

6. COMPANY AUDITOR

NO.	QUESTION	Sec.	ABC	PAGE
1.	Appointment of first Auditor.	224(5)		
2.	Appointment of auditor by passing a special resolution.	224 A		
3.	Appointment of Auditor by share holders.	224(1)		
4.	Appointment of Auditor by Central Government.	224(3)		
5.	Appointment of Auditor of Government Company.	617		
6.	Qualifications and Disqualifications.	226		
7.	When retiring auditor of a company cannot be reappointed?	224(2)		
8.	Auditor's remuneration.	224(8)		
9.	What are the Rights/Powers of an auditor?	227		
10.	What are the duties of Auditor?	227, 229		
11.	How can a casual vacancy of an auditor to be filled up?	224(6)		
12.	Removal of auditor.	-		
13.	Ceiling prescribed on number of audits in the companies act.	224(1B)		
14.	Audit of accounts of Branch Office.	228		
15.	Exemption from Branch Audit.	228(4)		
16.	Special Audit.	233 A		
17.	Cost Audit.	233 B		
18.	Distinction between financial Audit & Cost Audit.	-		
19.	Distinction between special Audit & Cost Audit.	-		
20.	Audit Committee.	292 A		
21.	Corporate Governance & Audit committee.	-		
22.	Appointment of Secretaries.	383A		

Q.NO.1. WRITE SHORT NOTES ON APPOINTMENT OF FIRST AUDITORS OF A COMPANY?

Ans:

- Appointment by Board:** Sec.224 (5) specifies that the Board of Directors can appoint the First Auditor(s) of a Company.
- Time of Appointment:** The appointment shall be made by the Directors, within 1 month from the date of incorporation of the Company.

- 3. Tenure of Office:** The First Auditor(s) shall hold office till the conclusion of the first AGM.
- 4. Failure:** If the Board fails to appoint the First Auditor(s) within one month of registration, the Company in General Meeting is empowered to make the appointment.
- 5. Members' Power of Removal:** The Company may, at a general meeting, remove such an Auditor or all or any or them and appoint another or others in his or their place, on a nomination being made by any member of the Company. For this purpose, notice should be given to the members of the Company, not less than 14 days before the date of the meeting.
- 6. Provision in Articles:** An Auditor cannot be appointed as First Auditor(s) simply because his name has been stated in the Articles of Association.
- 7. Intimation:** The Company need not send any statutory intimation to the First Auditor(s), of their appointment within 7 days. Notice of appointment can be sent in the ordinary course of business within reasonable time.
- 8. Acceptance:** The First Auditor(s) are themselves not required to inform the ROC about their acceptance or refusal of such an appointment.

Subsidiary Questions:

1. State the procedure for removal of First Auditor appointed by the Board of Directors before the expiry of his term.
2. State the procedure for appointment of First Auditor, when the Board of Directors did not appoint the First Auditor within 1 month from the date of registration of the Company.

Q.NO.2. WRITE SHORT NOTES ON APPOINTMENT OF AUDITOR BY SPECIAL RESOLUTION?

Ans:

- 1. Special Resolution:** Sec.224A of the Act states that Special Resolution is required for appointing or reappointing at each AGM, the Auditor in the case of a Company in which not less than 25% of the Subscribed Share Capital is held, whether singly or in any combination by :
 - a. A Public Financial Institution or a Government Company or the Central Government or any State Government, or
 - b. Any financial or other institution established by a Provincial or State Act in which a State Government holds not less than 51% of the Subscribed Share Capital, or
 - c. A Nationalised Bank or an Insurance Company carrying on general insurance business.
- 2. Omission by Company:** Where a Company referred to above omits or fails to appoint an Auditor(s) by a special resolution in its AGM, the Central Government shall have the power to appoint a person to fill the vacancy u/s 224(3).
- 3. 25% Holding:**
 - a. For determining 25% holding, the material date shall be the date of the AGM in which the special resolution is required to be passed.
 - b. In cases where the holding is less than 25% on the date of notice, but exceeds 25% as on the date of AGM, it is advisable for the Company to:
 - Adjourn the meeting, issue another notice to the members for appointment of Auditors by special resolution and pass the special resolution at the adjourned meeting, or
 - Omit or pass over the item on the agenda regarding the appointment of Auditor.

Sec. 224A will apply to all cases of shareholding in any combination by any way of the institutions mentioned in the clauses. They are not mutually exclusive.

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Note: Shareholding as a percentage of Subscribed Capital has to be considered, and not of Paid Up Capital.

**Illustration on Applicability of Sec. 224A
Shareholders and % of Shareholding**

Company	% of Shareholding in Subscribed Capital				
	A	B			C
Nature of Capital	Only Equity	Both Equity and Preference			Only Preference
Shareholders		Equity	Preference	Total	
ICICI	5%	5%	3%	8%	26%
NABARD	11%	10%	2%	12%	-
HDFC	13%	2%	-	2%	-
LIC	8%	4%	1%	5%	-
Resolution for appointment of Auditors	Ordinary	Special			Special
Reason	HDFC is not a Public Financial Institution, so its % of Shareholding is not considered.	% of Subscribed Capital is 25%. [Caution: Condition in Law is not less than 25%. Don't read this as 25% or more]. Further, Subscribed Capital includes Preference Share Capital also.			Subscribed Capital exceeds 25%

Note: Refer to Practical Question from Examination:

P6: Holding of 25% share capital- what is the material date?

Q.NO.3.WRITE SHORT NOTES ON APPOINTMENT OF AUDITORS BY SHARE HOLDERS?.

Ans:

- 1. Appointment:** Under Sec.224 (1), every Company shall, at each Annual General Meeting, appoint an Auditor(s). Appointment in a General Meeting of the Company means appointment by the Shareholders of the Company.
- 2. Certificate from Auditor:** Before appointment or re-appointment at the AGM, the Company shall obtain from the Auditor(s), a certificate to the effect that the appointment, if made, will be within the ceiling limits specified u/s 224(1B).
- 3. Tenure of Office:** The Auditor shall hold appointment from the conclusion of that AGM (in which he is appointed) till the conclusion of the next AGM.
- 4. Intimation:** The Company shall give intimation of appointment to the concerned Auditor within 7 days of the appointment.
- 5. Intimation to Previous Auditor:** The appointed Auditor shall communicate to the Previous Auditor about the appointment and enquire whether there is any professional reason why the appointment should not be accepted. This forms part of the Chartered Accountant's Code of Conduct.
- 6. Acceptance:** The Auditor, on receipt of the intimation from the Company about his appointment, is required to send a written communication to the ROC in e-Form 23B within 30 days of the receipt of intimation stating whether he has accepted or refused to accept the appointment.

Q.NO.4.WHEN CAN THE CENTRAL GOVERNMENT EXERCISE IT POWERS TO APPOINT AUDITORS OF A COMPANY?

Ans:

1. Sec. 224(3) of the Act provides that where at the AGM, no Auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy.
2. Under Sec. 224(4), the Company shall give notice of the fact within 7 days to the Central Government, of its power becoming exercisable.

3. If the Company fails to give such notice, the Company and every Officer of the Company who is in default shall be punishable with fine. which may extend to Rs.5,000.
4. Where a Company is required to appoint an Auditor at an AGM by passing a special resolution, but omits or fails to pass such resolution due to any reason, it shall be deemed that no Auditor has been appointed by the Company at its AGM, and the provisions of Sec.224 (3) of the Act will be attracted. [Sec.224A(2)]

Subsidiary Question:

1. A Company, whose AGM was held on 30th Sept, failed to appoint the Auditor. Explain.

Q.NO.5.WRITE SHORT NOTES ON THE APPOINTMENT OF AUDITORS OF GOVERNMENT COMPANY?

Ans:

1. **Government Company [Sec.617]:** A Government Company means any Company in which not less than 51% of the Paid-Up Share Capital is held:
 - a. By the Central Government, or
 - b. By any State Government or Governments, or
 - c. Partly by the Central Government and partly by one of more State Governments.
 It includes a Company, which is a Subsidiary of a Government Company as above defined.
2. **Appointment [Sec.619]:** The Auditor of a Government Company shall be appointed or re-appointed by the Comptroller and Auditor General of India.
3. **Sec.619B Companies:** Sec.619B deals with any Company in which not less than 51% of the Paid-Up Share Capital is held by one or more of the following or any combination there of:
 - a. The Central Government and one or more Government Companies,
 - b. Any State Government or Governments and one or more Government Companies,
 - c. Central Government, one or more State Governments and one or more Government Companies.
 - d. Central Government, one or more Corporations owned or controlled by the Central Government,
 - e. Central Government, one or more State Governments and one or more Corporations owned or controlled by the Central Government,
 - f. One or more Corporations owned or controlled by the Central Government or the State Government,
 - g. More than one Government Company.
 The Auditors of Companies specified u/s 619B shall be appointed or re-appointed by the C&AG of India.
4. **Remuneration:** Remuneration of Auditors of Government Companies shall be fixed by the Company in General Meeting or in such manner as the Company in General Meeting may determine.

Subsidiary Question:

1. M/s Rao & Rao, a Firm of Chartered Accountants, have to be appointed as the Auditors of ABC Co Ltd, a Government, Company. Explain the steps to be taken regarding the appointment and payment of remuneration to the auditors.

Q.NO.6.QUALIFICATIONS & DISQUALIFICATIONS TO BE APPOINTED AS AN AUDITOR.

Ans: These are contained in Sec.226 and are applicable for all types of appointments in previous questions.

Qualifications:

1. C.A.:

- a. The person proposed to be appointed as an auditor should be a qualified Chartered accountant as per the Chartered Accountants Act, 1949.
- b. If a partnership firm is proposed to be appointed as an auditor then all the partners practicing in India shall be qualified chartered accountants as per the chartered accountant's act, 1949.
- c. In case a partnership firm is appointed any partner may act in the name of the firm.

- 2. Restricted state auditor's:** The holder of a certificate in previous Part-B states entitling him to act as an auditor of companies.

Disqualifications:

- 1. Sec.226(3):** The following persons are disqualified for appointment as auditors of a company:

- a. A body corporate.
- b. An officer or an employee of the company.
- c. A partner or an employee of an officer or employee of the company.

d. Indebtedness:

- i. A person who is indebted to the company for more than Rs.1,000 Or
- ii. Who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for more than Rs. 1000.
- iii. When a firm is indebted to the company, each partner of the firm also is deemed to have been indebted to the company and vice versa is also correct.

- e. **Security:** A person holding any security of that company. (For the purposes of this Sec., security means an instrument which carries voting rights).

- 2. Subsidiary/Holding:** A person is not eligible for appointment as auditor of any company, if he is disqualified from acting as auditor of that company's subsidiary or holding company or of any other subsidiary of the same holding company. (Sec.226(4)).

- 3. Vacation:** If an auditor, after his appointment, become subject to any of the disqualification specified in 1 & 2 points, he shall be deemed to have automatically vacated his office.

- 4. Partnership firm:** If any of the partners in a partnership firm is subject to any of the above disqualifications then that partnership firm will be disqualified from being appointed as an auditor of that particular company.

Note:

- 1. The provisions contained in Sec.226 are applicable to all types of companies.
- 2. Further Sec.8 of the Chartered Accountants Act, also contains additional disqualifications (Not within your scope).
- 3. Receipt by the auditor of any installment of his fees exceeding 1,000 at any time before completion of the audit assignment will not be construed as indebtedness of the auditor.

Note: Refer to Practical Questions from Examination:

P1: Disqualifications of auditor on account of indebtedness.

P2: Disqualification on account of holding of a security of a company.

P3: Can a firm be re-appointed as auditor if one of the partners of the firm is appointed as a director in the AGM.

P4: Change in the constitution of a firm of auditors.

Q.NO.7.UNDER WHAT CIRCUMSTANCES THE RETIRING AUDITOR OF A COMPANY CANNOT BE REAPPOINTED?

1. Generally the retiring auditor is again reappointed at AGM but it cannot be considered as a right for the retiring auditor.
2. According to Sec.224(2) an auditor can't be reappointed under the following circumstances:
 - a. If he has been disqualified under Sec.226.
 - b. If he has exceed the ceiling limit prescribed under Sec.224 (1B).
 - c. If he in writing has expressed his unwillingness to be reappointed.
 - d. **If a resolution has been passed at the meeting:**
 - i. Appointing somebody other than him or
 - ii. Providing clearly that he shall not be re-appointed.
 - e. **Failure of notice:**
 - i. If a notice of the intended resolution has been served on the company,
 - ii. Proposing to remove him and
 - iii. Appoint somebody else in his place and
 - iv. Such notice could not be proceeded with,
 - v. In the AGM due to death of the latter.

E.g.: 'A' is the auditor of XYZ Ltd. A notice has been issued to him with a proposal to remove him and appoint 'B' in his place and 'B' dies before the holding of the AGM. In this case, 'A' can't presume that he is auditor.
 - f. Even for re-appointment, passing of a resolution is essential.

Q.NO.8.WRITE THE CO.'S ACT PROVISIONS RELATING TO AUDITORS REMUNERATION?

1. **Fixed by:** The remuneration shall be fixed by (Sec.224(8)):
 - a. By the directors - When the appointment is made by it.
 - b. By the C.G. - When the appointment is made by it and
 - c. By the shareholder's:
 - i. When the appointment is made by shareholders.
 - ii. When the appointment is made by C&AG (For government & deemed govt. co.'s).

For this purpose, the expression "remuneration" should be deemed to include any sums paid by the company in respect of auditor's expenses.
2. **Same meeting:** The act does not require that the remuneration should be fixed at the same meeting at which the appointment is made. It may be fixed at a subsequent meeting.
3. **Retiring auditor:** Where a retiring auditor is re-appointed, if no resolution is passed fixing his remuneration his old remuneration will continue for.
4. **Additional work:** Where in addition to the normal audit work, the auditor is also required to undertake any other work, he is entitled to receive an extra remuneration. This additional remuneration will be decided by the directors.
5. **Disclosure:** It shall be disclosed in the P&L Account as below (Part II of Schedule VI):
 - a. As auditor.
 - b. As adviser or consultant in respect of :
 - i. Taxation matters.

- ii. Company law matters.
- iii. Management services.
- c. In any other manner.

Q.NO.9.WHAT ARE THE RIGHTS/POWERS OF AN AUDITOR?

1. Right to receive information and explanations:

- a. According to Sec.227(3), the company auditor has to state in his report, whether he has received necessary information and explanations for the purpose of audit.
- b. It is not possible for the auditor to draw conclusions without obtaining proper explanations and information.
- c. It is for the auditor to decide the matters in respect of which information and explanations are required by him.
- d. When the auditor is not given/provided the information required by him his only remedy would be to report the same to the shareholder's through qualification in the auditor's report.

2. Right of accessibility to the books and records:

- a. The auditor enjoys the right of accessibility to books and records because he has to mention in his report whether proper books and records are maintained.
- b. It is logical that this right is available to the auditor because the books and records form part of the evidences on the basis of which the auditor draws his conclusion.
- c. The books will include:
 - i. Books of accounts (Financial & Costing).
 - ii. Vouchers & supporting evidences or documents &
 - iii. Statutory books.
 - iv. Quantitative records like production, sales, stock records etc.
 - v. Branch books, vouchers etc.
- d. It is for the auditor to determine what record or document is necessary for the purpose of the audit.
- e. This right can be exercised by the auditor at all times – mean that Normal business hours on a working day & during the period of his office.

3. Right to visit branches:

- a. Since the auditor has to report on the consolidated financial statements which also include the results of the branch operations, he has the right to visit the branches to obtain information.
- b. Even if the branch accounts are audited by another auditor, this right is still available because it is possible that the auditor may not be getting full information from the branch auditor regarding the branch accounts.

4. Right of lien: The term lien refers to the right of possession. The auditor enjoys this right over the books of the clients if there is a fees due. The guidelines to be followed while exercising this right is:

- 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. Such of the documents can be retained which are connected with the work on which fees have not been paid.

5. Right to attend G.M.:

- a. The auditor enjoys the right to receive notice of GM and attend GM.
- b. However, he cannot participate in the discussions of the G.M.
- c. The purpose is to clarify the doubts raised by the shareholders.
- d. It is not his duty to attend, but it is only a right.
- e. Further such a right extends only to G.M.'s and not to the board meeting's.
- f. It may be advisable for the auditor to attend the meeting when any important matter has come to his knowledge subsequent to his signing the audit report, so as to bring this matter to the notice of the shareholder's.

Subsidiary question:

- 1. The auditor's lien on client's books is unconditional. Comment.

Q.NO.10. WHAT ARE THE DUTIES OF AUDITOR?

A. Statutory & Non statutory audit: In the case of non statutory audits, the auditor's duties would depend upon the agreement between the auditor & the client. On the other hand in case of statutory audit the duties of a company auditor are given in the Companies Act itself.

B. Duties of company auditor as given under companies act are as below:

- 1. **Sec.227(1A):** Under this Sec. it is the duty of the auditor to enquire:
 - a. Whether loans and advances given on security have been properly secured and the terms & conditions on which they have been made are harmful to the interest of the company.
 - b. Whether transactions which are represented merely by book entries in fact have taken place and are harmful/prejudicial to the interest of the company. (E.g. In books purchases were recorded for. In reality no such transaction has taken place. The auditor's report should mention this fact).
 - c. Whether any of the assets of the company consisting of shares, debentures etc. have been sold at a price less than the cost of such shares etc. (This is not applicable to an investment company or a banking company). (This doesn't prohibit the sale below cost. If the sale is bonafide and the price is reasonable having regard to the circumstances of the case, need not be reported.)
 - d. Whether loans and advances made by the company have been shown as deposits.
 - e. Whether personal expenses have been charged as business expenses.
 - f. Where it is stated in the books of accounts that any shares have been allotted for cash, then the cash has been actually so received. (DCA notification - Shares allotted against a debt payable by the company shall be taken as 'shares allotted for cash').

Note: The auditor is required to report on above matters only if the answers are negative.

- 2. **Sec.227(2):** Under this sec. it is the duty of the auditor to make a report whether, in his opinion the financial statements give a true & fair view:
 - a. In the case of the B/s - of the financial position of the company at the end of the financial year &
 - b. In the case of the profit and loss account - of the profit or loss for the year.
- 3. **Sec.227(3):** Under this sec. it is the duty of the auditor to state the following in his audit report:
 - a. Whether he has obtained all the information and explanations which were necessary for the purposes of his audit.
 - b. Whether the audit report on the financial statements of any branch office audited by

a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

- c. Whether the company's balance sheet and profit and loss account are in agreement with the books of accounts and branch returns.
 - d. Whether any director is disqualified under Sec.274 (1) (g). (Sec.274(1)(g) - A person is disqualified from being appointed as a director, if the company in which he is a director has not filed the annual returns for any continuous 3 financial years Or has failed to repay its deposit or interest thereon on due date Or redeem its debentures on due date Or pay dividend and such failure continues for ≥ 1 year.)
 - e. In **bold** or in italics the observations of the auditors which have any adverse effect on the functioning of the company.
 - f. Whether the cess payable under Sec. 441A has been paid and if not, the details of amount of cess not so paid".
 - g. Whether, in his opinion, proper books of accounts, as required by law, have been kept by the company and proper returns adequate for the purposes of his audit have been received from the branches. Remember that the cost records prescribed under Sec.209(1)(d) also from part of books of accounts.
 - h. Whether accounts give the information required by the act in the manner so required.
 - i. Whether in his opinion, the balance sheet and the profit and loss account comply with the accounting standards referred to in Sec.211 (3C) of the Companies Act.
4. **Sec.227 (4):** Where any matters referred in Sec.'s 227(2) and 227(3) are answered in negative, it is the duty of the auditor to state the reasons for such answers in his audit report.
 5. **Sec.227(4A):** It is the duty of the auditor to include in his report a statement on such matters as may be specified by the C.G.- Called CARO, 2003 (Companies auditor's report order).
6. **Other duties:**
 - a. Duty to sign the auditor's report.
 - b. Duty to certify the prospectus & Duty to certify the statutory report.
 - c. Duty to attend audit committee meetings.

Subsidiary questions:

1. Mention the items to be considered by the auditor U/s 227(1A)?
2. List the points where the company auditor has to make "statements of fact" and "express opinions" (Ans.: Facts - 3 a to f, Opinions - 3 g to i & 2)
3. Additional Reporting requirements U/s 227 of the Companies Act. (Ans.: 3 e & f)

Note: Refer to Practical Questions from Examination:

P7: Liabilities of auditor.

P8: Whether auditors are liable if they rely on incorrect certificate relating to value of stock.

Q.NO.11. HOW CAN A CASUAL VACANCY IN THE OFFICE OF AN AUDITOR IS FILLED UP?

Ans:

1. **Meaning:** No definition is given in the act. In the opinion of the DCA, it means a vacancy in the position of the auditor after he was validly appointed & appointment was accepted.
2. **Reasons:** This may arise due to death, disqualification, dissolution of the firm of auditors, removal & resignation, etc.
3. **Who has to fill this?:**
 - a. **If it was due to resignation** - only by shareholders.

- b. If it was due to other reasons** - By board of directors.
4. The law requiring the shareholders to fill the vacancy created by resignation will increase auditor's independence. This process will bring out facts leading to auditor's resignation to the notice of the shareholders.
5. **Reappoint:** If the auditor could be found to be honest, the general meeting may even request him to reconsider his decision and take appropriate steps to cure the evils, if any, in the management.
6. **Duration of office:** The auditor appointed to a casual vacancy shall hold office till the conclusion of the next annual general meeting.
7. **Other Points:**
- a. When the Existing Auditors who have been re-appointed at the AGM refuse to accept the appointment, it does not create a Casual Vacancy or vacancy by resignation. The Auditor's appointment has not become effective due to the refusal.
 - b. If the Firm is appointed as Auditor, any reconstitution of the Firm due to admission, retirement, death etc. including change of name by 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.
 - c. A Casual Vacancy is not a vacancy created by any deliberate omission on the part of the Company to appoint an Auditor in its AGM. **[ICAI vs Jananendra Nath Saikia]**

Note: Refer to Practical Question from Examination:

P10: Refusal to accept an appointment.

Q.NO.12.STATE THE PROVISIONS OF THE COMPANIES ACT WITH REFERENCE TO REMOVAL OF COMPANY AUDITOR (A) ON THE EXPIRY OF HIS TERM, (B) BEFORE THE EXPIRY OF HIS TERM OF OFFICE?

1. **REMOVAL ON THE EXPIRY OF TERM OF OFFICE:** Sec.225 lays down the procedure for removal of the Auditor on the expiry of his term of office, as under:
- a. **Special Notice:** Special Notice is required for a resolution at an AGM for:
 - Appointing as Auditor, a person other than the Retiring Auditor, or
 - Providing expressly that the Retiring Auditor shall not be re-appointed.
 - b. **Time Period of Notice:** The concerned member shall give the Company, a Special Notice about his intention to move a resolution to this effect at the ensuing AGM, at least 14 days before such meeting.
 - c. **Circulation of Notice:** On receipt of such a notice, the Company shall forthwith send a copy thereof to the Retiring Auditor as well as to the members of the Company. Special Notice is to be sent to all members of the Company atleast 7 days before the date of the AGM in terms of Sec.190(2).
 - d. **Retiring Auditors Rights:** The Retiring Auditor has the following rights:
 - To make a representation of a reasonable length to the Company,
 - To request that such representation be circulated among the members,
 - To require that the representations be read out at the AGM and be heard orally at the AGM.
 - e. **Company's Duties:** Where the Retiring Auditor makes a representation in writing to the members of the Company, the Company shall, unless the representation is received by it too late for it to do so:
 - State the fact of representations being made, in any notice of the resolution given to

members of the Company,

- Send a copy of representation to every member of the Company to whom notice of meeting is sent.

f. Situations when representations need not be circulated: In the following situations, the representations need not be circulated to members:

- When the representations are received too late by the Company.
- If the Central Government is satisfied, that the right of representation is being misused by the Auditor to secure needless publicity for defamatory matter, on the application made by the Company or any other aggrieved person.

g. Procedure at AGM: If a copy of the representation is not sent as the same was received too late or because of the Company's default, the Auditor may require that the representation shall be read out at the Meeting. He also has the right to be heard orally at the AGM. At the AGM, if a Special Resolution is required in terms of Sec.224A, the same should be duly passed.

h. Certificate from Appointed Auditor: Before any appointment or re-appointment of Auditors is made at an Annual General Meeting, 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 Sec.224(1B).

2. REMOVAL BEFORE EXPIRY OF TERM OF OFFICE: The provisions as to removal of an Auditor before the expiry of his term of office shall be summarised as under:

Particulars	Removal of First Auditor(s) Appointed by Board [Sec.224(5) proviso]	Removal of Existing Auditor(s) other than 1st Auditor [Sec.224(7)] See Note
1. Authority to remove	Company in a General Meeting.	Company in a General Meeting.
2. Approval of Central Govt.	Previous approval of Central Government is Not Required.	Previous approval of Central Government is Required.
3. Procedure	a. Obtain nomination of new Auditor by any member of the Company. b. Send a special Notice of atleast 14 days to all members and the existing Auditor, intimating the proposed change. c. If the members nomination for a new Auditor is accepted, a resolution to this effect should be passed.	a. Obtain previous approval for change in Auditor to members and the existing Auditor. b. Send intimation of the proposal for change in Auditor to members and the existing Auditor. c. Comply with the procedure given in Sec.225(2)/225(3) outlined above. d. Pass the appropriate resolution at the General Meeting for appointment of new Auditors.

The Company can remove the Auditors before the expiry of their term after following the aforesaid procedure.

Note: Provisions of Sec. 224(5) proviso are applicable only for removal of First Auditors appointed by the Board of Directors. For removal of First Auditors appointed by the Company in the General Meeting provisions of Sec. 224(7) should be followed.

The effect of non-forwarding of notice u/s 225(2) to the Retiring Auditors Will make the resolution for appointing or removing auditors illegal and ineffective.

C.No.35/6/68-CL-III.

Q.NO.13.WHAT IS THE CEILING PRESCRIBED ON NUMBER OF AUDITS IN THE COMPANIES ACT?

Ans:

1. Restriction on Appointment [Sec.224(1B)]: No Company or its Board of Directors shall appoint or re-appoint any person or Firm as its Auditors if:

- a. Such person is in full time employment elsewhere, or
- b. Such person or Firm holds the office of Auditor of the specified number of Companies or more than the specified number of Companies.

In the case of a Firm of Auditors, 'Specified Number of Companies' means the number of Companies' specified for every Partner of the Firm who is not in full time employment elsewhere.

2. Ceiling Limit: The ceiling limit is 20 Company Audits per person. Of this 20, not more than 10 shall be in respect of Companies having Paid-Up Capital of Rs.25 Lakhs or more. Further points in this regard are given below:

Situation	Ceiling Limit
1. For individual CA's or Proprietary Firms	Ceiling Limit shall be 20 Company Audits.
2. For Partnership Firms	Ceiling Limit shall be 20 Company Audits per Partner who is not in full-time employment elsewhere. Suppose, a Firm has 5 Partners, the overall ceiling will be 5 x 20 = 100 Company Audits, of which not more than 50 should be Companies having Paid Up Capital of Rs. 25 Lakhs or more.
3. When a CA is a Partner in a number of Firms	Ceiling Limit shall be 20 Company Audits on his account in all the Firms together in which he is Partner or Proprietor.
4. Where the Partner of a Firm also holds office in his individual capacity	Ceiling Limit shall not exceed 20 Company Audits in his individual also holds office in his capacity and all Firms taken together.

3. Computation of Ceiling Limit:

Included Audits	Excluded Audits
1. Part Audit: When an Auditor is appointed to audit even a part of a Company's accounts, the part will be considered as a unit of audit for the purpose of calculation of the ceiling. 2. Joint Audit: When two or more Auditors are appointed as Auditors, each of the Joint Auditors is considered a Part Auditor for the purpose. Hence, any joint audit held by an Auditor will be included as one audit unit. 3. Sec.25 Companies: Audit of Nonprofit Companies would be included for the purpose of ceiling.	1. Branch Audit: Audit of a Branch of Company is not included in the computation of the ceiling. 2. Audit of Corporations, which are not Companies shall not be included for ceiling purpose. 3. Audit of Foreign Companies: shall not be included. 4. Guarantee Companies: Company Limited by Guarantee and not having Share Capital will not be included in the ceiling. 5. Private Companies: Audit of Private Limited Companies will not be included for ceiling u/s 224(1B). 6. Special Audit u/s 233A or Investigation of Companies will not be included for ceiling purposes.

4. ICAI Notification 53/ 2001: As per the ICAI Notification, a CA in practice will be guilty of professional misconduct, if he holds at any time, the appointment of more than **30 audit assignments, including audit of Private Companies**. This restriction is intended to uphold the principles of fairness and to provide equitable opportunities to all practising members. **[Note:** This provision is an additional restriction under the CA Act and does not override the Companies Act.]

5. Additional Points:

- a. In case of CA Firm, the ceiling limit is 30 Audits per Partner, including audit of Private Companies.
- b. Where a member is a Partner in more than one CA Firm, all the Firms in which he is a Partner will be together entitled to 30 Company audits in his account.
- c. Where a Partner of a Firm also accepts audits in his individual capacity / Proprietary Firm, the total number of Company audits should not exceed 30 in his individual capacity/ Proprietary Firm and all Partnership Firms taken together.
- d. As specified in Sec.224(1B), out of the above 30, the audits of Public Companies having paid up capital of Rs. 25 Lakhs or more, shall not exceed 10.
- e. For this purpose, joint Audits held will be construed as one audit unit for each of the joint Auditors.
- f. Audit of Head Office and Branches or one or more Branches of the same Company will be construed as one audit only.
- g. The number of Partners of a firm on the date of acceptance of audit assignment shall be taken into account for computing the ceiling for the Firm.
- h. A CA in full time employment elsewhere shall not be taken into account while computing the ceiling for the Firm.

Subsidiary Question:

1. Mr. Excellent, an individual Auditor wants to compute the specified number of audits and for this purpose, a list has been drawn out. Identify, the Company which shall be/not be taken into account for the purpose of calculating specified number of audits:
 - a. Audit of Private Company.
 - b. Guarantee Companies not having Share Capital.
 - c. Audit of Non-Profit Companies.
 - d. Special Audits.
 - e. Audits of Foreign Companies.
 - f. Branch Audits.
 - g. Company Audit where he is appointed as a Joint Auditor.

Besides, he wants to know that as a member of the ICAI, is there any other restriction on, him as a matter of self-regulation in the matter of inclusion/exclusion of audit of Private Companies for the purpose of calculating specified number of audit assignments. Advise.

Q.NO.14. STATE THE PROVISIONS OF THE COMPANIES ACT IN RESPECT OF AUDIT OF ACCOUNTS OF A BRANCH OFFICE OF A COMPANY?

Ans:

1. **Appointment [Sec.228(1)]:** The following persons are eligible for appointment as Branch Auditors:

In case of Local Branches	In case of foreign Branches
a. The Company's Auditor appointed u/s 224, or b. A person qualified for appointment as an Auditor u/s 226	a. The Company's Auditor appointed u/s 224, or b. A person qualified for appointment as an Auditor u/s 226, or c. An Accountant duly qualified to act as an Auditor in accordance with the laws of that foreign country.

2. **Appointment of persons other than Company Auditor as Branch Auditor [Sec.228(3)(a)]:**

- a. **General Meeting:** The decision to appoint any person other than the Company Auditor as Branch Auditor, should be taken at a General Meeting.
- b. **Appointment at Meeting or Authorisation to Board:** The Company may either appoint the Branch Auditor at the meeting or authorise the Board of Directors to appoint such an Auditor, in consultation with the Company's Auditor.

3. Rights of Branch Auditor [Sec.228(3)]:

- a. **Audit Powers:** To exercise the same powers and duties in respect of Branch Office Audit as enjoyed by the Company's Statutory Auditor in respect of the Company's Audit.
- b. **Reporting:** To prepare a Report on the accounts of the Branch Office examined by him and to forward it to the Company's Auditor who shall deal with it in the manner required to prepare / finalise his Report.
- c. **Remuneration:** To receive such remuneration as the Company in General Meeting or the Board may fix

4. Rights of Company Auditor [Sec.228(2)]: The Company Auditor shall have the following rights when the Branch Accounts are audited by another person:

- a. To visit Branch Office, if deemed necessary for the performance of his duties, and
- b. To have access at all times to the books, accounts and vouchers maintained at the Branch Office.

5. In case of Foreign Branches of Banking Companies, the Company Auditor is allowed access to such copies of and extracts from the books and accounts of the Branch, as have been transmitted to the Head Office in India.

Subsidiary Question:

- 1. Can a Company appoint any person other than its Statutory Auditor for the audit of its Branch? What are the provisions in case the Branch Office is situated outside India?

Q.NO.15. STATE THE CIRCUMSTANCES IN WHICH THE CENTRAL GOVERNMENT MAY EXEMPT ANY BRANCH OFFICE OF A COMPANY FROM THE AUDIT REQUIREMENTS AS PROVIDED IN THE COMPANIES ACT?

Ans: The Central Government is empowered to make rules for exempting the branch offices from audit in certain cases. The Central Government has framed the 'Companies (Branch Audit Exemption) Rules, 1961. The said rules provide for exemption from branch audit in two cases:

- 1. Exemption based on quantum of activity.
- 2. Exemption in other cases.

1. Exemption based on quantum of activity Conditions for exemption:

- a. The exemption is available only to a branch office where any manufacturing, processing or trading activity is carried on.
- b. The average of the 'quantum of activity' of such branch office during the relevant financial year does not exceed the higher of the following two limits:
 - i. Rs. 2 lakhs; or
 - ii. 2% of the average of the total turnover of the company including all its branch offices, earnings from services rendered and earnings from any other source.
- c. The company auditor shall have the following rights:
 - i. He shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor.
 - ii. He shall have a right of access at all times to the books, accounts and vouchers of the company maintained at the branch office.

Note: Meaning of certain terms:

1. 'Quantum of activity' is defined as the highest of the following:

- a. The aggregate value of goods produced, manufactured or processed.
- b. The aggregate value of goods sold and services rendered.
- c. The amount of expenditure, whether of revenue or capital nature, incurred by the branch office.

2. 'Average quantum of activity' shall be computed by taking average of the quantum of activity during 3 financial years immediately preceding the relevant financial year.

- a. If 3 financial years have not been completed since the establishment of the branch office, the average quantum of activity shall be computed by taking average of the quantum of activity during the 2 financial years preceding the relevant financial year.
- b. If 2 financial years have not been completed since the establishment of the branch office, the average quantum of activity shall be computed by taking average of the quantum of activity during 1 financial year preceding the relevant financial year.
- c. If 1 financial year has not been completed since the establishment of the branch office, the average quantum of activity shall be computed by taking the quantum of activity during the relevant financial year.

3. 'Relevant financial year' means the financial year of the company in respect of which exemption from branch audit is to be determined.

2. Exemption in other cases:

a. Grounds for exemption: The exemption may be given on *any* of the following grounds:

- i. That the company is not carrying on manufacturing, processing or trading activities *and* that it has made sufficient arrangements for the scrutiny and check of the accounts of the branch office of the company by a responsible person who is competent to scrutinise and check the accounts.
- ii. That the company has made arrangements for the audit of accounts of the branch office by a person otherwise qualified for appointment as a branch auditor, except that such person is an employee of the company. The employee of the company who is required to audit the accounts should be in possession of a certificate of practice from the ICAI. The exemption on this ground is available subject to the following conditions:
 - The managing director or the manager of the company shall give a certificate to the effect that the arrangements have been made for the audit of accounts of the branch office. Such certificate shall be attached with the application seeking the exemption from branch audit.
 - The company auditor shall make a written statement that in his opinion, arrangements made for the audit of books of the branch office are adequate. The said statement shall also state that the arrangements made for keeping books of account would enable the person auditing the accounts to certify that *they* show a true and fair view of the working of the branch office.
 - The company shall give such person access to the books, accounts and vouchers maintained at the branch office. The company shall also furnish him such information and explanations as he may require.
 - The person so employed shall prepare a report on the accounts of the branch office examined by him and forward the same to the company's auditor.
 - There shall be attached to the balance sheet a certificate to the effect that no material change has taken place in the arrangements made for the audit of accounts of the branch office. The certificate shall be signed by a director and the manager or secretary or where there is no manager or secretary, by two directors of the company, one of whom shall be a managing director, where there is one.

- iii. That having regard to the nature and quantum of activity carried on at the branch office or for any other reason, a branch auditor is not likely to be available at a reasonable cost.
- iv. That for any other reason, the Central Government is satisfied that exemption may be granted.

b. Conditions for exemption:

- i. The exemption may be given for a specified period and subject to certain conditions.
- ii. If terms and conditions of the exemption are not complied with, the exemption may be withdrawn by the Central Government.
- iii. The exemption order shall be given to the auditor of the company and shall also be read at the next general meeting.
- iv. The company auditor shall have the following rights:
 - He is entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor.
 - He has a right of access at all times to the books, accounts and vouchers of the company maintained at the branch office.

Q.NO.16. WHAT ARE THE POWERS AND DUTIES OF A SPECIAL AUDITOR CONDUCTING A SPECIAL AUDIT?

Ans: The main purpose of special audit is to provide to the Central Government a critical review of the company's working and the state of its affairs.

1. **Circumstances in which special audit may be ordered:** May be ordered by the Central Government if it forms an opinion as to the existence of *any* of the following circumstances:
 - a. That the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices.
 - b. That the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains.
 - c. That the financial position of the company is such as to endanger its solvency.
2. **Can shareholders apply to the Central Government for ordering special audit:** Where the shareholders form an opinion as to the existence of any of the above circumstances, they may make a complaint to the Central Government. If the Central Government is satisfied about the existence of such circumstances, it may order a special audit to be conducted. But, such a complaint does not bind the Central Government to order a special audit, even if the complaint is made by all the shareholders. Thus, the power of the Central Government to order special audit is discretionary in nature.
3. **No opportunity of being heard:** The special audit may be ordered by the Central Government without providing an opportunity of being heard to the company.
4. **Period of special audit:** Special audit shall be conducted for such period as may be specified in the order.
5. **Special auditor:** The Central Government may appoint either the company's auditor or any other chartered accountant (whether or not he is in practice) to conduct the special audit, who shall be called as the special auditor.
6. **Powers and duties:** The special auditor shall have the same powers and duties as an auditor of a company has under Sec. 227.
7. **Directions to furnish information:** The Central Government may direct any person to furnish to the special auditor such information as may be required by him.
8. **Report of special auditor:**
 - a. The report of the special auditor shall include all the matters required to be included in

an auditor's report under Sec. 227. The report shall also include a statement on any other matter which may be referred to him by the Central Government.

- b.** The special auditor shall make his report to the Central Government.
 - c.** On receipt of the report of the special auditor, the Central Government may take such action on the report, as it considers necessary.
 - d.** If no action is taken on the report within 4 months from its receipt, the Central Government shall send to the company either a copy of, or relevant extract from, the report with its comments thereon and require the company either to circulate that copy or those extracts to the members or to have such copy or extracts read before the company at its next general meeting.
- 9. Expenses:** The remuneration of the special auditor and the expenses of special audit shall be determined by the Central Government and such determination shall be final. If the company makes a default in such payment, the same shall be recoverable from the company as an arrears of land revenue.

Q.NO.17. WHEN IS A COMPANY REQUIRED TO APPOINT COST AUDITOR? WHAT ARE HIS DUTIES AND POWERS? WHAT ACTION CAN BE TAKEN BY THE CENTRAL GOVERNMENT ON RECEIPT OF COST AUDITOR'S REPORT?

Ans: The provisions relating to cost audit may be explained as follows:

1. Cost audit- When required:

- a.** Where a company is required to maintain the cost records as per Sec. 209(1)(d), the Central Government may direct the company to conduct a cost audit. The cost audit shall be in addition to the statutory audit conducted under Sec. 224.
- b.** Cost audit is necessary only when Central Government makes an order directing a company to conduct cost audit in respect of a particular year. However, such order may be made only in case of a company engaged in production, processing, manufacturing or mining activities. At present, the Central Government issues the order for cost audit on a perpetual basis and so companies are required to conduct the cost audit from year to year until the Central Government issues a specific order cancelling the cost audit.
- c.** In other words, cost audit is required to be conducted only if all the following conditions are satisfied:
 - i.** The company is engaged in production, processing, manufacturing or mining activities.
 - ii.** The company pertains to the class of companies that are required by the Central Government to maintain the cost records.
 - iii.** An order is issued by the Central Government directing the company to conduct cost audit.
 - iv.** The cost audit is required only for that particular year in respect of which the cost audit order has been issued.

2. Qualifications of cost auditor: The cost auditor shall be a cost accountant within the meaning of the Cost and Works Accountants Act, 1959. However, a chartered accountant possessing the prescribed qualifications may be appointed as the cost auditor if the Central Government is of the opinion that sufficient number of cost accountants are not available for conducting the cost audit and a notification is issued to this effect. At present, no such notification has been issued.

3. Disqualifications of a cost auditor:

- a.** A person disqualified to act as a statutory auditor of the company under Sec. 226(3) and (4) shall not be appointed for conducting the cost audit.
- b.** The statutory auditor of the company shall not be appointed as the cost auditor.
- c.** If the cost auditor, after his appointment, becomes subject to any of the above

disqualifications, he shall be deemed to have vacated his office.

- d. A person who is an employee of any of the partners of a firm of chartered accountants which is appointed as company auditor under Sec. 224 shall not be appointed as a cost auditor.
- e. An internal auditor of a company shall not be appointed as its cost auditor
4. **Appointment of cost auditor:** The cost auditor shall be appointed by the Board of directors with the previous approval of the Central Government.
5. **Ceiling on number of audits:** Before appointing the cost auditor, the Board shall obtain a written certificate from the auditor that his appointment, if made, will be in accordance with the provisions of Sec. 224(1 B).
6. **Powers and duties of cost auditor:** A cost auditor shall have the same powers and duties as those of a statutory auditor under Sec. 227(1).
7. **Cost-audit report:**
 - a. **Submission of report:** The cost auditor shall make his report to the Central Government in Form No. 23C within 180 days of the close of financial year. He shall also forward a copy of the report to the company.
 - b. **Reply by the company:** The company shall, within 30 days from the date of receipt of cost audit report, furnish the Central Government with full information and explanations on every reservation or qualification contained in the report of the cost auditor.
 - c. **Calling of further information:** The Central Government may call for such further information and explanation and thereupon the company shall furnish the same within such time as may be specified by that Government.
 - d. **Action by the Central Government:** The Central Government may take such action on the report, in accordance with the provisions of this Act or any other law for the time being in force, as it may consider necessary.
 - e. **Circulation to members:** The Central Government may direct the company to circulate to its members the whole or a portion of the cost audit report. If ordered, the report shall be circulated along with the notice of the annual general meeting to be held for the first time after the submission of such report.
8. **Duties of the company:** Upon receipt of an order of Central Government to conduct a cost audit, it shall be the duty of the company to give all facilities and assistance to the cost auditor for conducting the cost audit. The company shall submit the cost records to the cost auditor within 30 days of the close of financial year. If the cost records are not submitted within this time limit, the cost auditor shall intimate this fact to the Central Government.
9. **Penalty:** Non-compliance of Sec. 2338 shall result in a penalty upto Rs. 50,000 to the company. Also every officer of the company who is in default shall be liable to imprisonment upto 3 years or fine upto Rs. 50,000 or both.

Q.NO.18. DISTINGUISH BETWEEN FINANCIAL AUDIT AND COST AUDIT?

Ans. The distinction between financial audit and cost audit is as under:

Basis of distinction	Financial audit	Cost audit
1. Nature of companies	Financial audit is compulsory for all companies.	Cost audit is to be conducted only when so directed by the Central Government.
2. Scope of audit	Financial audit covers all records kept by the company including cost records.	Cost audit covers only cost records.
3. Qualifications	Financial audit is conducted by a practicing Chartered Accountant.	Cost audit is conducted by a practicing Cost Accountant.
4. Method of appointment	Financial auditor is appointed	Cost auditor is appointed by

5. Reporting to whom	by the company in general meeting. Financial auditor submits his report to the members of the company.	the BOD with the previous approval of Central Government. Cost auditor submits his reports to the Central Government. A copy of the report is submitted to the company also.
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Q.NO.19. DISTINGUISH BETWEEN SPECIAL AUDIT AND COST AUDIT IN RESPECT OF THE FOLLOWING?

- 1. THE CIRCUMSTANCES UNDER WHICH SUCH AUDITORS CAN BE APPOINTED**
- 2. THE ACTION THAT CAN BE TAKEN BY THE CENTRAL GOVERNMENT ON RECEIPT OF REPORTS FROM SUCH AUDITORS**

Ans: Distinction between special audit and cost audit is as under:

1. Circumstances in which auditors can be appointed:

a. Special audit: Special audit may be ordered by the Central Government if it forms an opinion as to the existence of any of the following circumstances:

- i.** The affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices.
- ii.** The company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains.
- iii.** The financial position of any company is such as to endanger its solvency.

Special audit may be ordered by the Central Government without providing an opportunity of being heard to the company.

b. Cost audit: Where a company is required to maintain the cost records as per Sec. 209(1)(d), the Central Government may direct the company to conduct a cost audit. As such, cost audit is necessary only when the Central Government makes an order for cost audit in respect of a particular year. However, cost audit can be ordered only in case of a company engaged in production, processing, manufacturing or mining activities.

2. Action on receipt of audit report:

a. Special audit:

- i.** On receipt of the report of the special auditor, the Central Government may take such action on the report, as it considers necessary.
- ii.** If no action is taken on the report *within 4 months* from its receipt, the Central Government shall send to the company either a copy of, or relevant extract from, the report with its comments thereon and require the company either to circulate that copy or those extracts to the members or to have such copy or extracts read before the company at its next general meeting.

b. Cost audit:

- i.** On receipt of the report of cost auditor, the Central Government may call for such further information and explanation and thereupon the company shall furnish the same within such time as may be specified by that Government.
- ii.** It may take such action on the report, in accordance with the provisions of this Act or any other law for the time being in force, as it may consider necessary.
- iii.** It may direct the company to circulate to its members the whole or a portion of the cost audit report. The report shall be circulated along with the notice of the annual general meeting to be held for the first time after the submission of such report.

Q.NO.20. WRITE A SHORT NOTE ON AUDIT COMMITTEE?

Ans. The Companies (Amendment) Act, 2000 has made it mandatory for certain companies to appoint an audit committee. The provisions in this regard are as follows:

- 1. Applicability of Sec. 292A:** Every public company having paid up capital of Rs. 5 crores or more shall constitute an audit committee.
- 2. Composition of audit committee:**
 - a. Determined by Board:** The Board shall determine the composition of the audit committee.
 - b. Number of members:** Only a director can become a member of the audit committee. The audit committee shall have at least 3 members. Two third of the total number of members of the committee shall be the directors other than managing or whole time directors.
 - c. Chairman:** The members of the audit committee shall elect a chairman from amongst themselves.
 - d. Proceedings of committee:**
 - i. Auditors etc. to tend meetings of committee:** The auditor, internal auditor and the director in-charge of finance *shall* attend and participate in the meetings of the audit committee. But, they shall have no right to vote.
 - ii. Chairman to attend the AGM:** The chairman of the audit committee *shall* attend the annual general meetings of the company to provide any clarification on matters relating to audit.
- 3. Functions of the audit committee:**
 - a. Functions as specified by the Board:** The audit committee shall act in accordance with the terms of reference as specified in writing by the Board.
 - b. Compliance of internal control:** It shall ensure compliance of internal control system.
 - c. Discussions with auditors:** It shall hold discussions with the auditors periodically about internal control systems, the scope of audit including observations of the auditors.
 - d. Review of financial statements:** It shall review the half yearly and annual financial statements before submission to the Board.
- 4. Powers of the audit committee:**
 - a. Investigation:** The audit committee shall have the authority to investigate into - (i) any matter in relation to the items specified in this Sec.; and (ii) any matter referred to it by the Board.
 - b. Access to records:** It shall have access to information contained in the records of the company.
 - c. External professional advice:** It shall have the power to seek external professional advice, if necessary.
- 5. Disclosure requirements:** The annual report shall disclose the composition of the committee.
- 6. Recommendations of audit committee:**
 - a. Recommendations binding on Board:** The recommendations of the audit committee on any matter relating to financial management. including the audit report shall be binding on the Board.
 - b. Board to state reasons for non-acceptance:** If the Board does not accept the recommendations of the committee, it shall record the reasons therefore and communicate such reasons to the shareholders.
- 7. Penalty for non-compliance:** The company and every office in default shall be punishable

with imprisonment for a term which may extend to one year or fine which may extend to Rs. 50,000 or both.

Q.NO.21. WHAT IS MEANT BY 'CORPORATE GOVERNANCE'? EXPLAIN HOW THE PROVISIONS OF THE COMPANIES ACT, 1956 RELATING TO AUDIT COMMITTEE WILL HELP IN ACHIEVING SOME OF THE OBJECTIVES OF 'CORPORATE GOVERNANCE'?

Ans.

1. Corporate governance stipulates parameters of accountability, control and reporting functions of the Board of directors. It also emphasises the importance of various stakeholders in direction and performance functions of the company. It also calls for establishing a proper and a viable relationship amongst the various stakeholders of the company.
2. Corporate governance is a process or a set of systems and processes to ensure that the company is managed to suit the best interests of all the stakeholders. The stakeholders may be internal (promoters, members, workmen and executives) or external (customers, lenders, dealers, vendors, bankers, community, Government and regulators etc.). Corporate governance is concerned with the establishment of a system whereby the directors are entrusted with the responsibilities and duties in relation to the directions of corporate affairs.
3. Corporate governance calls for total transparency, integrity and accountability of the management, and discharge of social responsibility of the company. The importance of corporate governance lies in its contribution both to business prosperity and to accountability.. Corporate governance is about the nitty-gritty of how a company fulfils its obligations to investors and other stakeholders. It is about commitment to values and ethical business conduct and a high degree of transparency. The best practices of corporate governance will broadly include - a definition of practices that define corporate governance, a code of best practices covering the constitution of the Board, defining their goals and responsibilities, exploring preferred internal systems and disclosure requirements.
4. To act as a measure of good corporate governance, Sec. 292A was inserted in the Companies Act by Companies (Amendment) Act, 2000 requiring mandatory appointment of audit committee by every public company having paid up capital of Rs. 5 crores or more. The following provisions of Sec. 292A will go a long way in achieving some of the objectives of corporate governance:
 - a. Mandatory appointment of audit committee by every public company having a paid up capital of Rs. 5 crores or more.
 - b. At least two-third of the total number of members of the committee shall be the directors other than managing or whole time directors.
 - c. The auditor, internal auditor and the director-in-charge of finance shall attend and participate in the meetings of the audit committee.
 - d. The chairman of the audit committee shall attend the annual general meetings of the company to provide any clarification on matters relating to audit.
 - e. Functions of the audit committee shall include compliance of internal control, discussions with auditors about internal control systems, the scope of audit including observations of the auditors, review of financial statements before submission to the Board and other functions as may be specified by the Board.
 - f. Powers of the audit committee shall include the power to investigate into any matter in relation to the items specified in Sec. 292A and any matter referred to it by the Board. It shall have access to information contained in the records of the company. It shall have the power to seek external professional advice, if necessary.
 - g. The annual report shall disclose the composition of the audit committee.
 - h. Recommendations of audit committee on any matter relating to financial management, including the audit report shall be binding on the Board. If the Board does not accept

the recommendations of the committee, it shall record the reasons therefore and communicate such reasons to the shareholders.

Thus, it is evident that the establishment of audit committee would result in additional assurance regarding the quality and reliability of the financial information used by the Board and financial information used by the company. It would thus prevent accounting failures and corporate scandals, strengthen accounting and audit function, solve the problems of mounting bank NPA's, flouting going concern principle, capital erosion, non-repayment of deposits and debentures, all of which have something to do with financial reporting.

5. An effective audit committee would assess the risk and judge the audit performance. It would ensure that auditors are a watchdog of interests of stakeholders. It would instill confidence and trust amongst the users of financial statements.
6. To conclude, the audit committee is a sincere step to enhance the corporate governance, effective audit function and quality financial reporting. This would restore investor and public confidence, and business and economy will grow as a whole.

Q.NO.22. EXPLAIN THE PROVISIONS OF COMPANIES ACT RELATING TO APPOINTMENT OF SECRETARIES?

Ans:

1. Appointment of Secretaries:

- a. Every Company having Paid-Up Share Capital of Rs.2 Crores and above, shall have a Whole Time Secretary.
- b. A Firm or Body Corporate cannot be appointed as Secretary.
- c. Where the Board of Directors of any Company comprises only 2 Directors, neither of them shall be appointed as the Secretary of the Company.

2. Filing of Compliance Certificate:

- a. **Applicability** Company which is not required to appoint Whole Time Secretary and having a Paid Up Share Capital of Rs.10,00,000 or more.
- b. **Compliance Certificate** A Certificate has to be obtained from a Secretary in whole-time practice as to whether the Company has complied with all the provisions of the Companies Act, 1956. A Copy of the certificate shall be attached to the Board's Report.
- c. **Rules** Companies (Compliance Certificate) Rules, 2001 apply in this regard.
- d. **ROC Filing** The Compliance Certificate should be filed with the Registrar in e-Form 66.
- e. **Time Limit for filing :**
 - i. Where AGM is held - Within 30 days from the date of AGM.
 - ii. Where no AGM is held - Within 30 days from the last date on which the AGM of the Company ought to have been held.

3. **Non-compliance:** The Company and every Officer in default shall be punishable with fine which may extend to Rs.500 for every day during which the default continues. However, the following shall constitute adequate defence against proceedings for default:

- a. That all reasonable efforts were taken to comply with the provisions of Sec.383A, or
- b. That the financial position of the Company is such that it will be beyond the capacity of the Company to engage a Whole Time Secretary .

Explanation to Sec.269 states that Whole-time Director include a Director in the whole time employment of the Company. So, the appointment of a Whole-Time Company Secretary as a Part-Time Director of the Board does not require approval of the Central Government u/s 269, so long as substantial powers of management of the affairs of the Company are not vested with the incumbent.

**Department
Clarification**

- 4. Ceiling Limit for signing Certificates:** A member of ICSI in practice cannot issue Compliance Certificate for more than 50 Companies in a calendar year. In case of Firm, the ceiling limit is 50 Companies per Partner.

Subsidiary Question: BEF Ltd, a Public Limited Company, is having a Paid Up Share Capital of Rs.2.50 Crores. Is it obligatory for the Company to have a Whole Time Secretary? Will it make any difference, if the Capital was Rs.1.50 Crores? If yes, what other formalities would have to be complied by that Company?

PRACTICAL QUESTIONS

P.Q.1. Can an auditor be disqualified for indebtedness in the following cases?

1. Where he is recovering his fees on a progressive basis even though the job is not complete.
2. Where the auditor's firm has purchased goods from the auditee company and not paid for them for over six months.

Ans. As per Sec. 226(3), a person who is indebted to the company for an amount exceeding Rs. 1,000 shall be disqualified for appointment as an auditor. The answer to the given problem is as under:

1. An auditor can receive the audit fees on a progressive basis in accordance with a resolution passed by the general meeting even though the audit is not complete. In such a case, he cannot be said to be indebted to the company and thus he does not vacate his office.
2. Where an auditor purchases goods from the company on credit he will be said to be indebted to the company in respect of such credit purchases, notwithstanding the fact that such credit period is normally allowed to all the customers by the company. Where the firm is indebted to the company, each and every partner of the firm is deemed to have been indebted. Thus, if the amount outstanding exceeds Rs. 1,000 the auditor shall vacate his office.

P.Q.2. Can a person holding any security of a company be appointed as an auditor of that company? What will be the position, if his relative holds such securities?

Ans.

1. As per Sec. 226(3)(e), a person shall not be qualified for appointment as an auditor of a company if he holds any security of that company. This disqualification shall apply after a period of 1 year from the date of commencement of the Companies (Amendment) Act, 2000, i.e. 13.12.2000. The expression 'security' for this purpose means any instrument which carries voting rights.
2. In case any security of the company is held by a relative of an auditor, the above clause is not attracted. However, as per Para (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a member would be deemed to be guilty of professional misconduct, if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has substantial interest, unless he discloses the interest in his report.
3. Similarly, a member shall be deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which one or more person who are his 'relatives' have either by themselves or in conjunction with such member a substantial interest unless he discloses the interest in his report [Clause (ii) of Part II of Second Schedule to the Chartered Accountants Act, 1949].
4. The expressions 'relative' has the same meaning as is assigned thereto under Sec. 6 of the Companies Act, 1956. The expression 'substantial interest' has the same meaning as is assigned thereto under Explanation 3 to Sec. 13 of the Income Tax Act, 1961.

P.Q.3. One of the members of ADB Ltd. has proposed the name of Mr. Fame for appointment as a director of the company in the Annual General Meeting and given a notice under Sec. 257 of the Companies Act, 1956. Mr. Fame is one of the partners of Fame & Fame, Chartered Accountants, who are the retiring auditors of the company. But the audit of the company is being looked after by another partner of the firm. Examine whether Fame & Fame can be reappointed as auditors, if Mr. Fame is appointed as director.

Ans: The present problem relates to Sec. 226 of the Companies Act, 1956. **The legal position:**

1. As per Sec. 226, a person shall be disqualified to be appointed or reappointed as an auditor of the company if he is an officer or employee of the company.
2. As per Sec. 2(30), a director is an officer of the company.
3. As per Sec. 257, any member of a public company can give a notice proposing the appointment of any person (whether a member or not) as a director of the company.

The given case:

1. Mr. Fame is a partner in the firm 'Fame & Fame'. 'Fame & Fame' are the retiring auditors of the company, and they are seeking reappointment in the forthcoming annual general meeting.
2. The name of Mr. Fame has been proposed as a director by a member by giving a notice under Sec. 257. Mr. Fame has been appointed as a director in the annual general meeting.

Conclusion: On appointment as a director, Mr. Fame becomes an officer of the company. Therefore, Mr. Fame and any firm in which Mr. Fame is a partner, is disqualified to be reappointed as auditors of the company.

P.Q.4: Does the death or retirement of a partner of a firm result in disqualification of the firm to act as an auditor? **(OR)** One of the partners of a firm of chartered accountants appointed as auditors dies. Advise.

Ans: Where any of the partners of a firm retires or dies, a change in constitution of the firm takes place. However, the firm is not dissolved and thus no casual vacancy arises. As such the remaining partners can carry on the existing audits provided the firm continues to be in practice and the fact of retirement or death of the partner is known to the company. Similar position would prevail in case of admission of a partner.

P.Q.5: Ram & Company was appointed as auditor of ABC Limited at the Annual General Meeting held on 30th September, 200 . Can Ram & Co. continue as auditor of the company in case the next annual general meeting has not been held in time? What would be the position in case the next annual general meeting was held on 30th September, 2005, but adjourned without considering the business of appointment or re-appointment of auditor?

OR

At an AGM held on 25.09.2007 the Auditor was appointed to hold office upto the conclusion of next AGM. The next AGM was convened on 20.09.2008, but stood adjourned without transacting any business. Does the Retiring Auditor continue in office?

Ans:

1. The duty and responsibility for holding the annual general meeting (AGM) is on the directors and so where AGM is not held within the time limit specified under Sec's. 166 and 210, they vacate their office on the last day on which the AGM should have been held. This is because the directors cannot be allowed to take advantage of their own default.
2. However, an auditor has no responsibility to hold the AGM and hence he does not vacate his office if AGM is not held.
3. Moreover, Sec. 224(1) provides that an auditor shall hold his office from the conclusion of one AGM to the conclusion of the next AGM.
4. As such, an auditor is not appointed to audit the accounts of a particular financial year, but is appointed for the period falling between two AGMs. Thus, an auditor shall continue in office until the next AGM is concluded.
5. Where an AGM is held whereat the new auditors are appointed, but the AGM is adjourned to a later date, the new auditors cannot assume office until the conclusion of the adjourned AGM. The present auditors would continue to be the auditors till the conclusion of the adjourned AGM, since the auditors hold office from the conclusion of one AGM to the conclusion of next AGM.
6. Where an auditor was appointed for the year 1954, but no AGM was held until 1957, it was held that the auditors should audit all the accounts of the company which were placed in the AGM held next after their appointment
7. **Applying the above provisions, the given problems are answered as under:**
 - a. In case the next AGM is not held in time, Ram & Company shall continue as auditor.

- b. In case the next AGM is held on 30th September, 2005, but is adjourned without considering the business of appointment or re-appointment of auditor, Ram & Company shall continue as auditor.

P.Q.6: The shareholding of LIC and UTI increased from 23% to 27% of the subscribed share capital of the company after issue of notice of the annual general meeting. Explain how will the appointment of auditors be made.

Ans:

1. Sec. 224A requires a company to appoint an auditor by passing a special resolution where 25% or more of its subscribed capital is held by the Government or its instrumentalities. However, it does not specify the date on which 25% of the subscribed share capital must be held by the government instrumentalities, i.e., whether the date of notice of the meeting or the date of passing the special resolution shall be the effective date.
2. Ordinarily, there will be no difference in the shareholding as on the date of issue of notice and the date of the annual general meeting. However, in exceptional cases, where the shareholding as on these two dates differ, the material date is the date of the annual general meeting. In such a case, the company has two options, as discussed below:
 - a. **Option 1:** The company may adjourn the annual general meeting and later issue the required notice in accordance with the provisions of the Act. The special resolution appointing the auditors shall be passed in the adjourned annual general meeting.
 - b. **Option 2:** The company may omit or pass over the item on the agenda regarding the appointment of auditors. The auditors shall be appointed by the Central Government in such a case.

P.Q.7: What is the liability of an auditor for failure to point out in his report that dividend is paid out of sale of the company's real estate?

Ans: An auditor who is a party to payment of improper dividend is liable to make good the loss caused to the company. Also, he may be liable for misfeasance proceedings in case the company goes into winding up.

Where the auditors stated in their official report that the value of the assets depended upon realisation but submitted a different confidential report to the directors and the directors, going by the official report, paid away dividend which depleted the company's capital, the auditors were held liable to make good the company's loss [*Re, London and General Bank No. 2, (1895)*].

P.Q.8: The auditors of PQR Ltd. accepted the Certificate of the Manager, a person of acknowledged competence and high reputation, as to the value of the stock in trade. The stock was grossly overstated for several years in the balance sheets of the company. As a result of this over valuation dividends were paid out of capital. The Auditors did not examine the books of account very minutely. If they had done so and compared the amount of stock at the beginning of the year with the purchases and sales during the year, they would have noticed the over valuation. The company subsequently went into liquidation and the auditors were sued to make good the loss caused by the wrongful payment of dividends relying on the balance sheets figures. Based on the above facts, you are required to decide with reference to the provisions of the Companies Act, 1956 and the decided case laws, the following issues:

- i. Whether auditors of the company will be liable for the loss caused to the company by the wrongful payment of dividends based on the Balance Sheets duly audited by the Auditors.
- ii. What are the statutory duties of the Auditors in this regard?

Ans:

1. As per AAS 1 (Basic Principles Governing an Audit), an auditor should exercise due skill and care in conduct of audit. Moreover, in case of any suspicious circumstances, the auditor should seek additional evidences. Stock in trade is a material item appearing in the financial statements. Applying the provisions of AAS 1 with respect to valuation of stock, an auditor is duty bound to ensure that the company has an efficient system for recording the purchase, sale, storage, consumption and disposal of stock and raw materials.
2. As per AAS 5 (Audit Evidence), it is the duty of the auditor to obtain sufficient appropriate audit evidence before forming any conclusions.
3. As per AAS 11 (Representations by Management), the auditor should obtain representations from

management, where considered appropriate. However, representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. If a representation by management is contradicted by other evidence, the auditor should examine the circumstances and, when necessary, reconsider the reliability of other representations made by management.

4. Failure to verify the books of account by the auditor amounts to negligence since it amounts to failure to exercise reasonable care and skill in the performance of duties of an auditor.
5. An auditor has no right to *rely* upon others where physical verification is possible. The auditor should not blindly rely on the certificate or representation of management as regards the matters which are capable of direct verification by him from books and accounts and vouchers. Valuation of stock is a material item, for which corroborative evidences must be obtained.
6. In the given case, the auditor has not scrutinised the books of account, and so he has been grossly negligent.
7. Thus, an auditor who approves of whatever is stated to him by the management of the company, does not discharge his duty of exercising reasonable skill and care (Controller of Insurance v H C Das, AIR 1957].
8. An auditor is duty bound to verify the assets of the company himself, and he cannot rely on the verification done by persons appointed by the company. The auditor is not entitled to assume that the directors, officers or employees of the company would have done their work correctly, and so dispense with verifying them (Fox & Sons v Morrish Grant & Co. (1918)).
9. The statutory duties of auditors are as follows:
 - a. To ensure that the company has an efficient system for recording the purchase, sale, storage, consumption and disposal of stock and raw materials.
 - b. To verify the books of account.
 - c. To reconsider the reliability of certificate of valuation of stock in trade submitted by the manager of the company.

P.Q.9: If company fails to hold its annual general meeting within the period prescribed by Sec. 166, will the auditor vacate is office?

OR

At an annual general meeting held on 25.9.1989, the auditor was appointed to hold office upto the conclusion of the next annual general meeting. The next annual general meeting was convened on 20.9.1990 but stood adjourned without transacting any business. Does the retiring auditor continue in his office?

OR

Is it in order for an auditor appointed at an annual general meeting to continue to function as auditor when the next annual general meeting has not been held in time? Can he continue as auditor in case a new auditor has been appointed in his place at the annual general meeting which was adjourned to a later date?

Ans: Refer to Answer of P.Q.5.

P.Q.10: The refusal to accept an appointment by an auditor results in a casual vacancy. Discuss.

Ans:

1. The term 'casual vacancy' has not been defined by the Companies Act. It implies a vacancy caused by the auditor ceasing to act as such after accepting a valid appointment, e.g. due to death, disqualification, resignation etc.
2. Where the auditor appointed in an AGM refuses to accept the appointment, it cannot be said that the appointment is complete and effective. In such a case, no valid appointment has been made in the AGM.
3. Thus, it would be wrong to say that the refusal to accept the appointment results in a casual vacancy which can be filled by the Board. Since no appointment of auditors has been made in the AGM, the auditors shall be appointed by Central Government.
4. The shareholders have no power to appoint the new auditors or to authorise the Board of directors to appoint the new auditors.

P.Q.11: The Subscribed Share Capital of AJR Company Ltd at the end of the financial year ending 31.03.2007 was Rs.20 Crores, out of which two Public Financial Institutions were holding Share Capital amounting to Rs.3 Crores. During the financial year 2007-08 the Company through public issue of shares raised its Subscribed Capital by additional Rs.60 Crores. Out of Rs.60 Crores, the two Public Financial Institutions were further allotted shares amounting to Rs.20 Crores, raising the total contribution of these two institutions to Rs.23 Crores before the date of the Company's closure of books for AGM scheduled for 15.09.2008, where Auditors were to be appointed. The Company as usual, by getting an ordinary resolution passed, appointed the Auditors. A group of Shareholders of the Company allege that the appointment of Auditors is violative of certain provisions of the Companies Act, 1956. They however, did not raise any objection to the appointment of auditors at the previous AGM held on 10/09/2007. Decide:

- a. Whether the contention of the Shareholders is tenable?
- b. If the contention of shareholders be tenable, what action should the Company take for the appointment of Auditors at the AGM scheduled for 15.09.2008?

Would your answer be still the same in case the total Subscribed Capital contributed by the two Public Financial Institutions is only, Rs.10 Crores, including the previous Contribution of Rs. 3 Crores?

Ans: Note: Refer to provisions of Sec. 224A given above.

1. For AGM held on 10/09/2007, the holding of Public Financial Institution was Rs.3 Crores ÷ Rs.20 Crores = 15%. Hence Sec.224A is not attracted. Hence, appointment of Auditor(s) by an Ordinary Resolution is valid.
2. For AGM held on 15/09/2008, the holding of Public Financial Institutions will be Rs.23 Crores ÷ Rs.80 Crores = 28.75%. Hence, special resolution is required to be passed, for appointment of Auditor(s), in terms of Sec.224A. Appointment by way of ordinary resolution is **not valid**. Hence the Shareholder's contention is tenable.

Note: If the Total Subscribed Capital of Public Financial Institution is only Rs.10 Crores out of Rs.80 Crores, the holding is only 12.5%. In such case, special resolution u/s 224A is not required.

3. Action by Company: Refer Q.No.4 above

P.Q.12: ROC has issued a notice to the Company and its Directors to show cause as to why prosecution be not filed against them for not appointing a qualified Company Secretary, in contravention of Sec.383A. According to the Company, there is adequate justification for not appointing the Secretary as it is a closely held Company with only 7 Shareholders and there is no adequate work for him. Further, the Company cannot afford to pay him the Salary, which will not be less than Rs.15,000 to 20,000 p.m. What is the remedy available to the Company and its Directors:

- a. Before any prosecution is filed by, ROC ?
- b. After the prosecution is filed by ROC in the Magistrate's Court?

Ans:

1. **Non-Compliance with Sec.383A:** Sec.383A as to appointment of Whole Time Qualified Company Secretary where the paid up capital of the company is Rs.2 Crores or more, is mandatory. In case of noncompliance, a fine upto Rs.500 per day is leviable.
2. **Defence by Company:** The following shall constitute adequate defence against proceedings for default:
 - a. That all reasonable efforts were taken to comply with the provisions of Sec.383A, or
 - b. That the financial position of the Company is such that it will be beyond the capacity of the Company to engage a Whole Time Secretary.

However, such a defence is available to the accused during the trial by the Magistrate's Court. It is advisable for the Company to appoint the Secretary, even though there is sufficient work under the Company Law, however, he may also attend other functions in the Company.

3. Remedy available to Company before prosecution is filed by ROC:

- a. **Sec.621A:** The Company and its Directors can apply to the ROC u/s 621A for compounding the offence, after appointing the Secretary. ROC shall forward the same to the CLB / Regional Director, as the case may be, along with his comments. Once the offence is compounded, no prosecution can be filed by ROC.

- b. Sec.633(2):** Alternatively, Directors may approach the High Court for relief u/s 633(2), having acted honestly and reasonably and they ought to be executed. However, no relief is available to the Company.
- c. Reply to ROC:** Lastly, the Company and Directors may reply to the Show Cause Notice with their explanations and request for not taking any action. However, generally in such a case, ROC may leave the matter to be decided by the Court, after the prosecution is filed by him.

4. Remedy available to Company after prosecution is Filed by ROC:

- a. Sec.621A:** Even after prosecution is filed, the Company and its Directors can apply to the ROC u/s 621A for compounding the offence, after appointing the Secretary. ROC shall forward the same to the CLB / Regional Director, as the case may be, along with his comments. Once the offence is compounded, the same shall be brought to the notice of the Court by ROC, and the Company and its Directors shall be discharged.
- b. Sec.633(1):** Remedy u/s 633(2) before the High Court is not available after the prosecution is filed. A similar relief can, however, be sought from the Trial Court u/s 633(1) of the Act.
- c. Action in Court:** Alternatively, the Company can contest the prosecution case in the Trial Court and plead its case in defence. Also, it is open to the Company to plead guilty on the first date of appearance and pay the fine imposed by the Court.

The End