of the Securities Premium Account or out of divisible profits of the company; and
  - d) That if the shares were redeemed out of profits, otherwise available for dividend, an amount equal to nominal amount of shares redeemed has been transferred to the Capital Redemption Reserve Account.

#### **We must note that:**

The Capital Redemption Reserve Account is treated as part of capital in the same way as Securities Premium Account. It cannot, therefore, be applied except for paying up unissued share capital of the company to be issued to members as fully paid up bonus shares.

- Where a **company is not in a position to redeem any preference shares or to pay dividend it may**, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal, **issue further redeemable preference shares** equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:
- It is clarified that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

**Alteration of Share Capital [Section 61]**

According to section 61 of the Companies Act, 2013 following points related to the share capital may be altered. The law given in the provision provides that a limited company having a share capital may alter its capital part of the memorandum.

- According to the provision a limited company having a share capital may, if so authorised by its articles, alter its memorandum **in its general meeting** to:
  - a) increase its authorised share capital;
  - b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.
  - c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
  - d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum.
  - e) cancel unissued shares.
- The cancellation of shares shall not be deemed to be a reduction of share capital.
- Notice regarding alteration of share capital should be given to the Registrar in e-form SH-7 within 30 days in the prescribed form along with an altered memorandum [Section 64].

**Reduction of Capital [Section 100 of Companies Act, 1956]**

**Note:** Reduction of Capital is discussed as per section 100 of the Companies Act, 1956, which is replaced by the section 66 of the Companies Act, 2013. This section is not yet notified.

The duties of the auditor in this regard are following:

- Verifying that the meeting of the shareholder held to pass the **Special Resolution** was properly convened; also that the proposal was circularised in advance among the members.
- Confirming that the **Articles of Association authorise** reduction of capital.
- Examining the **order of the Tribunal confirming the reduction** and seeing that a copy of the order and the minutes have been registered and filed with the Registrar of Companies.
- Inspecting the Registrar's Certificate as regards reduction of capital.
- Vouching the **journal entries** recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also seeing that the requirements of Schedule III, Part I, have been complied with.
- Verifying the adjustment made in the members' accounts in the Register of Members and confirming that either the paid up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled.
- Confirming that the words '**and reduced**', if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- Verifying that the **Memorandum of Association of the company has been suitably altered**.

**Forfeiture of Shares**

The auditor should:

- Ascertain that the **Articles authorise** the Board of Directors to forfeit shares and that the power has been exercised by the Board in the best interest of the company;
- Verify the amount of call which was outstanding in respect of each of the share forfeited;
- Ascertain that the **procedure in the Articles has been followed**, such as, the notice given to the defaulting shareholders, warning them that in the event of non-payment of calls in arrears by a specified date, the shares shall be forfeited;
- Verify the **journal entries** recorded in the books of account consequent upon forfeiture of shares to confirm that the premium, if any, received on the issue of shares has not been transferred to the Forfeited Shares Account.

### **Re-issue of Forfeited Shares**

The auditor should:

- Ascertain that the Board of Directors has the **authority under the Articles to re-issue** forfeited shares;
- Refer to the **resolution** of the Board of Directors, realloiting forfeited shares;
- Vouch the **amounts collected** from person to whom the shares have been allotted and verify the **entries** recorded from realloiment;
- **See that the total amount received on the share, including that received prior to forfeiture, is not less than the par value;** and
- Verify that computation of the amount of **surplus resulting on the reissue of shares credited to the Capital Reserve Account;**
- Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is **considered as an allotment at a discount** and compliance of the provisions of Section 53 of the Companies Act, 2013 is essential

### **Option on Share Capital**

Schedule III, Part I, requires disclosure of the particulars of any option on unissued share capital. **An option on shares arises when a person has acquired a right under an agreement with the company to subscribe for share in the company if he so chooses.** Such options generally arise under the following circumstances:

- a) Under the promoter's agreements, subsequently ratified by the company;
- b) Collaboration agreement;
- c) Loan agreements, debenture deeds (Refer to Section 81 of the Companies Act);
- d) Agreements to convert preference shares into equity shares; and
- e) Other contracts, such as for supply of capital goods and/or merchandise.

### **Shares Transfer Audit [Section 56]**

Frequently, big companies require auditors to undertake audit of share transfer recorded by the company during the previous year. The object of such an audit is detection of mistakes in the registration of transfers which may have the effect of saddling the company with the liability for damages claimed by a shareholder on account of losses suffered in consequence thereof.

As per section 56 of the Companies Act, 2013 read with Rule 11 of the Companies (Share Capital and Debentures) Rules, 2014, the following aspects are required to be examined by the auditor in conducting the share transfer audit:

- No transfer of securities or the interest of a member takes place in case of a company having no share capital, other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository.
- Check where an instrument of transfer of securities held in physical form is in e-form SH-4 duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee within a period of 60 days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.
- Check where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company registers the transfer on such terms as to indemnity as the Board may think fit.
- Company has the power to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.
- Where an application is made by the transferor alone and relates to partly paid shares, examine that the transfer is not registered, unless the company gives the notice of the application in e-form SH-5 to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.
- Examine that the company, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, delivers the certificates of all securities allotted, transferred or transmitted:
  - a) within a period of 2 months from the date of incorporation, in the case of subscribers to the memorandum;
  - b) within a period of 2 months from the date of allotment, in the case of any allotment of any of its shares;
  - c) within a period of 1 month from the date of receipt by the company of the instrument of transfer or, as the case may be, of the intimation of transmission, in the case of a transfer or transmission of securities;
  - d) within a period of 6 months from the date of allotment in the case of any allotment of debenture:
- where the securities are dealt with in a depository, examine that the company intimates the details of allotment of securities to depository immediately on allotment of such securities.
- If there any default made in complying with the provisions. Verify the amount of fine paid.

**Issue of Bonus Shares [Section 63]**

- A company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of
  - a) its free reserves;
  - b) the securities premium account; or
  - c) the capital redemption reserve account.
- The auditor should ensure that no issue of bonus shares shall be made by capitalizing reserves created by the revaluation of assets.
- Further, he should also ensure the compliance of condition for capitalization of profits or reserves for the issuing fully paid-up bonus shares like

- a) it is authorised by its articles;
- b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- f) it complies with such conditions as may be prescribed like the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.
- g) The bonus shares shall not be issued in lieu of dividend.

### **Audit of Debentures**

#### **Allotment of Debentures**

- The auditor also must ascertain that the directors, while issuing the debentures, had acted within their powers having regard to restrictions contained in Section 180 and any further restrictions which may be contained in the Articles of Association.
- Section 71 has now made it compulsory for filing of Debenture Trust Deed and creation of Debenture Redemption Reserve as per section 71. It is specified that Debenture Trust Deed shall be open for inspection and can be made available on payment. Section 71 has also made it compulsory appointment of debenture trustees and specified their duties.
- Further, the auditor should ensure that the issue of debentures with an option to convert such debentures into shares, wholly or partly at the time of redemption, are approved by a special resolution passed at a general meeting.
- no company shall issue any debentures carrying any voting rights
- Issue of Secured debentures should comply with following terms and conditions:
  - a) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. It is also provided that a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;
  - b) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;
  - c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and
  - d) the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on any specific movable property of the company (not being in the nature of pledge); or any specific immovable property wherever situate, or any interest therein.
- Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be

utilised by the company except for the redemption of debentures. The company should create Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

- a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
  - b) the company shall create Debenture Redemption Reserve equivalent to notified rate i.e at least 25 percent of the amount raised through the debenture issue before debenture redemption commences.
  - c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any specified method
  - d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.
  - e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.
- The auditor should take following steps for such verification:
    - Verify that the Prospectus or the Statement in lieu of Prospectus had been duly filed with the Registrar before the date of allotment.
    - Check the applications for debentures with the Application and Allotment Book to verify that the name, address of the applicants and the number of debentures applied for are correctly recorded.
    - Verify the allotment of debentures by reference to the Directors' Minute Book.
    - Vouch the amounts collected as are entered in the Cash Book with the counterfoils of receipts issued to the applicants; also trace the amounts into the Application and Allotment Book.
    - Check postings of allotments of debentures and the amounts received in respect thereof from the Application and Allotment Book, into the Debentures Register.
    - Verify the entries on the counterfoils of debentures issued with the Debentures Register.
    - Extract balances in the Debentures Register in respect of amounts paid by the debenture holders and agree their total with the balance in the Debentures Account in the General Ledger.
    - Examine a copy of the Debenture Trust Deed and note the conditions including creation of Debenture Redemption Reserve contained therein as to issue and repayment.
    - If the debentures are covered by a mortgage or charge, it should be verified that the charge has been correctly recorded in the Register of Mortgages and Charges and that it has also been registered with the Registrar of Companies. Further, that the charge is clearly disclosed in the Balance Sheet.
    - Compliance with SEBI Guidelines should also be seen.
    - Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be referred to.



**Issue of Debentures**

- Debentures may be issued at par or at a premium or at a discount. When these are issued at a premium, the amount of premium collected should be credited to Premium on Debenture Account. Since it would be a capital profit, the balance to the credit of this account subsequently should be transferred to the Capital Reserve Account.
- Where debentures have been issued at a discount, the amount of discount should be debited to Discount on Debenture Account so that the Debenture Account is credited with the full normal value of debentures. The balance in this account shall appear in the Balance Sheet until written off.

**Redemption of Debentures at a Premium**

The provision for the premium payable on redemption of debentures may be made in either of the following two ways:

- a) The total amount of premium payable on redemption may be debited to an account denominated as “Loss on Issue of Debentures” and credited to “Premium payable on Redemption of Debentures Account or subsequently, the debit balance in the first mentioned account should be carried forward till it is written off, while the latter account would be closed on payment of the premium, on redemption of debentures.
- b) The fact that the debentures will have to be redeemed at a premium may be disclosed by way of a note in the Balance Sheet along with the date of redemption and, as and when redemption is made, the amount paid as a premium should be debited to the Premium on Redemption of Debentures Accounts.

It may be noted that the second method is only a slight variation of the first in so far that, in the latter case, the premium paid on debentures is written off subsequent to the redemption.

**Interest on Debentures**

- The payment of interest should be vouched with the acknowledgment of the debenture holders, endorsed warrants and in the case of bearer debentures, with the coupons surrendered.
- The total amount paid should be reconciled with the total amount due and payable with the amount of interest outstanding for payment.
- Interest on debentures is payable whether or not any profit is made. Therefore, a provision should be made unless it has been specially agreed with the debenture holders that interest in such a case would be waived by them.
- The interest paid on debentures, like that on other fixed loans, must be disclosed as a separate item in the Profit and Loss Account.

**Audit of Dividends**

**Chapter VII of Companies Act, 2013 is on ‘Declaration and Payment of Dividend’. It contains Section 123 to 127. Out of the above only Section 123, 126 and 127 has been notified in the 282 section notified of Companies Act, 2013. Section 124 & 125 are NOT yet notified.**

A dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights

attaching thereto. As per Section 2 (35) of the Companies Act, 2013, term “Dividend” includes interim dividend also.

### **Section 123 of Companies Act, 2013**

- No dividend can be declared or paid by a company for any financial year except:
  - a) out of profits of the company for the year arrived at **after providing for depreciation**, or
  - b) out of the undistributed profits of the company for any previous financial year or years arrived at after providing for depreciation and remaining undistributed, or
  - c) out of **moneys provided by** the Central **Government** or a State Government for payment of a dividend pursuant to the guarantee given by the Government.

Provided that:

- a) if the company has **not provided for depreciation for any previous financial year** or years, it will, before declaring or paying dividend for any financial year provide for such depreciation out of the profits of that financial year or out of the profits of any other previous financial year or years;
  - b) Provided that no dividend shall be declared or paid by a company from its reserves other than free reserves.
  - c) Provided that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company;
  - d) Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf:
- Depreciation shall be provided in accordance with the provisions of Schedule II.
  - The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared:

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

- The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.
- No dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash:

Provided that nothing in this sub-section shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company:

Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

- A company which fails to comply with the provisions of sections 73 and 74 (relating to acceptance and repayment of public deposits) shall not, so long as such failure continues, declare any dividend on its equity shares.

### **Dividends out of Past Profits (Reserves)**

The Companies (Declaration and Payment of Dividend) Rules, 2014 provided that in the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of the **accumulated profits earned by it in previous years and transferred by it to the reserves (not lying P&L Account)**, subject to the conditions that:

- 1) The **Rate of the Dividend** declared shall not exceed Average Rate of Dividend of three years immediately preceding that year or
- 2) **Amount** to be withdrawn from Accumulated Profits  $\leq 1/10^{\text{th}}$  of its Paid-Up Capital and Free Reserves

**Note:** The amount so drawn shall, first be utilised to set off the losses incurred in the year before any dividend in respect of preference or equity shares is declared, and

- 3) The **Balance of Reserves** after such withdrawal shall not fall below 15% of its paid-up share capital.

If the company has incurred any loss in any previous financial year or years, then, the **amount of the loss or an amount which is equal to the amount provided for depreciation for that year or those years whichever is less**, shall be set off against the profits of the company for the year for which dividend is proposed to be declared or paid.

**It should be noted that Interim Dividend cannot be declared out of Reserves.**

### **Transfer to Reserve**

The Board of Directors are free and can appropriate a part of the profits to the credit of a reserve or reserves as per section 123 (1) of the Companies Act, 2013. Appropriation of a part of profit is sometimes made under law.

- a) For example, under the Banking Regulation Act, a fixed percentage of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed.
- b) Transfer of a part of profit to a reserve is also necessary where the company has undertaken, at the time of raising of loan, that before any part of its profit is distributed, a specified percentage of the profit every year shall be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount shall remain invested in a specified manner.

Apart from appropriations aforementioned, it may also be necessary to provide for losses and arrears of depreciation and to exclude capital profit, as mentioned earlier, to arrive at the amount of divisible profit.

### **Distribution of Capital Profit**

**Capital Profit** means those profits which arise from transactions which do not fall within the normal activities of the business. For example a trading company sells part of its fixed assets at a price which is higher than the original cost of these assets.

As per AS 10 on 'Accounting for Fixed Assets', any gain arising from the disposal of a Fixed Asset should be recognised in the Profit and Loss Account.

Further, Section 123 does not make distinction between Capital Profit and Other Profit.

As per Court judgments in Lubbock vs The British Bank of South America Ltd, and Foster vs The New Trinidad Lake Asphalt Co., Capital Profits can be distributed as dividends by a Company, only if all the following conditions are fulfilled -

- a) The Articles of Association permit such distribution,
- b) The Capital Profit is realised in cash, and
- c) Such Capital Profits remain after a revaluation of all Assets and Liabilities.

Thus, Capital Profit can be distributed by way of Dividend, subject to above conditions.

**Capital Reserve** is defined as a reserve of a corporate enterprise which is not available for distribution as dividend. Thus, capital reserve cannot be used for distribution of dividend.

**Capital Receipts** by their nature cannot be distributed by way of dividend. Examples of capital receipt include share premium amounts and profit on re-issue of forfeited shares.

### **Revaluation Reserve**

- Revaluation Reserve refers to a Reserve created on the Revaluation of the Assets or Net Assets of an Enterprise. It represents the Surplus of the Estimated Replacement Cost or Estimated Market Values over the Book Values of Assets.
- As per Schedule III of Companies Act, 2013, every Balance Sheet subsequent to such Revaluation should show the increased figure with the date of increase in place of the original cost, for the first 5 years.
- Revaluation Reserve represents Unrealised Gain, and hence it is not available for distribution as dividends. As per the ICAI's Guidance Note, Revaluation Reserve should not be applied to declare dividends.
- Revaluation Reserve should not be used to write off past revenue losses or arrears of depreciation, because that will facilitate a distribution of dividend without being required to earn a revenue surplus for the purpose. This will violate Section 123 of the Act.
- However, Revaluation Reserve may be used for adjustment of additional depreciation on the increased amount due to revaluation from year to year or on the retirement of Fixed Assets.
- Revaluation Reserve cannot be applied in issuing Bonus Shares as per the Bonus Issue Guidelines issued by SEBI, or in paying up Debentures or Loan Stock or Calls on partly-paid Shares.
- If the Company utilises the Revaluation Reserve for issue of Bonus Shares, the Auditor should qualify his report.

### **Unpaid Dividend (Section 124)**

- Section 124 states that where a dividend has been declared by a company but has not been paid or claimed **within 30 days from the date of the declaration**, to any shareholder entitled to the payment of dividend, **the company shall within seven days from the date of expiry of the said period of 30 days**, transfer the total amount of dividend which remains unpaid or unclaimed within the said period of 30 days **to a special account to be opened by the company in this behalf in any scheduled bank, to be called 'Unpaid Dividend Account of..... Company Limited./Company (Private) Limited.** The expression 'dividend which remains unpaid' means any dividend the warrant in respect thereof has not been encashed or which has otherwise not been paid or claimed.

- Any money which has been transferred to unpaid dividend account of a company and which **remains unpaid or unclaimed for a period of Seven Years from the date of such transfer, the amount shall be transferred by the company to the Fund established under Section 125 (i.e. Investor Education & Protection Fund).**
- When unclaimed dividends are transferred to the Fund, the company must furnish to such authority or committee as the Central Government may appoint, a statement in the prescribed form setting forth in respect of all sums included in such transfer:
  - a) the nature of sum;
  - b) the name and last known addresses of the rightful recipients;
  - c) the amount to which each person is entitled;
  - d) the nature of his claim thereof; and
  - e) such other particulars as may be prescribed.
- The company shall be entitled to a receipt from the authority or committee under Section 125 for any money transferred to it to the Fund and such a receipt shall be an effectual discharge of company's liability.

### **Investor Education and Protection Fund (Section 125)**

- The Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter in this section referred to as the 'Fund').
- There shall be credited to the Fund the following amounts, namely:
  - a) amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;
  - b) amounts in the unpaid dividend accounts of companies;
  - c) the application moneys received by companies for allotment of any securities and due for refund;
  - d) matured deposits with companies;
  - e) matured debentures with companies;
  - f) the interest accrued on the amounts referred to in clauses (a) to (d);
  - g) grants and donations given to the Fund by the Central Government. State Governments, companies or any other institutions for the purposes of the Fund; and
  - h) the interest or other income received out of the investments made from the Fund;

Provided that no such amounts **referred to in clauses (a) to (d)** shall form part of the Fund unless such amounts have **remained unclaimed and unpaid for a period of seven years** from the date they became due for payment.

Explanation: For the removal of doubts, it is hereby declared that **no claims shall lie against the Fund or the company** in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of any such claims.

- The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors in accordance with such rules as may be prescribed.
- The Central Government shall, with such members as the Central Government may appoint, to administer the Fund, and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor General of India.
- It shall be competent for the authority or committee appointed to spend moneys out of the Fund for carrying out the objects for which the Fund has been established.



### Dividend, Bonus or Right kept in Abeyance (Section 126)

- Section 126 of the Companies Act, 2013 requires that where any instrument of transfer of shares has been delivered to any company for registration and a transfer of such shares has not been registered by the company, the company shall transfer the dividend in relation to such shares to the special account referred to in section 124\*. Further the company shall also keep in abeyance and offer to right shares and any issue of fully paid up bonus shares in respect of such shares which have not been registered by the company.
- However, the company may transfer the dividend in case it has been authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer.
- Penalty for failure to distribute dividend within the prescribed period, i.e., 30 days, has been made quite stiff by prescribing imprisonment for 2 years. Rs. 1,000 everyday for which the default continues as also liability to pay simple interest at the rate of 18% p.a.

### Punishment for failure to distribute dividends (Section 127)

- Where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within **30 days from the date of declaration** to any shareholder entitled to the payment of the dividend, **every director** of the company shall, if he is **knowingly a party to the default**, be punishable with **imprisonment** which may extend to **2 years**. He shall also be liable for a **fine** which shall **not be less than Rs.1,000 for every day** during which such default continues.
- The **company** shall also be liable to pay **simple interest at the rate of 18% p.a.** during the period for which such default continues.
- However, the following are the **exceptions** under which no offence shall be deemed to have been committed:
  - a) where the dividend could not be paid by reason of the **operation of any law**;
  - b) where a **shareholder has given directions** to the company regarding the payment of the dividend and those directions **cannot be complied with** and the same has been **communicated** to him;
  - c) where there is a **dispute** regarding the right to receive the dividend;
  - d) where the dividend has been **lawfully adjusted** by the company against any sum due to it from the shareholder; or
  - e) where, **for any other reason**, the failure was **not due to any default** on the part of the **company**.

### Interim Dividend

- Interim Dividend is a dividend paid by the Board of Directors between two AGM's. Dividend has been defined to include interim dividend also.
- The interim dividend could be **declared by the Board of Directors only** if there was an **authorisation in the Articles of Association** to do so. However, the same has to be **regularised at the general meeting** because interim dividend was a dividend paid by the directors any time between two AGM.
- As per Section 123, the Board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within 5 days from the date of declaration of such dividend.



- The provisions contained in sections 123, 124, 125, 126 and 127 shall, as far as may be, also apply to any interim dividend.
- The distinction between interim and final dividend was that unlike interim dividend, a final dividend once declared by the company in general meeting was a debt and created an enforceable obligation.

### **Non-Provision of Proposed Dividend**

It has been noticed that a large number of companies do not provide for the proposed dividend but either carry forward the balance on the Profit and Loss Account or transfer an amount to the general reserve and charge the dividend to the profit and loss account or to the reserve when payment is made.

The Council of the Institute of Chartered Accountants of India has considered the issues involved and is of the view that proposed dividend does not represent a liability, nor does it amount to a provision, pending the approval of the shareholders in the general meeting.

The Council is further of the opinion that:

- Old Schedule VI required provision to be made for proposed dividend.
- Revised Schedule VI **or Schedule III**, requires **disclosure** of the amounts of dividend proposed and the related amount per share **in notes to accounts**.
- **AS 4** states that, there are events which, although take place after the BS date are sometimes reflected in FS (i.e adjusted) because of Statutory requirement (example given in AS 4 is of proposed dividend).
- Provision for proposed dividend was statutory requirement as per Old Schedule VI, hence **it was** adjusting event. However, this statutory requirement has been changed to disclosure by way of notes as per Schedule III. Therefore, provision for proposed dividend **is** non-adjusting event.

So, if the provision for proposed dividend has not been made and only disclosure by company is done in notes to account, then, auditor should not qualify his report.

### **Verification of Dividends**

- Examine the company's Memorandum and Articles of Association to ascertain the dividend rights of different classes of shares.
- Confirm that the profits appropriated for payment of dividend are distributable having regard to the provisions contained in Section 123. If the company proposes to pay the dividend out of past profit in reserves, see that either this is in accordance with the rules framed by the Central Government in this behalf or the consent of the Government has been obtained.
- Inspect the shareholders' Minute Book to verify the amount of dividend declared and confirm that the amount recommended by the directors.
- If a separate bank account was opened for payment of dividends, check the transfer of the total amount of dividends payable from the Dividends Accounts.
- Check the particulars of members as are entered in the Dividend Register or Dividend List by reference to the Register of Members, test check the calculation of the gross amount of dividend payable to each shareholder on the basis of the number of the shares held and the amount of CDT, if applicable. Verify the casts and crosscast of the different columns.

- Check the amount of dividend paid with the dividend warrants surrendered. Reconcile the amount of dividend warrants outstanding with the balance in the Dividend Bank Account.
- Examine the dividend warrants in respect of previous years, presented during the year for payment and verify that by their payment, any provision contained in the Articles in the matter of period of time during which amount of unclaimed dividend can be paid had not been contravened.
- According to section 123, as it is compulsory for a company to transfer the total amount of dividend which remains unpaid or unclaimed, within thirty days of the declaration of the dividend to a special bank account entitled “Unpaid Dividend Account of .... Company Limited/Company (Pvt.) Limited”. Such an account is to be opened only in a scheduled bank. The transfer must be made within 7 days from the date of expiry of thirty days.
- In case any money transferred to the unpaid dividend amount of a company remain unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred to Investor Education and Protection Fund established under section 125 of the Act.
- Ensure the compliance, in case dividend is paid in case of inadequate profits.

**Illustration 62**

A Public Limited Company proposes to issue fully-paid Bonus Shares: (a) in lieu of dividend, and (b) without converting Partly-Paid Shares into Fully Paid-Up Shares. Comment.

**Answer**

**Not Valid** - As per SEBI Guidelines on ‘Issue of Bonus Shares’, Bonus Shares in lieu of Dividends is not Permissible. Also, for Bonus Issue Shares must be fully paid.

**Illustration 63**

A Company has earned a total sum of Rs. 85 Lakhs during the past 6 years. It has neither declared any Dividend nor transferred any amount to the Reserves during these years and kept the amount in the Profit and Loss Account. Now the Company proposes to appropriate a part of this amount for making payment of Dividend for the current year in which it has earned a profit of Rs. 8 Lakhs. The Board proposes a payment of dividend of Rs. 25 Lakhs. Comment.

**Answer**

A Company is permitted to declare dividend out of its past accumulated profits. In the given case, the Current Profits are only Rs. 8 Lakhs but the amount of dividend is Rs. 25 Lakhs. Hence, Dividend is being declared out of past accumulated profits only.

Section 123 and Companies (Declaration of Declaration of Dividend out of Reserves) Rules, 2014 are not applicable to the Company, since the amounts are kept in the Profit and Loss Account only.

The Company can freely appropriate past profits towards any insufficiency in the current year profit for the purpose of payment of dividend.

In the given case, the Company can appropriate any part of Rs. 85 Lakhs (i.e. Past Accumulated Profits) for payment of dividend in the current year. It can also utilize the Current Profit of Rs. 8 Lakhs for payment of dividend. However, the Company should ensure compliance with Section 123 on Depreciation.

**Illustration 64**

During the year under audit, Z Ltd credited to the P&L Account, the entire profit of Rs. 20 Lakhs on the sale of land not required for its use. You are informed that the Directors would like to propose dividend out of the above profit. State your views on the above.

**Answer**

Profits on Sale of Land is a Capital Profit, representing the excess of Sale Value over the Original Cost of the asset. Hence, the question is one of whether dividends can be declared out of Capital Profits or not.

As per AS 10 on ‘Accounting for Fixed Assets’, any gain arising from the disposal of a Fixed Asset should be recognised in the Profit and Loss Account. Further, Section 205 does not make distinction between Capital Profit and Other Profit.

However, as per Court judgments in Lubbock vs The British Bank of South America Ltd, and Foster vs The New Trinidad Lake Asphalt Co., Capital Profits can be distributed as dividends by a Company, only if all the following conditions are fulfilled -

- a) The Articles of Association permit such distribution,
- b) The Capital Profit is realised in cash, and
- c) Such Capital Profits remain after a revaluation of all Assets and Liabilities,

The Auditor has to verify whether the provisions of the Companies Act as regards Provision of Depreciation on other Fixed Assets, Dividend Declaration Rules, etc. have been complied with. He should also verify whether the conditions pertaining to distribution of Capital Profits in above cases are complied with.

**Illustration 65**

X Ltd is good in profits, but suffers temporarily in liquidity. It proposes to declare dividend of 10% in the AGM. But the Board of Directors proposes to defer payment of dividend by two months from the date of AGM by passing a resolution at the AGM. Comment.

**Answer**

**Not Valid** – As per Section 127 of Companies Act, 2013, Dividends once declared become the liability of the Company and must be paid within 30 days of the declaration. The shareholders have no power to authorise the Company to extend the payment dates to two months, since the Act cannot be overruled by a resolution of the Shareholders, irrespective of the majority.

**Company to Contribute to Charitable Funds [Section 181]**

- The **Board of Directors** of a company **may contribute** to bona fide charitable and other funds.
- **Prior permission of the company in general meeting** shall be required for such contribution in case any amount the aggregate of which, in any financial year, **exceeds 5% of its average net profits** for the three immediately preceding financial years.

**Illustration 66**

XYZ Ltd. Co. gave a donation of Rs. 50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2014. The average net profits of the company for the last three years were 15 lakhs. Comment.

**Answer**

The company has given donation of Rs. 50,000/- each to the two charitable organisations which amounts to 1,00,000. The average profits of the last 3 years is Rs. 15 lakhs and the 5% of this works out to Rs. 75,000. Hence the maximum of donation could be Rs. 75,000 only. For excess of Rs. 25,000 the company is required to take prior permission in general meeting which is not been taken. As Section 181 is contravened, the auditor should qualify his audit report accordingly.

**Prohibitions and Restrictions regarding Political Contributions [Section 182]**

- A company may contribute any amount directly or indirectly to any political party. Here, 'political party' means a political party registered under section 29A of the Representation of the People Act, 1951.
- The **following companies are not allowed** to contribute to any political party:
  - a) a Government company; and
  - b) a company which has been in existence for less than 3 financial years.
- The aggregate of the amount which may be so contributed by the company in any financial year shall not exceed 7.5% of its average net profits during the three immediately preceding financial years.
- No such contribution shall be made by a company unless a **resolution authorising the making of such contribution is passed at a meeting of the Board of Directors**.
- Every company shall **disclose in its Statement of Profit and Loss** any amount or amounts contributed by it to any political party during the financial year to which that account relates, giving particulars of the **total amount contributed and the name of the party** to which such amount has been contributed.
- **Penalty** for contravention:
  - a) The **company** shall be punishable with fine which may extend to five times the amount so contributed; and
  - b) **every officer** of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.

**Note:** The MCA vide General Circular 19/ 2013 dated 10<sup>th</sup> December 2013, issued a clarification that **Companies contributing** any amount or amounts **to an 'Electoral Trust Company'** for contributing to a political party or parties **are not required to make disclosures** required under section 182(3) of Companies Act 2013. It will be sufficient, if the Accounts of the company disclose the amount released to an Electoral Trust Company.

**Power of Board & Company for Contributions to National Defence Fund [Section 183]**

- The Board of Directors of any company or company in general meeting, may, contribute **such amount as it thinks fit** to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence.
- Every company shall **disclose in its Statement of Profits and Loss, the total amount or amounts contributed** by it to the Fund mentioned above, during the financial year to which the amount relates.

## CH 2 – Vouching and Verification

### Meaning of Vouching

The act of examining vouchers is referred to as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transactions recorded in the primary books of account. It essentially consists of verifying a transaction recorded in the books of account with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mentioned in the voucher has been posted to an appropriate account which would disclose the nature of the transaction on its inclusion in the final statements of account. On these considerations, the essential points to be borne in mind while examining a voucher are:

- a) That the date of the voucher falls within the accounting period;
- b) That the voucher is made out in the client's name;
- c) That the voucher is duly authorised;
- d) That the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and
- e) That the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.
- f) After the examination is over, each voucher should be either impressed with a rubber stamp or initialed so that it may not be presented again in support of another entry.

### Meaning of Verification

Verification means the procedures normally carried out at the year end to confirm the ownership, valuation and existence of items at the balance sheet date. Verification leads to establishing the correspondence of actual facts or details with those represented.

Verification of assets means an inquiry in to:

Existence	It includes Physical Examination of assets.
Ownership / Title	It includes examination of legal and official documents.
Possession	Possession should be with client. It should be seen that whether or not they are free from any charge or lien.
Valuation	Valuation should be as per Generally Accepted Accounting Principles and Accounting Standards.
Disclosure	Statutory Requirements should be complied with.

### Vouching V/s Verification

Vouching	Verification
Vouching examines the entries relating to transactions recorded in accounts books.	Verification examines the assets and liabilities appearing in the balance sheet.
Vouching is done throughout the year.	Verification is done at the end of year when the balance sheet is prepared

Vouching is based only on documentary examination.	Verification is based on personal as well as documentary examination.
Vouching is done by juniors like articles or audit clerks.	Verification is done by the auditor himself.
Vouching does not include valuation	Verification includes valuation
Objective is to verify the authority, authenticity and genuineness of transactions.	Objective confirms the existence, ownership, possession, valuation and disclosure of items of balance sheet.

**‘In vouching payments, the auditor does not merely check proof that money has been paid away.’ Discuss.**

Vouching is a substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records. It involves examination of documentary evidence to support the genuineness of transaction. Thus the object of vouching is not merely to ascertain that money has been paid away; but the auditor aims to obtain reasonable assurance in respect of following assertions in regard to transactions recorded in the books of account that:

- a) A transaction is recorded in the proper account and revenue or expense is properly allocated to the accounting period;
- b) A transaction pertains to entity and took place during the relevant period;
- c) All transactions which have actually occurred have been recorded;
- d) All transactions were properly authorised; and
- e) Transactions have been classified and disclosed in accordance with recognised accounting policies and practices.

Thus, it is through vouching that the auditor comes to know the genuineness of transactions recorded in the client’s books of account wherefrom the financial statements are drawn up.

The auditor’s basic duty is to examine the accounts, not merely to see its arithmetical accuracy but also to see its substantial accuracy and then to make a report thereon. This substantial accuracy of the accounts and emerging financial statements can be known principally by examination of vouchers which are the primary documents relating to the transactions. If the primary document is wrong or irregular, the whole accounting statement would, in turn, become wrong and irregular. Auditor’s role is to see whether or not the financial statements are wrong or irregular, and for this, vouching is simply imperative.

Thus, vouching which has traditionally been the backbone of auditing does not merely involve checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in accounting records.

**How would you, an auditor, vouch the following?**

**Credit Sales**

- The credit sales should be verified by reference to **copies of invoices** issued to customers and, in the process, attention should be paid to the following matters:
  - a) That each item of sales relates to the **period** of account under audit;
  - b) That the goods are those that are **normally dealt** in by the concern.
  - c) That the **sale price** has been correctly arrived at and the copy of the requisition slip issued by the Sales Department and the copy of the **Despatch Note** showing the



date and mode of despatch of goods are attached with the invoice. Entry in **Goods Outward Book** should also be checked.

- d) That the amount of the invoice has been adjusted in an **appropriate account**; and
- e) That the sale has been **authorised by a responsible official** and in token thereof he has initialled the invoice; also that any alteration in the invoice has been attested by the same person.
- All the **cancelled sales invoices** must be kept together for verification by auditors, who should see that cancelled invoices are properly treated in books.
- Examine the **normal sequence** of source documents (sales orders, sales invoices) generated within the organization
- It should be generally verified that the **sales have been made at a uniform rate**, and on identical terms as regards payment of freight, sales-tax, packing, forwarding charges, etc.
- The **additional charges** for freight, packing, sales tax etc. recovered along with the sale price should be credited to separate accounts, appropriately headed, and not to the Sales Account.
- When a **trade discount** is allowed, the amount thereof should be **deducted from the sale price**. Where any special trade discount has been allowed, the reason thereof should be ascertained.
- The sale of goods on **hire-purchase** basis or the goods sent out on **sale or return basis** or on **consignment basis** should be **separately recorded**.
- Ensure that the provisions of **AS-9 on 'Revenue Recognition'** have been followed. According to AS-9, income component in sales of goods should be recognized when property in goods has been transferred to the buyer with all significant risks and reward of ownership and the seller retains no effective control over the goods.
- In the case of **sales to directors as well as to associated concerns**, it should also be verified that these have been **made at market rates**. Compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Cash Sales**

- Check the **prices** charged, discounts allowed, rates of VAT or applicable sales tax charged to ensure that they are proper and duly authorized.
- Check the **arithmetical accuracy of cash memos**.
- Check the copies of cash memos with reference to **entries** in daily cash sales summary.
- Check the counterfoils of **pay in slips** relating to deposit of sale proceeds in the bank.
- Check whether the original copies of each cash memo have been retained and cancelled, where the sales against them have been shown to have been **cancelled**.
- Examine whether the dates on **cash memos and cash sales summary** are the same.
- Ensure that the provisions of **AS-9** have been completed with. According to AS-9, income component in sales of goods should be recognized when property in goods has been transferred to the buyer with all significant risks and reward of ownership and the seller retains no effective control over the goods.
- For sales to Related Parties, compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.

- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Sales Return**

- Examine the accounting basis for such transactions with reference to corresponding **Debit Note** to Debit Note. The relevant correspondence may also be examined.
- Verify by reference to relevant corresponding record in **good inward book** or the stores records. Further, the figures in these documentary evidences should be compared with the original invoices for rates and other charges and calculation should also be checked.
- Examine in depth to eliminate the possibility of **fictitious sales returns** for covering bogus sales recorded earlier when such returns outwards are in substantial figure either at the start or end of the accounting year.
- **Cross-check with reference to original invoices any rebates** in price or allowances if any given by buyers on strength of their Debit Notes.
- For sales return from Related Parties, compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Goods sent out on sale or return basis**

'Goods sent out on sale or return basis' means customer (buyer) has the option either to accept the goods or to return them within a specified period of time. Auditor has the following duties:

- Check whether a separate **memoranda record** of goods sent out on sale or return basis is maintained. The **party accounts are debited only after the goods have been sold** and the sales account is credited.
- As per **Sale of Goods Act**, when goods are sold on approval basis Sales can be recorded only when the customer gives his acceptance for goods or the time limit for approval has expired. Ensure that **entry for Sale is passed** only when the customer confirms his **acceptance of goods or when time limit for approval is expired**.
- Ensure that the goods in respect of which the **period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited**.
- Confirm that the **stock of goods sent out on approval, the period** of approval in respect of which had **not expired** till the close of the year lying with the party, **has been included in the closing stock as 'Stock with Customer'**.
- Compliance with **AS 2** on 'Valuation of Inventories' and **AS 9** on 'Revenue Recognition' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Goods Sent on Consignment**

Goods on consignment basis refer to those goods that are sent by the principal to his agent, to be sold at principal's risk. The person who consigns the goods is called consignor and the one to whom the goods are consigned is called consignee.

- Verify the **accounts sales submitted by the consignee** showing goods sold and stock of goods in hand.
- **Reconcile the figure of the goods on hand**, as given in the last accounts sales, with the proforma invoices and accounts sales received during the year.
- Obtain **confirmation from the consignee for the goods held on consignment on the balance sheet date**.
- Verify the terms of agreement between the consignor and the consignee to check the **commission** and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.
- Ensure that the quantity of **goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses**, e.g., freight, dock dues, customs due, etc., unless the net realizable value is lower.
- See that goods in hand with the consignee have been **shown distinctly** under stocks.
- Compliance with **AS 2** on 'Valuation of Inventories' and **AS 9** on 'Revenue Recognition' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Packages and Empties**

- When the empties or containers in which goods necessarily have to be supplied are costly, the manufacturers normally agree to purchase them back at a reduced price as compared to the one charged for them or the empties would be returnable. For example, barrel of oil.
- In such a case, it is necessary to keep a **separate account of the empties 'issued and received'** and the number of them held by the customers, which they may return after the close of the year. At the time of issue, customers account is debited with the cost of containers and credited when they are returned.
- **Containers in regard to which period specified for returning them has not expired, should be treated as stock with the customer** and they along with stock of containers in hand should be carried forward to next accounting year **at depreciated value**. They would be regarded as per Fixed Assets with Customers and compliance with provision of **AS 10** on 'Fixed Asset' should be verified.
- Verify whether as per **AS 29** on 'Provisions, Contingent Liability and Contingent Assets', **provision** has been made against the contingency of the containers being returned by customers and that for the **wear and tear** which they would suffer in the process.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Credit purchases**

- Examine the transactions recorded in the **purchase book** with reference to related purchase invoice & other supporting documents attached to it. Eg. purchase order, receiving reports etc.
- The invoices should be **addressed to the client** at his normal business address.
- The date of invoice should be checked with its record in the purchase book, and it should be checked that it **falls within the period under audit**.

- **Purchases of capital assets should be recorded in journal proper and not in purchase book.**
- Entry in **Goods Inward Book** should also be checked.
- **Castings (totaling) and carry forwards** in purchase book and posting there from to general and bought ledgers should be carefully checked.
- Goods purchased must **not be for the personal use** of directors or officers.
- **Statement from suppliers** may be obtained to verify his purchase records.
- Invoice after being vouched, should be cancelled with an inedible rubber **stamp mark** so that it cannot be again be produced in support of another entry.
- Sometimes, creditors are paid in **advance for supplies** to be made in future. Such payments need to be differentiated from those for actual purchase.
- For goods purchased from Related Parties, compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

#### **Purchase Return**

- Examine **debit note issued to the supplier which in turn may be confirmed by corresponding credit note** issued by the supplier acknowledging the same. The relevant correspondence may also be examined.
- Verify by reference to relevant corresponding record in **good outward book** or the stores records. Further, the figures in these documentary evidence should be compared with the supplier's original invoices for rates and other charges and calculation should also be checked.
- Examine in depth to eliminate the possibility of **fictitious purchase returns** for covering bogus purchases recorded earlier when such returns outwards are in substantial figure either at the beginning or end of the accounting year.
- **Cross-check with reference to original invoices any rebates in price** or allowances if any given by suppliers on strength of their Credit Notes.
- For goods returned to Related Parties, compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

#### **Factors which increases the Gross Profit**

- **Undervaluation of opening stock**; it may be either the effect of non-inclusion of certain items of stocks or that of valuation of the stock at a rate lower than that warranted by the basis of valuation adopted or miscalculation of the value of one or more items of stock.
- **Overvaluation of closing stock**, either by the inclusion therein of fictitious items of stock or over-statement of values of some of them.
- **Alteration of the basis of valuation of closing stock**, e.g., where the opening stock was valued at cost or market rate whichever was lower, valuing the closing stock at the market price which is higher than cost.
- Increase in the values of some of the items included in the opening stock (which were valued at market rate which was lower than cost) above cost, on account of which the unsold stock of these items at the close of the year is valued at cost.

- Under-statement of opening stock or over-statement of closing stock, due to adjustment of the amount of sales, when goods sold but not delivered are included in the closing stock or when goods were delivered and taken out of stock last year, but sales invoices are raised in the current year.
- **Entry of fictitious sales to boost up profits**, If such a practice has been resorted to, it would have the effect of reducing the rate of gross profit in the ensuing year.
- Inclusion in the closing stock of **goods received for the sale on approval or on a consignment basis**.
- **No provision or under-provision in the expenses accounts included in the Trading Account**. For example, purchase may be understated, provision for outstanding wages or carriage inward may not have been made.
- Wrong allocations of expenses, e.g., carriage inwards either in whole or in part may be wrongly taken to the Profit and Loss Account.

### **Factors which decreases the Gross Profit**

- **Over valuation of the opening stock or undervaluation of closing stock** either due to mistakes made in taking stock or in its valuation.
- **Alteration of the basis of valuation of stock**, e.g., closing stock having been valued at cost, which is below the market price, when the opening stock was valued at market price above cost.
- **Inclusion in the year of the amount of goods purchased in the previous year, that were received and where taken in the same year**.
- **Reversal of the fictitious sale entries** recorded in the previous year to boost up profit.
- Entry of sales returns twice or failure to account for purchase returns when the goods in question have been sent back.
- **Excessive provisions** have been made for wages or direct expenses.
- **Failure to include in closing stock goods sent out for sale on approval or on a consignment basis**.
- **Omission to adjust the value of unused stock of consumables stores**, such as fuel and packing material or inclusion in Trading Account expenses which should have been included in the Profit in the Loss Account.
- **Failure to take credit for the amount of an insurance claim** in respect of a consignment of goods lost in transit or destroyed by fire.
- **Failure to account for goods sold or destroyed or given away as samples**.

### **Rental Receipts**

- Examine **terms & conditions** of agreement & lease deed to check
  - a) Period of tenancy
  - b) Amount of rent
  - c) Details of amount payable i.e. portion of rent, maintenance charges, amenities charges etc.
- Examine whether the enterprise maintains **adequate records of all properties given on rent**.
- Examine whether the **rent accrued but not received** has been properly accounted for.
- Obtain a **confirmation from tenants** who are lagging in payment of the rent.



- The **amounts collected from tenants** on account of rent should be checked by reference to receipts issued to them
- Verify whether any **TDS is deducted as per Section 194-I** of Income Tax Act and also cross check it with amount deposited with Government for the same from Form No. 26AS.
- Ensure that the Rent Income is **credited to respective account in full**. i.e. before deduction of TDS.
- Prepare statement of rent accrued & reconcile the same with rent receipts. Enquire in to any unexplained difference.
- Investigate in to the **abnormal rent outstanding**.
- Compliance with **AS 9** on ‘Revenue Recognition’ should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Rent Income should be disclosed in Statement of Profit or Loss under the head Other Income.

### **Interest & Dividend Income**

- Examine whether the enterprise maintains **adequate records** of its investments, loans and deposits. Verify amount of interest, date of investment etc.
- The **dates** on which dividends or interest payments generally fall should also be noted.
- Ensure the **type of investment**, whether cum dividend or ex-dividend or cum-interest or ex-interest.
- Check the computation of **accrued interest** on cumulative deposits.
- Vouch interest outstanding with records of investments and loans and examine its proper disclosure in books.
- Verify whether any **TDS is deducted** as per Income Tax Act and also cross check it with amount deposited with Government for the same from Form No. 26AS.
- Ensure that the interest and dividend received are **credited to respective account in full**. i.e. before deduction of TDS.
- Compliance with **AS 9** on ‘Revenue Recognition’ should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Interest and Dividend Income should be disclosed in Statement of Profit or Loss under the head Other Income.

### **Commission**

- Study the terms of **agreement** for receiving commission.
- Examine the **receipts** of commission in the cash book with counterfoils of cash receipts.
- Check the **calculation** of commission.
- Verify whether any **TDS is deducted** as per Income Tax Act and also cross check it with amount deposited with Government for the same from Form No. 26AS.
- Ensure that the Commission Income is **credited to respective account in full**. i.e. before deduction of TDS.
- Compliance with **AS 9** on ‘Revenue Recognition’ should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Commission Income should be disclosed in Statement of Profit or Loss under the head Other Operating Revenues.



**Sale Proceeds of Junk/Scrap Materials**

- Review the **internal control** on junk materials, as regards its generations, storage and disposal and see whether it was properly followed at every stage.
- Ascertain whether the organisation is maintaining **reasonable records** for the sale and disposal of junk materials.
- **Review the production and cost records** for the determination of the extent of junk materials that may arise in a given period.
- **Compare the income** from the sale of junk materials with the corresponding figures of the preceding three years.
- **Check the rates** at which different types of junk materials have been sold and compare the same with the rates that prevailed in the preceding year.
- See that all junk materials sold have been **billed** and check the calculations on the invoices.
- Ensure that there exists a **proper procedure to identify** the junk material and good quality material is not mixed up with it.
- Make an **overall assessment** of the value of the realisation from the sale of junk materials as to its reasonableness.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Sale of Junk/Scrap Material should be disclosed in Statement of Profit or Loss under the head Other Income.

**Recovery of Bad Debts written off**

- Bad debts written off are **verified with reference to relevant correspondence and proper authorisation**.
- Ascertain the **total amount** lying as bad debts.
- Ensure that all **recoveries of bad debts have been properly recorded** in the books of account. It should be credited to Bad Debts Recovered Account.
- Examine **notification from the Court or from bankruptcy trustee. Letters from collecting agencies or from debtors** should also be seen.
- Check Credit Manager's file for the amount received and see that the said **amount has been deposited into the bank promptly**.
- Vouch **acknowledgement receipts** issued to debtors or trustees.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Bad Debt Recovered should be disclosed in Statement of Profit or Loss under the head Other Operating Revenues.

**Royalties Received**

- Examine the relevant contract and note down the important provisions relating to the **conditions of payment of royalty** as to
  - a) Rate of royalty
  - b) Due date for payment
  - c) Tax deduction details etc.
- **Periodical statements** received from the publishers and the calculation of royalty should be checked.

- **Royalties due but not yet received** should have been properly accounted for.
- Verify whether **proper acknowledgements** have been issued to proprietor.
- Verify whether any **TDS is deducted** as per Income Tax Act and also cross check it with amount deposited with Government for the same from Form No. 26AS.
- Ensure that the Royalty Income is **credited to respective account in full** i.e. before deduction of TDS.
- Compliance with **AS 9** on 'Revenue Recognition' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Royalty Income should be disclosed in Statement of Profit or Loss under the head Other Operating Revenues.

### **Insurance Claim Received**

Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims, the auditor should follow the following procedure:-

- Examine a copy of **insurance claim lodged** with the insurance company.
- **Correspondence** with the insurance company and the insurance agent should also be seen.
- Counterfoils of the **receipts** issued to the insurance company should also be seen.
- Copy of **certificate/report** containing full particulars of the amount of loss should also be verified.
- **The difference between actual loss and claim received should be debited to Statement of Profit or Loss.**
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Refund of General Insurance Premium paid**

The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds:

- Ascertain the **reasons** for refund of insurance premium.
- **Examine insurance policy or cover note** to find out the amount of premium.
- **Verify advice of refund received from the insurance company.** When refund is admitted, the insurance company sends the advice. This will be an evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.
- Scrutinise **correspondence** between the insurance company and the client.
- Check **entries in the bank book or the bank statement.** If necessary counterfoil of the pay-in-slips can also be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Receipt of Capital Subsidy**

- Refer to **application** made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.

- Examine **documents for the grant of subsidy and note the conditions attached** with the same relating to its use, etc.
- See that **conditions to be fulfilled** and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
- Check **relevant entries** for receipt of subsidy.
- Check compliance with requirements of **AS 12 on “Accounting for Government Grants”** i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Bankruptcy Dividends**

- When a debtor has been sued for bankruptcy it is necessary to **prove that the debt is due from him to the Official Receiver or Assignee** before any amount can be recovered from his estate.
- The **amounts** of claim admitted are received subsequently, usually in parts, which are referred to, as dividends.
- For the verification of these part amounts, it is necessary to refer to the **correspondence with the Official Receiver or Assignee** to find particulars of part amounts already collected and the balance outstanding at the beginning of the year. The advice, if any, received from the same authority along with the payment should be referred to.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Bankruptcy Dividend should be disclosed in Statement of Profit or Loss under the head Other Operating Revenues.

### **Wages and Salaries**

- Study the **accounting system and internal controls** relating to wages and salaries and their evaluation through compliance procedures.
- Check the **arithmetical accuracy** of the payroll i.e. additions, subtractions etc.
- Examine the **primary employee data** - name, wage rate, attendance, etc. with reference to records maintained by personnel department and time keeping department.
- Examine the **receipts/acknowledgements** by employees.
- Trace the recoveries out of loans and advances, outstanding against employees into the employees' loans and advance register.
- Obtain a **list of employees who retired or otherwise left the services** of the enterprise and check that they have **not been included in the payroll**.
- Ensure that the **rate or amount of wages and salaries** is in accordance with legal regulations or contractual requirements.
- Check the **statutory deductions** such as income tax, provident fund and premium for group insurance schemes made from the wages or salaries.
- Ensure that **no dummy workers** are included in the pay-roll summary.
- Compute the **ratio of total wage & salaries** to the total turnover and compare it with last 2-3 years ratio to determine the reasonableness.

- Check the **statements for unclaimed wages** and ensure that the said amount has been deposited in to a bank in a separate account by referring to counterfoil of pay-in-slip.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Wages and Salaries should be disclosed in Statement of Profit or Loss under the head Employee Costs.

### **Petty Cash**

- Trace the **amounts advanced to the petty cashier for meeting petty office expenses** from the Cash Book in the Petty Cash Book.
- **Vouch payments with vouchers** which must be supported, wherever possible, by external evidence e.g., payee's receipted bill or invoices, cash memo, etc.
- **Trace payments** made for the purchase of **postage stamps** recorded in the Postage Book.
- **The totals of the Postage Book should be test checked.** The amounts of postage stamps in hand, at the end of the year, should be credited to Postage Account by debiting the amounts to Postage in Hand Account. Confirm that the postage expense for the year is reasonable as compared with that in the postage expenses from month to month.
- See where a columnar Petty Cash Book is maintained, that the extension have been carried forward into appropriate amount columns.
- **Check the column totals and cross totals.**
- Trace posting of the various columns in which payments are classified to the respective ledger accounts.
- **Verify the cash balance in hand.**
- Auditor should also verify whether the **amount of petty cash imprest is fixed** and whether this amount is reasonable.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. The balance of Petty Cash is our Asset and is disclosed under the head Cash & Cash Equivalent in Balance Sheet.

### **Advertisement Expenses**

- Ascertain the **nature of advertisement expenses** to ensure that the same have been charged properly.
- Obtain the **complete list of advertisement, mediawise**, i.e., newspapers, slides, hoardings, magazines, television, radio, etc. showing the dates, exact location, timings, etc., along with the amounts paid in respect of each category.
- See that advertisement expenses relate to the client's business.
- Ascertain whether there is a **regular contract with an advertising agency**. See that regular statements are obtained from the agency showing the advertising media and amounts debited to the client. Discounts, if any, should be properly adjusted and disclosed in the bills.
- Check the **receipts for amounts paid** for the advertising expenses incurred.
- See that **outstanding advertising expenses** have been properly disclosed on the liabilities side of the balance sheet.

- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Advertisement Expenses should be disclosed in Statement of Profit or Loss under the head Other Expenses.

### **Discounted Bills Receivable Dishonoured**

- Obtain the **schedule** of discounted bills receivable dishonoured.
- Check the **entry in bank statement** regarding the amount of bills dishonoured and see that the bank has debited the account of client.
- Verify the **bills receivable returned** by the bank alongwith bank's advice.
- See that the **dishonoured bills have been noted and protested** by following the proper procedure and the account of the drawee or the debtor is also debited.
- Check that **bank commission**, if any, charged by the bank has been recovered from the party.
- For Bill Discounted and Dishonoured, **Debtor A/c is Debited and Bank A/c is Credited** with proper amount including Noting Charges.

### **Research and Development Expenses**

- Ascertain the **nature** of research and development work at the outset and enquire whether separate Research and Development Department exists.
- See **allocation of expenses** under revenue and capital. Ensure that expenses which are **Research expenses are charged to Profit and Loss Account. Development expenses are capitalized only if the criteria given in AS 26 on 'Intangible Asset' are fulfilled.**
- Check whether the concerned research activity is **authorised** by the Board and has relevance to the objectives of the company.
- Ensure that if any machinery and equipment have been bought specially for the purpose of research activity, the cost thereof, less the residual value should be appropriately debited to the Research and Development Account.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Foreign Travel Expenses**

- Examine **Travelling and Accommodation (T.A.) bills** submitted by the employees stating the details of tour, details of expenses, etc.
- Verify that the tour programme was properly **authorised** by the competent authority.
- Check the T.A. **bills along with accompanying supporting documents** such as air tickets, travel agents bill, hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- See that the **tour report** accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the **purpose of the tour** as shown by the tour report conforms with the authorisation for the tour.
- Check **Reserve Bank of India's permission**, if necessary, for withdrawing the foreign exchange.
- Verify compliance of Foreign Exchange Management Act (**FEMA**) & Foreign Exchange Regulation Act (**FERA**).

- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

#### **Provision for Income Tax**

- Obtain the **computation of income** prepared by the auditee and verify whether it is as per the **Income Tax Act, 1961 and Rules** made thereunder.
- **Review adjustments, expenses, disallowed special rebates**, etc. with particular reference to the last available completed assessment.
- Examine relevant records and documents pertaining to advance tax, self assessment tax and other demands.
- **Compute tax payable** as per the latest applicable rates in the Finance Act.
- Ensure that overall **provisions on the date of the balance sheet** is adequate having regard to current year provision, advance tax paid, assessment orders, etc
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Provision for Tax is separately disclosed in Statement of Profit or Loss.

#### **Liability towards Gratuity / Retirement Gratuity to Employees**

- The liability towards gratuity **payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service**, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.
- The auditor should **check the quantification** of the gratuity liability. He should ascertain whether the same had been actuarially determined.
- The auditor should **treat the actuary as an expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 620**.
- The auditor should check the **technical competence** of actuary, the **input fed** to the actuary, the **assumptions** made by the actuary, the **methodology** adopted by the actuary, opinion given etc.
- The auditor should bear in mind the **relevant pronouncements of AS 15 on 'Employee benefits'** in this regard. He should check whether the expenses of provision for gratuity are towards a defined benefit plan or contribution plan.
- If the contributions are made to outside agency, say the insurance company, he should check the premium paid, the acknowledgement receipts issued by the insurance company, the coverage of policy etc. Premium due but not paid, prepaid premium etc should be appropriately accounted.
- If the company maintains its trust for gratuity, the auditor may peruse whether the trust is an approved one under income tax law, whether the trust accounts are audited, copy of the latest accounts etc.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Provision for Gratuity is a Long Term Provision disclosed under Non-Current Liability in Balance Sheet.

#### **Expenditure incurred for promotion of a product**

- The expenditure incurred for promotion of a new or existing product may entail future benefits. It may be **like advertisement in the papers, television, sales exhibition, participation in trade fair, issue of promotional pamphlets, free gifts etc.**



- The auditor should vouch the authority and accuracy of the transactions. He should read the **contract** with advertisement agencies, promotional policies decided by the management from the board minutes etc.
- He should check the amounts paid to the agencies from **bank book**. He should check the accuracy; he should ascertain whether **tax had been deducted (TDS)** in accordance with the tax law provisions if any applicable in this regard.
- He should check whether the **unpaid** amounts and accrued liability towards promotional advertisement contracts **had been duly provided for** in the accounts.
- The huge expenditure should **not be treated as deferred revenue expenditure**, but is to be expensed and transferred to P&L A/c.
- **According to AS 26, these are not intangible assets and so these must be expensed in the year in which these arise.**
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Advertisement Expenses should be disclosed in Statement of Profit or Loss under the head Other Expenses.

### **Remuneration paid to Directors**

The following points must be considered while vouching the directors' remuneration in case of a public company and private company which is a subsidiary of a public company.

- **Examine the Entitlement:** The directors are not automatically entitled to remuneration. It is paid either according to the terms of articles of association or in accordance with a resolution of the general meeting.
- **Examine Adherence to Legal Provisions:** The auditor should examine adherence to relevant sections of the Act such as :
  - a) Section 197(6) which deals with manner of payment of managerial remuneration.
  - b) Section 197(5) which deals with payment of listing fees.
  - c) Section 197(1), which has prescribed the overall limit to managerial remuneration.
  - d) Schedule V to the Act that has laid down conditions for payment of remuneration for companies having no profits or inadequate profits and companies having negative effective capital.
  - e) Proviso to Section 197(1) which provides for increase in remuneration with the approval of the Central Government.
- Compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Directors Remuneration should be disclosed in Statement of Profit or Loss under the head Employee Costs.

### **Transactions with Related Party**

- As per **Section 188** of the Companies Act, 2013 read with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014, no company shall enter into any contract or arrangement with a related party except with the consent of the Board of Directors given by a resolution at a Board Meeting with respect to:
  - a) sale, purchase or supply of any goods or materials;
  - b) selling or otherwise disposing of, or buying, property of any kind;
  - c) leasing of property of any kind; availing or rendering of any services;

- d) appointment of any agent for purchase or sale of goods, materials, services or property;
  - e) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
  - f) underwriting the subscription of any securities or derivatives thereof, of the company.
- **Prior approval of the company by a special resolution is required** for entering into contract or arrangement with any related party in case of:
    - a) a company having a **paid-up share capital of ten crore rupees or more**;
    - b) sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding twenty five percent of the annual turnover;
    - c) selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding ten percent of net worth;
    - d) leasing of property of any kind exceeding ten percent of the net worth or exceeding ten percent of turnover;
    - e) availing or rendering of any services directly or through appointment of agents exceeding ten percent of the net worth;
    - f) appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and half lakh rupees;
    - g) remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding one percent of the net worth.

**Note:** The Turnover or Net Worth referred above shall be on the basis of the Audited Financial Statement of the preceding financial year. In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.

- Consent or approval of Board or of Company by a special resolution, as appropriate, should be taken **either before the contract is entered into or within three months thereof**. In case compliance is not undertaken, then such contract or arrangement shall be voidable at the option of the Board.
- Where any **director is interested** in any contract or arrangement with a related party, such director must disclose the nature of his concern or interest to the company at the Board Meeting (Section 184) and **shall not be present** at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.
- Where a **member of the company is a related party**, he **shall not vote** on such special resolution to approve any contract or arrangement which may be entered into by the Company.
- Section 188 **shall not apply** to any transactions entered into by the company in its ordinary course of business which are on an arm's length basis.

#### **Payments controlled by the Companies Act, 2013**

- Under Section 143(1)(e), whether personal expenses charged to the revenue account of a company should be reported.
- Under section 180, the Board of Directors of a company except with the **consent of the company by a special resolution** exercises the following powers.

- a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.
  - b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;
  - c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business:
  - d) Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.
  - e) to remit, or give time for the repayment of, any debt due from a director.
- Under section 181, the Board of Directors of a company except with the prior permission of the company in general meeting, **contribute to the bonafide charitable and other funds** any amount in any financial year, the aggregate of which exceeds 5% of its average net profits for the three immediately preceding financial years.
  - Section 182 deals with prohibition and restriction regarding **political contributions**. According to this section, a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party. In other cases, contribution in any financial year should not exceed 7.5 % of average net profits during the three immediately preceding financial years.
  - Section 183 permits the Board and other person to make **contributions to the National Defence Fund** or any other Fund approved by the Central Government for the purpose of National Defence to any extent as it thinks fit.

### **Payment for Acquisition of Assets**

- The purchase of an asset must be duly **supported by the receipt** for the amount paid.
- In case of an immovable property the auditor must also **inspect the title deeds**. The title of an immovable property passes only on registration. It is therefore essential for an auditor to see that **property has been registered in the purchaser's name** as required by the **Transfer of Property Act, 1882** and also that the title of the transfer to sell property has been verified by a solicitor or an advocate.
- In the case of movable property requiring registration of ownership, e.g., a car or a ship, it must be verified that such a registration has been made in favour of the purchaser.
- It is necessary for the auditor to satisfy himself generally as regards existence, value and title of the assets acquired.
- It must also be verified that the assets were purchased only by a person who had the authority to do so. Section 179 of the Companies Act, 2013 provides that only the Board of Directors can invest the funds of the company. Thus the Board alone can sanction the purchase of a fixed asset.
- If the benefit of an item of expense has been acquired by the purchaser along with the asset, its value should be debited to a separate account, e.g., when a motor car has been purchased on which certain taxes and insurance charges were paid by the seller for a period that had not expired.

- In the case of an asset constructed or manufactured by the client himself, e.g., where a building has been constructed or a plant or machinery manufactured by the concern with its labour and materials, it must be verified that the cost of labour, materials and other direct expenses incurred has been charged as cost of the asset on a proper allocation of the total expenditure debited under these heads.
- It must also be seen that **neither expenses on repairs and maintenance have been capitalised nor the cost of additions to assets charged off as revenue expenses.**
- Compliance with **AS 10** on 'Fixed Assets' should be verified.

#### **Assets acquired on Hire Purchase Basis**

- Examine the **Board's Minute Book approving the purchase** on hire-purchase terms.
- Examine the hire-purchase **agreement** carefully and note the description of the machinery, cost of the machinery, hire purchase charges, terms of payment and rate of purchase.
- **As per AS 10** on 'Fixed Assets', **Assets acquired under Hire Purchase System should be recorded at the full cash value** with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.
- The **interest** payable along with each installments, whether separately or included therein **should be debited to the interest account and not to the asset account.**
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Assets under Hire Purchase are separately shown in the Balance Sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.

#### **Assets Acquired on Lease**

Considering the requirement of **AS 19, 'Lease'**, which classify transaction into

- a) Finance lease or
- b) Operating lease.

In case of **operating lease**, **lease payment should be recognised as an expense in the Statement of Profit and Loss** on a straight-line basis over the lease term. Whereas in case of **finance lease**, all the substantial risks and rewards incidental to ownership are transferred thus, considering the indication as prescribed in AS 19, **the lessee should recognise the lease as an asset** and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. The lease agreement has to be studied and nature of agreement will decide the treatment of the lease payments.

#### **Customs Duties**

- **Examine Cash Book:** Examine the payment of custom duties in the cash book with reference to bill of entry.
- **Examine the Bill of Entry:**
  - a) Check the amount of custom duty was calculated correctly, i.e., in accordance with the applicable rate for dutiable goods.
  - b) If the duty has been paid by dealing and forwarding agent, examine bill of entry with reference to agent's bill.

- c) If the duty has been paid by the client directly, examine bill of entry together with receipt evidencing payment of customs duty.
- **Examine Disputed Cases Carefully:** In case of a dispute about the amount of duty payable, a provisional payment may have been made. The auditor should determine the duty payable and ensure any additional duty to be paid or refund expected should have been adjusted.
  - **Verify for Duty Drawback:** Duty drawback refers to a scheme under which central excise and customs duties paid for raw-materials and other inputs used in the manufacture of the product prior to its export are refunded to the exporter. The auditor should verify the claim of duty drawback with reference to acknowledgement issued by the Directorate of duty drawback.

### **Excise Duties**

**Excise duty becomes payable at the time of releasing at excisable goods from the factory/godown to the manufacturer.** Normally, the excise duty payable is deposited with the designated bank to the credit of the controller of excise and one copy of the challan is forwarded to him for obtaining the permit and another copy is sent to the dispatch department evidencing payment of required duty. The auditor may adopt the following procedures to vouch the payment of excise duties:

- **Verify payment of excise duties** by examining the duly paid as per **challans** with reference to the quantity of goods in respect of which issue permits have been received.
- Test check the accuracy of the amount of duty paid by multiplying the rate of excise duty with the value of goods issued as per the client's stock register.
- In respect of **excisable goods manufactured but remaining to be released, ensure that necessary provision for unpaid excise duty has been made.**
- Ensure that in every case **CENVAT credit has been adjusted and only net excise duty has been paid.**

### **Repairs to Assets**

- **Repairs should be charged to Statement of Profit or Loss as Revenue Expenditure.**
- Where expenditure results in improvements to an asset so as **to add its value or productivity, it should be capitalized** and debited to the asset account.
- **Comparison** with expenditure or repairs in the past years will also help in analyzing the current year's expenditure.
- Expenditure on repairs should be vouched from the estimates submitted by the maintenance staff or contractors, labour charges and receipts against payments.

### **Preliminary Expenses**

- Preliminary expenses are all expenses relating to the formation of an enterprise such as registration fees, cost of printing of documents, legal fees etc.
- Examine the expenditure on various items of preliminary expenses by reference to the relevant supporting documents such as agreements, bills, receipts, statements etc.
- If the preliminary expenses incurred by the promoters have been reimbursed to them, auditor should verify it with reference to resolution of BOD and the power in AOA.



- Review Minutes Book to examine the decision taken to write off the preliminary expenses over a period.
- Cross check the amount of preliminary expenses with that disclosed in the prospectus, statutory report and the balance sheet.
- Expenditure in connection with the **preliminary expenses should be treated as an expense in the year of incurring and not to be carry forwarded** for writing off in future years as per the compliance of **AS 26 on 'Intangible Assets'**.
- Ensure that no expense other than those which constitutes preliminary expenses are booked under this head e.g. brokerage paid for shares and debentures, underwriting commission.

### **Sales Commission Expenditure**

- Ascertain **agreement**, if any, in respect of sales transaction actually occurred during the year carried out by authorized parties on its behalf. If yes the commission should be in accordance with the **terms and conditions** as specified.
- Check **evidence of services rendered** by the party to whom commission is paid with reference to correspondence etc.
- Ensure that the **sales in fact have taken place** and the same has been charged to profit and loss account.
- **Compare** the amount incurred in previous years with reference to total turnover.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied. Sales Commission Expense should be disclosed in Statement of Profit or Loss under the head Other Expenses.

### **Premium paid for Insurance of a Motor car**

- **Insurance cover note** issued by the insurance company verified the car no. and period of insurance coverage.
- Verify that **no claim bonus** is given – where entitled – by the insurance company.
- Ensure that proper **adjustment is made for pre-paid** insurance premium.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Receipt of Special Backward Area Subsidy from Government**

- The claim for backward area subsidy submitted to the authorities should be studied.
- It should be ascertained whether the grant is of a capital nature for funding assets or of a revenue nature. Mere computation formula of quantum of grant with reference to the cost of project of itself will not make the grant a capital nature is to facto.
- The accounting of grant should be in accordance with **AS 12 on 'Accounting for Government Grants'**. The revenue grant can be taken to income statement, with appropriate disclosure.
- The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to profit and loss account each year in proportion to depreciation of that asset charged in profit and loss account.
- The **receipt** of the grant should be **checked with bank statement**, remittance challan etc.



- The **conditions attached to grant should be fulfilled by the company**. The auditor should check whether any liability or refund of grant for breach of conditions could arise.
- Disclosure requirement as per **Schedule III of Companies Act, 2013** should be complied.

### **Sale of Investments**

- See that sale of investment has been made on the **proper authorisation** of Board or other competent authority.
- Ascertain the **method** of selling investments. It may be either through broker, directly or through a bank. See the broker's sold note.
- See that the **difference between the carrying amount and the sales proceeds, net of expenses, is recognised in the Profit & Loss Account**. Ensure that when only a part of the holding of an individual investment is sold, the carrying amount is allocated on the basis of average carrying amount of the total holding of the investments.
- See that proper disclosures as required by **AS 13 on 'Investment Accounting'** are made as follows:
  - a) Interest, dividends, rentals on investments are to be shown in P& L A/c at Gross Value and TDS as advance tax paid.
  - b) Showing separately profit & Loss on disposal and changes in carrying amount of current and long term investments.

### **Payment of Revenue Expenses**

- See that all **payments have been duly authorised** by a competent authority.
- Ensure that all payments **relates to business**.
- Ensure that all payments have been received by the correct payee and acknowledged by a **receipt note** or in the voucher itself.
- See that expenses relate to the **period under audit**.
- Ensure that **no personal expenses** are charged as business expenditure.
- See that all payments have been **correctly recorded** in the books under appropriate sub-head.
- See that if the payment relates to prior period it is classified so and the amount payable is correctly authorised.
- See **mode of Payment** cash, cheque etc., and relate to corresponding entry in cash or Bank book.
- Verify the cash memos, invoice with the amount paid.
- Ensure that if any payment relates to period that extends to next year, a proportionate amount is carried forward as **Pre-paid expenses**.

### **Repayment of amount of foreign loan for purchase of an asset**

- Check the **loan agreement**, rate of interest, terms of security.
- Check the **remittances** made during the year towards installments of repayments made.
- Check the receipted voucher/account **confirmation** for the balance of outstanding.
- The year end liability of foreign loan should be **translated** to the rate of exchange prevalent as on the closing date.

- The gain or loss arising on exchange conversion is to be credited or debited to Statement of Profit or Loss in accordance with the **AS 11** on ‘Effect of Changes in Foreign Exchange Rates’.
- Check banker exchange rate chart for correctness of the conversion.
- Check **RBI or other agencies’ permission** for remittances outside India.
- Verify compliance of Foreign Exchange Management Act (**FEMA**) & Foreign Exchange Regulation Act (**FERA**)

### **Loss of Stock by Theft**

- The most important evidence for verification will be the First Information Report (**FIR**) filed with the police for this theft.
- The contents of the FIR will be cross checked with the financial books and stock records.
- **If no FIR is lodged, then deeper analysis will be required including satisfaction of the reasons for not filing FIR.**
- The **quantity and value** of the stolen stock is not included in the closing stock will be ensured.
- Verify whether such stock was insured and whether theft claim was lodged with the insurance company.
- Loss due to theft is to be disclosed separately in Statement of Profit or Loss.

### **VERIFICATION OF ASSETS**

#### **General considerations for Valuation & Verification of Assets**

It is not sufficient for the auditors only to verify correctness of the amount of assets shown in the balance sheet, he must verify them by actual inspection or otherwise and establish the existence of assets.

Points requiring auditor’s attention for verification are as under:

- a) Cost:** In regard to assets, verification procedure need not generally be extended to determination of the correctness of costs and authority to incur costs unless the items concerned were purchased during the accounting period under review. In such cases the auditor should check the correctness of costs through normal vouching method. He should ensure that adequate distinction has been made between ‘revenue’ and ‘capital’ nature of costs.
- b) Ownership:** Where ownership of assets is evidenced by documents of title etc. as in the case of immovable property, a reference should be made to such documents. If the documents are held by third person the auditor should either obtain a certificate directly from that party or arrange to inspect them at the third party’s place of business.
- c) Valuation:** It must be ascertained that all assets are valued in accordance with appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change. Even then a disclosure is required for the change and its monetary effect.
- d) Existence:** Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence be considered e.g. machinery imported held in customs godown or materials sent to subcontractor for job work or fabrication. In such circumstances certificating of such parties should be obtained and if considered necessary even physical verification may be requested.

- e) **Presentation in accounts:** Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading. The disclosures required under the statute or statement issued by ICAI should be complied with.

### **Building**

- **Examine the title deeds** of buildings to see whether the client holds the title on the balance sheet date. If the property has been **mortgaged**, the title deeds will be in the possession of the mortgagee, from whom a certificate should be obtained to that effect.
- **Verify the original cost** of buildings by reference to the deed of conveyance. If the building is constructed by the client, verify the original cost by reference to the cost as recorded in the books of account of the year in which the construction was completed.
- Verify that **appropriate depreciation** has been provided against the buildings. In case no depreciation is provided on the buildings, a note to this effect should be given in the profit and loss account.
- See the appropriate **lease deed**, if the building is leasehold, to ascertain the cost, amortisation, etc. Also ensure that all covenants in the lease deed have been fulfilled by the client.
- See that the buildings have been valued at **cost less depreciation**. If any **revaluation** has taken place, see the basis of revaluation and ensure that the disclosure of the same has been made. In case of a company, the **requirements of Schedule III** have been complied with.
- See that the relevant particulars of buildings have been entered in the **fixed assets register** maintained by the client.
- Ensure distinction between **capital and revenue expenditure**.
- Ensure that **costs of land and buildings are segregated** for the purpose of depreciation.
- If enterprise has contract construction **work in progress** at the end of financial year, the auditor must ascertain the cost of construction by reference to the **architect's certificates** for percentage of work completed and contractor's receipts for amounts paid to him.
- Ensure whether any **charge** is created on Building. If yes, Verify e-Form CHG-1 for 'Creation of Charge' & e-Form CHG-4 for 'Satisfaction of Charge', filed with ROC and check whether it is appropriately disclosed.
- Ensure the compliance of **AS 10** on 'Fixed Assets' and **AS 6** on 'Depreciation'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Free hold Lands**

- Verification of freehold land will include a careful inspection of **title deed, conveyance or purchase deed**.
- Freehold land should be **shown separately** in the balance sheet.
- Verify the **additional land purchased** during the year, with bank statements, documents registered in the client's favour and receipts issued by vendors.

- Verify that the amount of **Profit or Loss on sale** has been correctly adjusted in the accounts, if there has been any sale of land during the year.
- Being a non-depreciable asset, verify that **no depreciation** has been provided on Land.
- Verify whether proper entries have been passed for **Revaluation** of Land, if they are revalued.
- Ensure whether any **charge** is created on Freehold Land. If yes, Verify e-Form CHG-1 for 'Creation of Charge' & e-Form CHG-4 for 'Satisfaction of Charge', filed with ROC and check whether it is appropriately disclosed.
- Ensure the compliance of **AS 10** on 'Fixed Assets'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Lease hold property**

- **Inspect the lease agreement** to ascertain the amount of premium for securing the lease, and its terms and conditions.
- Examine the counterpart of the tenant's agreements, if part of the lease hold property has been **sublet**.
- Ensure that lease deed is **registered** with the Registrar of Companies.
- Ensure that outlay as well as any legal expenses incurred to acquire the lease which are shown as an asset in the Balance Sheet are being **written off** at a rate which could completely write off the asset over the unexpired term of the lease.
- The **cost of lease hold land** should be verified by reference to the letter from legal advisor and other relevant documents.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013**. Lease hold land should be **shown separately** as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Plant and Machinery**

- Examine the **schedule** of plant and machinery and the **fixed asset register**.
- Verify **proper authorisation for purchase** of new plant and machinery during the year.
- **Installation costs and other charges** incurred to the place asset in condition for use, should also be **capitalized**, irrespective of whether it has been purchased or constructed.
- Ensure whether any **charge** is created on Plant & Machinery. If yes, Verify e-Form CHG-1 for 'Creation of Charge' & e-Form CHG-4 for 'Satisfaction of Charge', filed with ROC and check whether it is appropriately disclosed.
- Auditor should ascertain whether the **profit or loss on sale** of the machinery has been calculated correctly and disclosed properly in the profit and loss account.
- Analyse whether the provision for **depreciation** has been made in accounts.
- Enquire cases of **revaluation of fixed assets** and obtain required explanations.
- Examine the manner of **disclosure** in the balance sheet and ensure compliance with the legal provisions.
- Ensure the compliance of **AS 10** on 'Fixed Assets' and **AS 6** on 'Depreciation'.

- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Capital Work-in-Progress**

Capital Work-in-Progress denotes assets under installation. This could either be plant or machinery under construction, or that construction project for establishment of a new factory is under progress. The auditor should take the following steps to verify the same.

- Ensure that the capital project is **authorised by the Board**. See the relevant Board Minutes for the purpose.
- Obtain the **break up** in details of the amount shown in the Balance Sheet under this head.
- **Check purchase cost** of plant machinery or other assets with reference to the contract with, and amount paid to the suppliers.
- Examine the **allocation of common costs** to the Capital Work-in-Progress in case such items have been constructed internally.
- Ensure that the **assets already put to commercial use are not included** under Capital Work-in-Progress.
- Verify that only expenses incurred up to pre commissioning stage are capitalised under this head.
- Obtain the **certificate of the engineering department** to ascertain the quantum of the Capital Work-in-Progress, and whether the value is correctly represented in the Balance Sheet, and its transfer to Fixed Assets on completion of the project or installation of the plant.
- Ascertain that **no depreciation** have been provided on Capital Work-in-Progress
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. Capital Work-in-Progress is **properly disclosed** in the Balance Sheet under the head Fixed Assets with main heading of Non-Current Assets.

### **Furniture and Fixture**

Furniture is a moveable asset & can be easily removed from one place to other, for example chair. While fixture on other hand, is an asset so affixed to land or to building as to become in fact a part thereof, for example laboratories in the schools. The verification of Furniture and Fixture should cover the following:

- Obtain a **schedule** of furniture giving details of description, location, cost, date of acquisition.
- Conduct **physical inspection** of furniture and fixture after ascertaining the efficacy of internal controls.
- Ensure that the **cost** of furniture and fittings which have become unserviceable or has been lost is written off to the profit and account under proper authority.
- Verify, whether proper **depreciation** has been properly charged on the items as per consistently adopted methods and rates.
- Examine whether the **statutory disclosures** requirements have been complied with.



- Ensure whether any **charge** is created on Furniture & Fixtures. If yes, Verify e-Form CHG-1 for ‘Creation of Charge’ & e-Form CHG-4 for ‘Satisfaction of Charge’, filed with ROC and check whether it is appropriately disclosed.
- Ensure the compliance of **AS 10** on ‘Fixed Assets’ and **AS 6** on ‘Depreciation’.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Assets Abroad**

- Examine the **title deeds** of immovable properties abroad.
- Ensure that the immovable properties abroad have been **properly classified and disclosed**.
- Where **documents of title** relating to assets held abroad are not available for inspection, a certificate should be obtained from the agent or any other party holding the document.
- Ensure whether any charge is created on Assets Abroad. If yes, Verify e-Form CHG-1 for ‘Creation of Charge’ & e-Form CHG-4 for ‘Satisfaction of Charge’, filed with ROC and check whether it is appropriately disclosed.
- Verify the compliance of **AS 11** on ‘Effect of Changes in Foreign Exchange Rate’ & **Schedule III of Companies Act, 2013**. It is disclosed as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Motor Vehicles**

- Examine the **Registration Certificate (RTO book)** so as to confirm the ownership, identification and other details.
- Examine **insurance policies** taken for vehicles and road tax receipts for information regarding ownership.
- Examine whether the entire consideration has been properly settled.
- Confirm that **all costs relating to acquisition has been capitalized**.
- Ensure whether any charge is created on Motor Vehicles. If yes, Verify e-Form CHG-1 for ‘Creation of Charge’ & e-Form CHG-4 for ‘Satisfaction of Charge’, filed with ROC and check whether it is appropriately disclosed.
- These assets should be valued and disclosed at the cost less depreciation.
- Where the **purchase is of second hand motor vehicle**, confirm whether the receipt contains all relevant details like registration number.
- Ensure the compliance of **AS 10** on ‘Fixed Assets’ and **AS 6** on ‘Depreciation’.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Tangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Patents**

A Patent Right is an official right to inventor to make, use or sell his invention.

- Obtain the **schedule** containing particulars of the patents owned by the client as on the balance sheet date. The particulars should contain the dates of registration of the patents with the related authorities and the dates in respect of the last renewal.



- See that the total of the values of the patent rights shown in each list agree with the values shown in the respective ledger accounts.
- Examine the **cost of patent rights**.
- See that the **renewal fees** in respect of the patent rights have been paid and the same has been **treated as a revenue** charge.
- Verify the **existence, ownership & possession** of a patent by examining certificates or **patent letters issued** upon the registration of the patent.
- Being an intangible asset, patent **cannot be subjected any charge**.
- The **last renewal receipt** should be examined to ascertain that the patent has not been lapsed.
- If the patent has been **developed in-house**, auditor should ascertain that only actual cost incurred in the process has been capitalized.
- The cost should be **amortized** over the period of validity or useful life, whichever is shorter.
- Ensure the compliance with the provision of **AS 26** on 'Intangible Assets'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Intangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Copy Rights**

A copy right is the exclusive legal right to produce or reproduce some kind of literary work. It is the legal protection provided to an author by which the publication of his work by other is prohibited.

- Verification of copy rights should be with reference to **original agreements** and correspondence and other supporting evidence.
- In case of large number of copy rights, the auditor should obtain a **schedule** of copy rights duly signed by a responsible official of the client and **verify their existence**.
- Being an intangible asset, copy right **cannot be subjected any charge**.
- Copy rights are generally revalued at the cost of each financial period. The auditor should see that revaluation has been made on a fair and reasonable basis.
- The cost should be **amortized** over the period of validity or useful life, whichever is shorter.
- Ensure the compliance with the provision of **AS 26** on 'Intangible Assets'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Intangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Trade Marks**

A trade mark is a distinctive sign, symbol or design or brand name established to enable the purchases to identify the product easily.

- Verify trademarks by examining the **certificate of registration** issued by the office of the registrar of trademarks.
- In case, trade-marks are purchased, the **agreement with the seller** should be verified.
- The **renewal payment** receipts should be examined.

- Trade-marks are shown in the balance sheet at their **cost less amortization charges till date**.
- The cost should be amortized over the period of validity or useful life, whichever is shorter.
- Being an intangible asset, trademark **cannot be subjected any charge**.
- Ensure the compliance with the provision of **AS 26** on 'Intangible Assets'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Intangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Goodwill**

Goodwill arises from business connections, trade name or reputation of an enterprise.

**AS 26** on 'Intangible Assets', states that "Internally generated goodwill should not be recognised as an asset, because it's cost cannot be measured reliably."

**AS 10** on 'Accounting for Fixed Assets', states that "Goodwill should be recorded in the books, only when money or money's worth has been paid for it."

The following points are to be noted for verification of goodwill:

- Examine the **vendors' agreement** on the basis of which assets of the running business have been acquired by the company as per the books of account or a specific amount has been paid for the goodwill.
- Ensure that whenever business is acquired at a price, payable in cash or otherwise, which is in **excess of the value of net assets taken over**, such excess amount is the goodwill.
- See that **goodwill has not been shown in the company's books by writing up the value of its assets**, on revaluation, or by writing back the amount of goodwill earlier written off.
- See that the goodwill is being **amortized** as per financial prudence over a reasonable period.
- Ensure the compliance with the provision of **AS 14** on 'Accounting for Amalgamation' and **AS 26** on 'Intangible Assets'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Intangible Assets under the head Fixed Assets with main heading of Non-Current Assets.

### **Investments**

- Obtain **schedule** of securities and shares in hand at the **beginning** of the audit period containing description, date of purchase, face value, book value, market value, rate of interest etc.
- Add to the above list, securities and shares **purchased and sold** during the year.
- The auditor should ascertain whether the investments made by the entity are **within authority**.
- Make a **physical inspection** of investments at the end of the accounting period.
- Current & Long term investments should be **properly classified**.
- **Inspect the investment certificates** to confirm the title. Inspect title deeds in respect of investment in immovable properties.

- If **investments are held in the name of nominees/trustees** as allowed under **section 187** of Companies Act, 2013, ascertain the reason for the same and examine the relevant documentary evidence.
- Ensure that provision of **section 143(1)** have been complied with.
- Ascertain that the **market value** of investments is in accordance with the authentic market reports or quotations.
- Ensure whether any **charge** is created on Investments. If yes, Verify e-Form CHG-1 for ‘Creation of Charge’ & e-Form CHG-4 for ‘Satisfaction of Charge’, filed with ROC and check whether it is appropriately disclosed.
- Ensure the compliance with the provision of **AS 13** on ‘Investment Accounting’.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. Long Term Investments are disclosed under Non-Current Assets while Current Investments are disclosed under Current Assets in Balance Sheet. Also, ensure that Market Value of Quoted Investments is disclosed in Notes to Accounts.

#### **Investment in the Shares or Debentures of a Subsidiary**

- Obtain a complete **schedule** of all such investments held, showing particulars as regards the name of the subsidiary company, class of shares or debenture, date of purchase, number of units and denoting numbers, book value, dividend received etc.
- All the particulars entered in the schedule should be verified with the relevant account in the **General Ledger**.
- Examine all the investments by **inspection** of the securities, share scrips or certificates, debenture bonds, etc.
- If any of the securities are held by bankers, verify them with their certificate which should disclose the **charge**, if they are subject to any such charge.
- Schedule III to the Companies Act, 2013 require that shares held in a subsidiary should be **shown separately**.
- The shares or debentures of a subsidiary are **generally valued at cost, as they are long term investments**.
- If the subsidiary has **suffered a loss a provision** for the proportionate part of the loss should be made in the accounts of the holding company.
- Ensure the compliance with the provision of AS 13 on ‘Investment Accounting’, AS 18 on ‘Related Party Disclosure’ & SA 550 on ‘Related Parties’.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. Being long term in nature, it is disclosed as part of Long Term Investments under the main head Non-Current Assets in Balance Sheet. Also, ensure that Market Value of Quoted Investments is disclosed in Notes to Accounts.

#### **Purchase of Quoted Investment**

- **Ascertain** the date of purchase, rate of purchase, nature of investments purchased and nature of transaction, i.e., error cum-dividend/interest/right/bonus.
- **Compare the rate of purchase** with quotation available. Obtain suitable explanations in case of significant variations.
- Verify the **amount paid** towards purchase of investments.

- **Trace the amount in the cheque book** counterfoils and bank statements.
- Obtain a **schedule** of investment from Management for physical verification at the year end.
- Verify the **investment certificate** to confirm title.
- Confirm compliance with **statutory provisions** such as AS 13 on 'Investment Accounting', and Section 143(1) of the Companies Act, 2013.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. Long Term Investments are disclosed under Non-Current Assets while Current Investments are disclosed under Current Assets in Balance Sheet. Also, ensure that Market Value of Quoted Investments is disclosed in Notes to Accounts.

### **Investment in the Capital of a Partnership Firm**

- Inspect the **partnership deed**, noting the capital contributed by the company, and the latest Balance Sheet and the Profit and Loss Account, duly audited.
- The amount of the loss, if any, falling to the share of the company should be debited to the profit and loss account; the share of profit should be similarly credited to the Profit and Loss Account.
- Verify whether the firm has been **duly registered** and note the particulars sent for registration.
- Verify that the Investment in Capital of a Partnership Firm is **disclosed separately**.
- Ensure the compliance with the provision of AS 13 on 'Investment Accounting'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. Being long term in nature, it is disclosed as part of Long Term Investments under the main head Non-Current Assets in Balance Sheet.

### **Livestock**

- Obtain a **schedule** of livestock at the close of the year
- Verify the entries in the same with the **Register of Animals**, if it has been maintained.
- Verify that the **entire stock of animals has been revalued on a uniform basis**, from year to year. The cost of animals which have either been sold or have died during the year being excluded, and that of newly born or purchased during the year being added.
- Verify that **proper adjustment has been made in the value of dry cattle** on appropriate basis.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements.

### **Debtors**

Verification of debtors involves the following three procedures:

- a) Examination of records
- b) Direct confirmation procedure.
- c) Analytical review procedures

#### **a) Examination of records:**

- Carry out an **examination of the relevant records** about the validity, accuracy and recoverability of debtor balances.
- Check and verify whether the balance shown in the ledger accounts are in agreement with balances as per **control accounts**.
- Auditor should pay **special attention** to the following:
  - The age of debts
  - Credit terms & credit policy of the entity.
  - Authorisation for account transfers.
- Ensure that **bad debts** are written off and **discounts allowed** to debtors are provided with prior permission of proper authority.
- Examine whether the **contingent liability in respect of bills accepted by customers and discounted** with the banks is properly disclosed.

**b) Direct confirmation procedures:**

- The verification of balances by direct communication with debtors is the best method of ascertaining whether the balances are genuine, accurate and undisputed.
- Direct confirmation procedures should be used only with the consent of the entity under audit.
- Confirmation date, method of requesting confirmation and the particular debtors from whom confirmation of balances is to be obtained are to be determined by the auditor.
- Objectives of confirmation:
  - To ascertain reasonability of collection.
  - To prevent & avoid frauds & teeming & lading.
  - To verify accuracy of the amount dues.
  - To examine the correctness of internal control system.
- The form of requesting confirmation may be either:
  - Positive Form: Reply whether agrees or not with the balance shown.
  - Negative Form: Reply only if disagrees with the balance shown
- The method of selection of the debtors to be circularized should not be disclosed to entity until the trial balance of debtors' ledger is handed over to the auditor.

**c) Analytical review procedures:**

- Comparison of closing balance of debtors with the corresponding figures of the previous year.
- Comparison of relationship between current year debtor balance and the current year sales with corresponding budgeted figures.
- Comparison of actual closing balances of debtors with the corresponding budgeted figures.
- Comparison of current year's ageing schedule with the corresponding figures for the previous year.
- Comparison of significant ratios relating to debtors with the industry norms.

**d) Disclosure:**

- a) Following disclosure should be made:

- Debt considered good & those considered doubtful.
- Debt due for a period of more than six months & others.
- Debts due by Directors, Officers or Other entities deemed to be under the same management along with their names.

b) Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Trade Receivables under the main head Current Assets in Balance Sheet.

### **Cash at bank**

- Examine the **counterfoils of cheques and pay in slips** and compare them with the entries in the concerned ledger of the client.
- Inspect **fixed deposit receipts** and bank advices for verifying fixed deposits.
- Remittances in transit should be verified with reference to their credit in bank account in the subsequent period.
- Examine the **bank reconciliation statement** to know the items that explains differences, if any between the balance shown by client's ledger and Bank statement.
- In case of **stale cheques (outdated cheques)**, the auditor should ensure suitable adjustments have been made in the books of account.
- Review the total number of bank accounts maintained by the entity to ensure that there are no **inoperative accounts** through which fraud is possible.
- Verify **official confirmation** of the balance by bank.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Cash & Cash Equivalent under the main head Current Assets in Balance Sheet. Further, it should be bifurcated as Balance with Scheduled & Non-Scheduled Banks.

### **Debt Due from Subsidiary Companies**

- Verify that the debts shown as outstanding from the subsidiary are **genuine** and have resulted from transactions entered into in the normal course of business.
- The balance outstanding should not only be confirmed with the statements of account received from the subsidiary but its basis should also be inquired into.
- If the debt is covered by an **agreement**, the same should also be referred to.
- Debts due from a subsidiary company should be **disclosed duly classified in the same way as sundry debtors**.

### **Cash in hand**

- The auditor should carry out **physical verification** of cash in hand at the year end or by way of surprise check any time during the year, provided the internal control on cash is effective.
- Auditor should check all items of cash balance e.g. Main cash, petty cash, imprest balances with the employees etc. simultaneously, so that the shortage in one balance is not made good by transfer of amount from others.
- Ascertain whether cash has been **disclosed** in the financial statements in accordance with recognized accounting policies and practices and, relevant statutory requirements.



- Ensure that **temporary advances are not included in cash-in-hand** and if postage and revenue stamps exists in a substantial number, they should be shown separately and not included in cash in- hand.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Cash & Cash Equivalent under the main head Current Assets in Balance Sheet.

### **Inventories**

- Inventories consist of tangible items that are held for sale or use in the production of goods and services. Inventories generally consists of:
  - a) Raw materials
  - b) Work-in-Progress
  - c) Finished goods
  - d) Materials such as stores, supplies and spare parts.
- **Examine stock records** with a reference to relevant documentary evidence such as receiving reports, inspection reports, material issue notes etc.
- Observe **physical count** of inventory by the management
- **Enquire about charge** on inventory. They might have been subject to a floating charge.
- Ascertain the nature of **internal controls** for stock movements and ensure that the same has been operating effectively during the period.
- Ensure that a **proper cut-off procedure** has been followed in accounting for purchase, sales, sales on approval basis, goods in transit etc.
- Ensure that the goods purchased but not received have been included in the inventories and the liability has been provided for.
- Ensure that goods sold but not dispatched have been excluded from the inventories and credit has been taken for sales.
- Ensure the compliance with:
  - a) AS 2 on 'Valuation of Inventories'
  - b) Guidance note on Audit of Inventories issued by ICAI.
- Ensure whether inventories have been **properly classified and disclosed** in the financial statements as per recognized accounting principles and statutory requirements.
- Auditor should carry out **analytical review** in verification of inventories:
  - a) Reconcile the quantities of opening stock, purchases, production , sales & closing stock.
  - b) Comparison of the relationship of the current year stock quantities and amounts with the current year sales & purchases, with the corresponding figures for the previous year.
  - c) Comparison of gross profit ratio of current year with previous year.
  - d) Comparison of actual stock, purchases & sales figures with the corresponding budgeted figures.
  - e) Comparison of significant ratios, like inventory turnover ratio, relating to inventories with similar ratios of other firms/companies in the industry.
- In case of **Work in Progress**:
  - a) Examine the production/costing records

- b) Obtain a certificate from the work engineer as to the correctness of Cost Sheets
- c) Ascertain the completion stage of WIP for assessing appropriateness of its valuation
- d) Compare the composition of cost & values placed on various components with that of the previous year
- e) Ensure that internal control system is working properly
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Current Assets in Balance Sheet.

### **Semi-finished Goods lying with Third Parties**

Semi-finished goods are the assets of the company and therefore such goods, though, at present not with the company, should be included in the closing stock under the head "stock with processors". The auditor shall be required to undertake the following steps in respect of inventories lying with third parties:

- Ensure that semi-finished goods have been **included for valuation** of inventory since these belong to the company.
- Obtain **confirmation letters from such third parties** in respect of quantity lying with them at the end of the year. The auditor may also consider carrying out the appropriate audit procedure to obtain assurance about the condition of such inventory.
- Examine the **basis of valuation**. In this case, it shall have to be done on the basis of the cost of work-in-progress and having regard to stage of completion and accordingly accounting for conversions costs.
- Verify compliance of **AS 2** on 'Valuation of Inventories'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed separately as part of Inventories under the main head Current Assets in Balance Sheet.

### **Stock lying with Sub-Contractors for Fabrication**

- The stock lying with the sub contractor for processing should be confirmed by the **confirmation letter** obtained from the sub contractors.
- The necessity of holding stock by them should be vouched. If the stock is lying with them for long, the reason for the same should be ascertained. The **condition of the stock should be confirmed** by the management.
- The stock should be **valued** at cost or net realizable value whichever is less. The processing charges incurred should be added to the cost. The provision for the liability towards unpaid processing charges should be created.
- Adjustment in accounts should be made for any **discrepancies** between stock confirmed and stock sent out as per memorandum records.
- Verify compliance of **AS 2** on 'Valuation of Inventories'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed separately as part of Inventories under the main head Current Assets in Balance Sheet.

### **Small Tools**

- Obtain **list** of inventory of tools, patterns, jigs, and dies along with the details of date of acquisition, copy of invoice etc.

- Find out the **method of valuation** regularly adopted by the management. Generally, **Revaluation Method** is used for valuation of Small Tools i.e. they are valued at Cost or NRV whichever is lower.
- Any **change in method of valuation** shall be disclosed along with its effect on the financial results of the company.
- Care should be taken to see that the inventory **does not include any worn out or defective articles**, the life of which has already run out.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Inventories under the main head Current Assets in Balance Sheet.

### **Bills Receivable**

- Verify the **opening balance** of bills receivable with reference to audited balance sheet of the last year.
- Ensure that bills which have been matured but the amount in respect thereof has not been received, have been **renewed** subsequently.
- Scrutinize the **schedules for any long outstanding or overdue bills** and investigate the reasons there of.
- Obtain a **confirmation certificate from the bankers** when some of the bills are lying with them for collection or **bills discounted**.
- Ensure that **adequate provision has been made for dishonoured bills**.
- Ensure that bills receivable from subsidiary companies have been shown separately.
- Verify that **Bill Receivable discounted with Bank not yet Matured** has been disclosed as Contingent Liability in Notes to Accounts.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Trade Receivables under the main head Current Assets in Balance Sheet.

### **Prepaid Expenses**

Prepaid expenses are outstanding assets representing expenditure already incurred, some portion or whole of which relates to a period subsequent to the date of the Balance Sheet.

- The auditor should ensure the proper calculation and accounting of prepaid expenses.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Short Term Loans & Advances under the main head Current Assets in Balance Sheet.

### **Endowment Policies/Sinking Fund policies**

Endowment policies or Sinking fund policies may be taken out for purposes like redemption of debentures, redemption of leases etc., where a lump sum amount is required at a certain future date.

- **Ascertain the specific purpose** for which the endowment policy is taken, e.g., Sinking Fund policies for redemption of debentures, redemption of leases or policies taken for other similar purposes, etc.
- Verify the terms **and conditions** of policies and ensure that all such conditions are in force and being followed.

- Check that **premium has been deposited in time and the policy is in force.**
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements.

### **Advances with the Suppliers**

- Obtain **schedule of debit balances** in creditors' account and pay particular attention to the age of the balances. Also **scrutinise the bought ledger.**
- Enquiry should be made for **long unadjusted outstandings** and check as to whether any of them would require provisioning.
- Examine that the advances have not been shown as deposits in balance sheet as per **Section 143(1)** of the Companies Act, 2013.
- **Confirmation** of balances should be obtained and reconciliation be done in case of any discrepancies.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Short Term Loans & Advances under the main head Current Assets in Balance Sheet.

### **Advance given to a director of a company**

- Verify **articles of association** for powers of the company to grant advances to director.
- As per **Section 185** of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.
- Check the **bank book/cash book** entries with vouchers.
- Study the **contract /loan agreement**, terms, rate of interest and inquire whether they are prejudicial to the interest of the company.
- Check the **confirmation** received from the director for outstanding advances.
- Check **interest** had been duly charged for the outstanding unless it is an interest free advance.
- The loan or advances made to the directors should be **distinctly shown** in the balance sheet.
- Verify compliance of **AS 18** on 'Related Party Disclosure' and **SA 550** on 'Related Parties'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements.

### **VERIFICATION OF LIABILITIES**

Liabilities are financial obligations of an enterprise other than owner's equity. The process of examining the liabilities by considering their legal and official documents and then forming an expert opinion as to existence, obligation, completeness, valuation and disclosure of liabilities is called verification of liabilities.

The auditor has to ensure that the liabilities:

- a) Shown in the Balance Sheet are actually payable.
- b) Are stated in Balance Sheet at fair and reasonable amounts.
- c) Represent obligations of business to third parties.

- d) Are classified and disclosed in financial statements as per statutory requirements.

### **Loans & Borrowings**

- **Examine the MOA and AOA** to see whether the company is empowered to borrow the money.
- Ensure that **proper resolutions** by shareholders have been obtained for excess borrowings.
- Obtain a certificate from the bank, showing particulars of securities deposited with the bank as security for the borrowings.
- Note the **purpose** for which loans have been raised; also confirm whether these have been utilized for the specified purpose or for some other purpose.
- Ensure whether any **charge** is created on Assets. If yes, Verify e-Form CHG-1 for 'Creation of Charge' & e-Form CHG-4 for 'Satisfaction of Charge', filed with ROC and check whether it is appropriately disclosed.
- Confirm loans and borrowings **outstanding** and interest payable on them directly with the lender.
- Ensure that provisions of Companies Act have been complied with in relation to **ceiling on maximum amount to be borrowed**.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements.

### **Trade Creditors**

- Obtain the **schedule** of creditors and examine it with reference to individual creditor's accounts.
- The **purchase ledger** should be checked with the books of original entry, invoices, credit notes etc.
- Provisions in respect of **discount on creditors** should be checked carefully with reference to creditor's accounts.
- Ensure that **conditions of agreements are complied** with if goods have been purchased on hire purchase basis.
- Ascertain by reference to the **goods inward** book that all the goods received during the last few weeks of the period under audit have been duly accounted for.
- The auditor may communicate directly with the creditors so as to obtain **confirmations of the amount due** from them either on the date of balance sheet or as at any other particular date.
- Find out the **reasons for non-payment of balance where it has remained unpaid for a long time**.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Trade Payables under the main head Current Liabilities in Balance Sheet.

### **Provision for Income tax**

- Recalculate the provision for tax liability for the year as per the provisions of **Income Tax Act, 1961**.

- Examine various records and documents such as bank statements, demand notices etc. to see about payment of advance tax, self assessment tax etc.
- The auditor should also examine whether the **disputed tax liability** requires a provision or suitable disclosure.
- Verify compliance with AS 22 on 'Taxes on Income'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Short Term Provisions under the main head Current Liabilities in Balance Sheet.

### **Deferred Tax Liability**

The deferred tax liability is created when there is timing difference which results in deferred tax payable with reduction in current tax to the same extent.

For example, when more depreciation amount is claimed in Income tax profits than in accounting profits, the current tax payable will be less with an liability to pay more tax in future. This is called Deferred Tax Liability.

- Check the creation of Deferred Tax Liability and its actual working.
- Check how much Deferred Tax Liability is reversed during the year.
- Check that Deferred Tax Liability is disclosed as relating to depreciation and as relating to others.
- Verify compliance with AS 22 on 'Taxes on Income'.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is separately disclosed under the main head Non-current Liabilities in Balance Sheet.

### **Debentures**

- Examine the **MOA and AOA** of the organization to ascertain the borrowing powers.
- Examine **Debenture Trust Deed** in order to ascertain the terms and conditions of the issue.
- Inspect a copy of debenture bonds that have been issued in acknowledgement of amounts received to ascertain the terms of repayment and particulars of the assets charged as security for repayment of amount.
- Ensure that the **provisions regarding redemption of the debentures** have been adhered to.
- See in case of the mortgage debentures that the obligations undertaken by the company under Debenture Trust Deed to debenture holders were being strictly honoured.
- Confirm that the under mentioned information, required by law, has been duly **communicated to the Registrar of Companies**:
  - a) Particulars of charges which have been created (via e-form CHG-9) over the assets of the company (Section 77).
  - b) Information in regard to satisfaction in whole, or in part, of any charge (via e-form CHG-4) relating to the property of the company (Section 82).
- Ensure that compliance with provision in regard to **listing requirements** and SEBI guidelines have been followed.



- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Long Term Borrowings under the main head Non-current Liabilities in Balance Sheet.

### **Bills Payable**

- Bills payable are acknowledgements of debts payable.
- Obtain a **schedule** of bills certified by a responsible official, giving details of tenure, amount etc.
- Examine in depth, a few cases for compliance with the **internal control procedures** prevalent in the organization, for acceptance of bills.
- **Trace all entries in the bills payable book in to the bills payable account** to confirm that the liability in respect of bills has been correctly recorded.
- Review the **confirmation** obtained from drawers or holders of bills payable regarding amounts due there on.
- Reconcile the total of schedule of bills payable outstanding at the end of the year with the balance in bills payable account.
- Vouch payments made to retire bills on their maturity or earlier and confirm that the relevant bills have been duly cancelled.
- Ensure whether any **charge** is created on Assets. If yes, Verify e-Form CHG-1 for 'Creation of Charge' & e-Form CHG-4 for 'Satisfaction of Charge', filed with ROC and check whether it is appropriately disclosed.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Trade Payables under the main head Current Liabilities in Balance Sheet.

### **Amount due to subsidiary companies**

- Examine whether the **subsidiary company is authorised** by its MOA to advance loan to the holding company.
- Verify the **interest rate** at which loan has been obtained.
- Inspect the **documents** executed by holding company which constitute the basis of loan.
- Compliance with **AS 18** on 'Related Party Transactions' and **SA 550** on 'Related Parties' should be verified.
- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is separately disclosed in Balance Sheet.

### **Outstanding Expenses**

- Obtain a **list of outstanding expenses** as on the Balance Sheet date, classified by nature of expense.
- Compare current year's outstanding expenses with that of last year to identify significant variations.
- Ensure that **no usual outstanding expenses** like salaries, wages, rent etc. **has been left out** to be provided.
- Verify the **documentary evidence** supporting the outstanding expenses.

- Verify that in case of a Company, the **requirements of Schedule III of Companies Act, 2013 are complied with** requirements. It is disclosed as part of Other Current Liabilities under the main head Current Liabilities in Balance Sheet.

### **Contingent Liabilities**

As per **AS 29**, a Contingent Liability is

- a) A **possible obligation** that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
- b) A **present obligation** that arises from past events **but is not recognized** because:
  - It is not probable that an outflow of resource embodying economic benefits will be required to settle the obligation; or
  - A reliable estimate of the amount of the obligation cannot be made.

Contingent liabilities should be shown by way of a foot note to the balance sheet, specifying the general nature and amount of each contingent liability, so as to comply with provisions of Schedule III of the Companies Act, 2013.

The examples of Contingent Liabilities are as follows:

- Claims against the company not acknowledged as debts.
- Uncalled liability on partly paid shares held as investments.
- Arrears of fixed cumulative dividend.
- Estimated amount of contracts remaining to be executed on capital account and not provided for.
- Bill receivable discounted with bank yet not matured.
- Other money for which the company is contingently liable.

The following general procedures may be useful in verifying contingent liabilities.

- Obtain a **letter of representation** from the client containing a statement that management is aware of not disclosed contingent liabilities.
- Review of **minutes** of the meetings of board of directors, committees of board of directors/other similar body.
- Review of **contracts**, agreements and arrangements.
- Review of **list of pending legal cases**, correspondence relating to taxes, duties, etc.
- Review of **terms and conditions of grants** and subsidies availed under various schemes.
- Review of records relating to contingent liabilities maintained by the entity.
- Enquiry of and discussions with, the management and senior officials of the entity.
- Ensure the compliance with provisions of AS 29 on 'Provisions, Contingent Liabilities & Contingent Assets'.