

AUDIT UNDER THE COMPANIES ACT, 1956

Audit of Annual Accounts of a company is **compulsory** and is indispensable part of incorporated business. Those who carry on business with the other people's money have to be accountable to the so-called owners. Management and accountancy demands specialised skill. Shareholders are generally laymen. Thus there arises a need of an agency to stand in between the shareholders and management. The agency, viz., statutory auditors, should be technically qualified for the job and should be independent, and able to withstand the pressure of management. It is because of this law demands for skill full and independent auditor, who is appointed by the shareholders of the company so that they are reported by a reliable person.

Section 224 (1) of the Companies Act, 1956 states that every company whether it is public or private limited shall have an auditor to audit its accounts. The appointment of auditor is mandatory in the Annual General Meeting for the ensuing year. The Auditors appointed at the Annual General Meeting hold the office from the conclusion of the Annual General Meeting at which he is appointed until the conclusion of the next Annual General Meeting. **Thus, the Act seeks to ensure that the appointment of auditors is not in the hands of the directors and is vested in the general body of shareholders.**

However, the first auditors of the Company are appointed by the Board of Directors within one month from the date of incorporation of a company. The auditors, so appointed, hold the office until the conclusion of the first annual general meeting of the Company. If the Board fails to appoint the first auditor, the company may do so at a general meeting.

The first proviso of Section 224 (5) of the Companies Act, 1956, states that the company may, at a general meeting, remove the first auditor appointed by the board and appoint in its place other auditor of whose nomination a special notice has been given.

As the auditor is appointed from the conclusion of one annual general meeting until the conclusion of the next annual general meeting, the auditor shall not cease to hold the office in case the next annual general meeting is not held in each calendar year as required by Section 166 of the Companies Act, 1956. Thus, he will continue in office until the next annual general meeting is actually held and concluded. He cannot be deemed to have retired on the date when the meeting ought to have been held.

MAXIMUM NUMBER OF COMPANIES FOR AN AUDITOR

Section 224 (1B) places a ceiling on the number of audits of public companies which a Chartered Accountant not in full time employment, or a firm of Chartered Accountants, can conduct.

- 1. A person can be appointed as an auditor, who is not in full-time employment elsewhere, of a maximum of 20 companies as described below**
- 2. Where some companies have paid-up capital of or more than 25 Lacs, a person can be appointed as auditor of only 20 companies out of which not more than 10 companies can have paid up capital of or exceeding Rs. 25 Lacs.**
- 3. In a firm of auditors, total number of 20 companies shall be for every partner of the firm who is not in full-time employment elsewhere.**

As per the fourth proviso added to sub-section (1B) by the Companies (Amendment) Act, 2000, private companies have been excluded from the existing ceiling of 20 audits per partner and sub-ceiling of 10 audits for companies having a paid up capital of Rs. 25 Lacs or more. Thus, apart from 20 audits of public companies, an auditor may conduct audit of private companies without any ceiling.

CONFIRMATION FROM AUDITOR

Before a company makes an appointment or reappointment of an auditor, a **written certificate** has to be obtained from the person concerned stating that the appointment or reappointment, if made, will be within the limits specified above.

NOTICE TO THE AUDITOR AND INTIMATION BY THE AUDITOR

After appointment/reappointment of an auditor at the annual general meeting, the company shall give intimation to the auditor, so appointed within seven days thereof. On receipt of the intimation from the company, the auditor shall submit a return to the Registrar of Companies within 30 days of the receipt of the intimation, informing the Registrar whether he has accepted or refused to accept the appointment, in Form No. 23B as prescribed by Companies (Central Government's) General Rules and Forms, 1956. **However, the first auditors are under no obligation to inform the Registrar.**

REAPPOINTMENT OF AUDITORS

At every Annual General Meeting, a retiring auditor shall be reappointed unless:-

- 1. he is not qualified for re-appointment;**
- 2. He has given the company notice, in writing, of his unwillingness to continue as auditor;**
- 3. A resolution has been passed at an annual general meeting appointing somebody or stating that he shall not be reappointed.**

Section 224(3) of the Companies Act, 1956 provides that where at an annual general meeting no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy. For this purpose, an application has to be made by the company to the Regional Director (to whom the powers have been delegated),

within 7 days of the conclusion of the meeting, for appointment of an auditor and fixing his remuneration.

CASUAL VACANCY [Section 224 (6)(a)]

A casual vacancy is a vacancy of a temporary nature that may occur during the currency of the year after the appointment is made by the company at its general meeting. The auditor appointed in a casual vacancy shall hold office till the conclusion of the next annual general meeting. If the casual vacancy arises, the remaining auditors, if any, will continue to act as the auditors of the company.

Where the casual vacancy arises due to death or disqualification, the Board of Directors may appoint another auditor. But where the **casual vacancy is caused by resignation of an auditor**, the Board cannot fill up the casual vacancy but the vacancy so caused by resignation, shall be filled by the company in **general meeting**.

RESIGNATION OF AUDITOR

An auditor may resign before his term of office expires by depositing a notice in writing to that effect at the company's registered office. His resignation becomes effective on the date he lodges such notice or on such later date as may be specified in the notice.

RETIRING AUDITOR CANNOT BE REMOVED BY THE BOARD [Section 224(7)]

The Board of Directors of the Company has no power to remove an auditor appointed by the company in general meeting, i.e., the auditors can be removed only by the company in general meeting and prior approval from the Central Government is also necessary for such removal of the auditors.

REMUNERATION OF AUDITORS [Section 224(8)]

The Board fixes the remuneration of the First Auditors. Where the auditor is appointed or re-appointed by the general meeting, the remuneration is fixed by the general meeting, or it may be fixed in any manner as determined by a general meeting. Where Central Government is approached for appointing the auditor, the Government fixes the remuneration. (This power of the Central Government is delegated to the Regional Director)

The remuneration fixed for an auditor is inclusive of all expenses allowed to him so that he cannot claim any amount additional to the remuneration fixed either as expenses or otherwise.

QUALIFICATION & DISQUALIFICATION OF AUDITORS [Section 226]

Only individual, possessing the requisite knowledge and skill, can be appointed as auditor of the company. The auditor should be independent in carrying out his work so that he is able to give an unbiased opinion based on an objective assessment of facts. Thus, he should have no interest, financial or otherwise and whether directly or indirectly, in the company and /or its management.

A person, who is Chartered Accountant within the meaning of Chartered Accountants Act, 1949 and holds a certificate of practice, or a partnership firm where of all the partners are Chartered Accountants holding certificates of practice, may be appointed as auditor of a company. However, in the latter case, the appointment as an auditor may be made in the firm name and any of its partners may act in the name of the firm.

The following persons cannot be appointed as auditor of a Company:

1. An officer or employee of the company;
2. A person who is partner with an employee of the company or employee of an employee of the company;
3. Any person who is indebted to a company for a sum exceeding Rs. 1,000/- or who have guaranteed to the company on behalf of another person for a sum exceeding Rs. 1,000/-.
4. A person who is holding any security of that company, after a period of one year from the date of commencement of Companies (Amendment) Act, 2000.

If an auditor, after his appointment, becomes subject to any disqualification mentioned above, he shall be deemed to have vacated as such.

SPECIAL RESOLUTION FOR APPOINTMENT OF AUDITOR [Section 224A]

This Section provides for appointment or reappointment of auditors at an annual general meeting by a **special resolution** when **25% or more** of the subscribed share capital of the company is held jointly or singly by a public financial institution, a Government company, Central Government, any State Government, any institution established by a State Act in which the State Government holds not less than 51% of the subscribed share capital, a nationalised bank or an insurance company.

Certified copy of the special resolution so passed shall be filed with the Registrar within 30 days of passing, in **Form No. 23**.

It is also to be noted that, if, after notice of the annual general meeting is issued in the usual course and before the holding of meeting, it happens that the holdings of the public financial institutions have reached 25% of the total subscribed share capital, then the meeting has to be adjourned and after issuing notice under this section, necessary special resolution is to be passed for appointing the auditor(s).

SPECIAL NOTICE FOR APPOINTMENT OR REMOVAL OF AUDITORS [Sec. 225]

The Act provides that for appointing a person other than the retiring auditor or for not appointing the retiring auditor, power has been given to a member to serve a special notice on the company of his intention to move a resolution at the next Annual General Meeting. On receipt of the notice, the company has to send a copy thereof to the retiring auditor.

The special notice should be given to the company at least 14 clear days before the meeting.

Further the Company shall also give intimation of the same to all the members of the company immediately and where it is not possible to do so, then the company shall

give notice to the members by advertisement in the newspaper circulating in the place of its registered office, not less than seven days before the meeting.

Where the retiring auditor makes a representation, the company shall, if it is possible, circulate the same to all the members of the company before the meeting. If it is not possible to circulate the representation to the members, the auditor may require the same to be read at the meeting. However, on an application by the company or an aggrieved person, the Company Law Board may order that the copies of representation need not be sent to the members or read at the meeting.

AUDITORS OF GOVERNMENT COMPANIES

Auditor of a Government Company shall be appointed or reappointed by the **Comptroller & Auditor General of India**. Remuneration of the auditor of a Government Company has to be fixed by the company in general meeting. However, the general meeting may, instead of fixing the remuneration of auditors, authorise the Board of Directors in this behalf.

FOREIGN COMPANIES

In case of shipping and airlines companies, the accounts may be audited by the statutory auditors of foreign companies; in case of other foreign companies, the accounts must be audited by the practicing Chartered Accountants in India.

AUDIT OF ACCOUNTS OF BRANCH OFFICE [Section 228]

Where a company, whether a public or a private limited, has a branch office, its accounts should also be audited. The audit of the accounts of branch office can be done **either** by:

- i. the company's auditor; or
- ii. by any other person who is qualified to act as the company's auditor

However, if the branch is situated in a country outside India, a person who is duly qualified to act as auditor of the branch in accordance with the laws of that country, can also be appointed as auditor of branch.

If the branch is not being audited by the company's auditor, he is then also entitled to visit the branch office if he considers it necessary to do so for the performance of his duties as the auditor. He has also a **right of access** at all times to books, accounts and vouchers of the company maintained at branch office.

Only the auditor of the company, or where a firm is so appointed, only a partner in the firm practising in India, may sign the auditors' report. **[Section 229]**

The auditor's report is required to be read out at the Annual General Meeting and shall be open to inspection by any member of the Company. **[Section 230]**

Section 231 of the Companies Act, 1956 confers a right on the statutory auditor to attend and to be heard at any general meeting on matters of his concern.

Thus, the Act seeks to ensure that the appointment of an auditor is not in the hands of the directors but is vested in the general body of shareholders and where the shareholders fails to exercise their power of appointing an auditor, the power vests with the Central Government. Therefore, **Auditors are not mere puppets** in the hands of the Directors of the Company.

The auditor makes his report to shareholders through the company and is responsible to the company for any failure in the performance of his professional duty. The auditors carry out such investigation as will enable them to form an opinion on whether proper books have been kept and proper returns adequate for their audit have been received from branches not visited by them and whether balance sheet and profit and loss account are in agreement with the books and returns.

In addition to verifying compliance with the Act, the auditors have also to acquaint themselves with their duties under the articles of the company, if any, so as to assure due compliance with them.

The Companies Act lays down detailed provisions regarding various matters and casts an obligation upon officers and directors of the company to carry out the requirements of law. However, where there is contravention of legal requirements by a company which has a bearing on the accounts and transactions of the company, the auditor

would in the normal course of his inquiry become aware of them and it would need to be brought to the notice of the shareholders. The duty of the auditor is that he must be **honest**; that he must not certify what he does not **believe to be true** and must take **reasonable care and skill** before he believes that what he certifies to be true.

What is required of auditor is his subjective satisfaction after taking reasonable care and skill. In this process, he is not barred from relying on the tried or trusted servants of the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. Thus, **Technical Competence** and **Professional Independence** plays a crucial role in discharging the duties, in practice. It is extremely difficult to precisely define the role, scope, etc., of the auditors. The above-mentioned provisions of the Act will pave the way to **achieve the desired objectives for which they are designed**.