2014

"Excel Commerce Academy Private Limited"

"Audit Under Companies Act, 1956"

A Practical Approach

Prepared By

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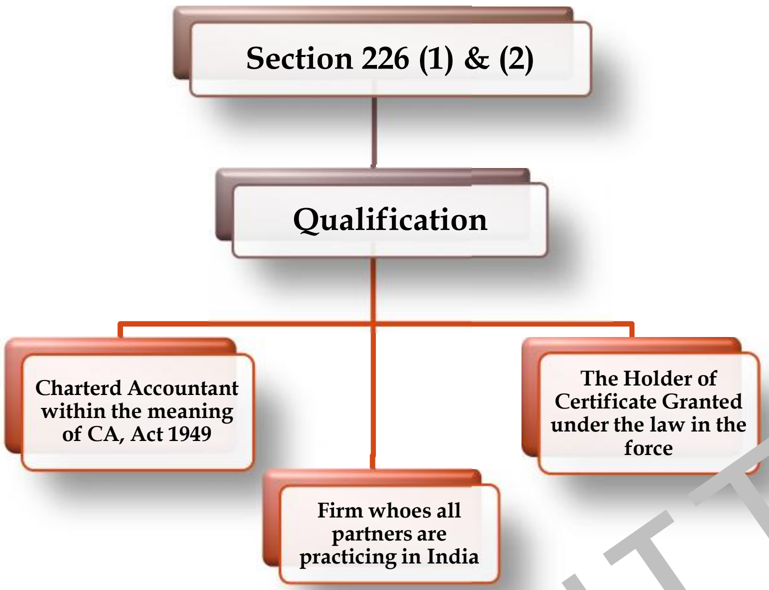
"Please do not copy, respect the effort behind these notes."

Index of Topics

Who Can be Appointed as CO. AUDITOR

"Sec. 226 is principal section describes the qualifications and disqualifications of a person to be appointed as auditor of a company."

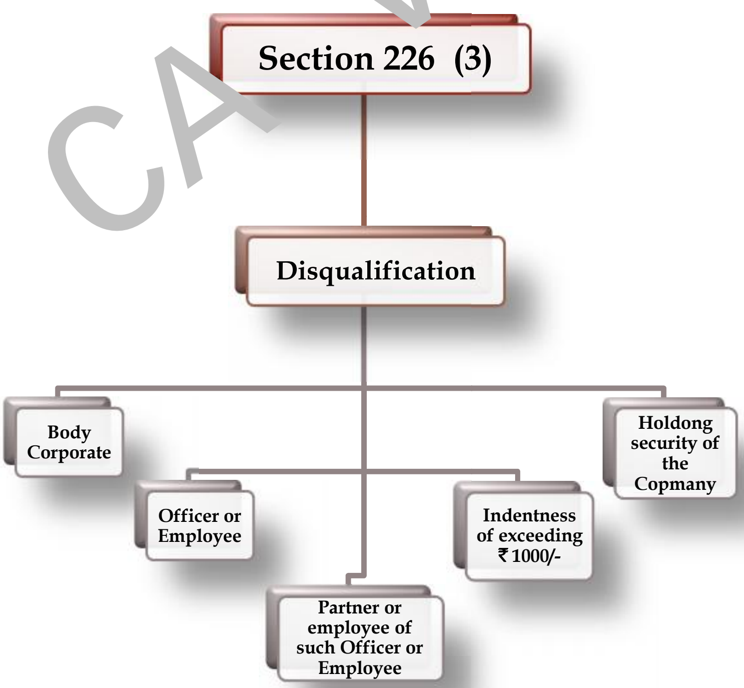
1. Qualifications of an auditor



Introduction

The shareholders of the company are the real owners of the Company. They invest their money in the company. However the management of the company lies in the hands of the directors. Generally the shareholders do not have the skills required to understand the financial statements. Thus audit of accounts of company has been made compulsory in order to protect the interest of the shareholders. Audit of accounts ensures that the statements of account are properly drawn up and they disclose all the requisite information. Auditor must also ensure that the company has not violated any of the provisions contained in the Companies Act, 1956. Although compliance with the relevant provisions of the companies Act, 1956 is the responsibility of the directors and officers of the company, nevertheless the auditor must make a report to the shareholders where non compliance results in

2. Disqualification of an Auditor



S. N..	Disqualification	Reason
1.	A Body corporate.	Its limited liability.
2.	An officer or employee of the company.	Questionable Independency.
3.	A partner or employee of persons in point no. 2.	Financial or Personal relationships with the officer and employees of the company are prohibited, in order to promote independence of the Company Auditor.
4.	Indebted to the company for an amount ₹ 1000/- or who has given guarantee or provided any security on behalf of third person to the company for an amount ₹ 1000/-.	Indebtness jeopardize independence or because to ensure that auditor is not under any financial obligation to the company or he is having financial freedom.
5.	Holding any security of the company.	Vested interest jeopardizes independence or it is also an aim to curb possible Insider Trading on the part of the auditor of the Company.

Section	Provision
Section 226(4)	•A personDisqualified as per the provision of 226(3) in any company as a auditor. •Than such a person can't be appointed as a auditor in its subsidiary or holding as a case may be.
Section 226(5)	•If any disqualification mentioned in section 226(3,4) is attracted after appointment. •Than there shall be a vacancy in the office of auditor from that date.

1. For the purpose of 226 (3) (b) above-

➢ According to council general guidelines 2008, issued by council of ICAI under Chartered Accountants Act 1949. "A Member will be found guilty of professional misconduct if he expresses opinion on financial statement of an entity in which his relative has substantial interest.**(To be discussed in the CODE OF ETHICS).**

☞ ***Section 314 –*** A C.A. is not disqualified if his Relative or his employee works as a Director, Secretary or any other person. But the permission of CG is must and a Special Resolution is reqd.**(*For detail refer Company Law module and section 314 of Co's Act").***

➢ **Clarification of the Department of Company Affairs** the legal position is as follows:

a) "Where the chartered accountant is employed whole-time, he is an employee of the company. In other cases, generally speaking there would appear to be only a contract for service and not a contract of service between the company and chartered accountant, *In Dhrangadhra Chemicals Works v. State of Saurashtra (1957 S.CA, p. 216) the Supreme Court* has laid down that the *prima facie test for determination of the relationship between master and servant is the existence of the right in the master to supervise and control the work done by the servant not only in matter of directing that work the servant is to do,* but also the manner in which he shall do his work, or to borrow the words of Lord Uthwatt, the proper test is whether or not the hirer had authority to control the manner of execution of the act in question.

b) Applying this test in any case, where the *chartered accountant is consulted only professionally on income tax* matters by a company, he cannot be said to be an officer or employee of the company.

c) "A Chartered Accountant's *main business is to render professional service for reward* like a lawyer or a doctor. Where such service is rendered professionally and not as an officer or employee of the company, a chartered accountant is not disqualified under Section 226(3) (b) of the Companies act, 1956".

2. For the purpose of 226 (3) (d) above-

- Indebtness of more than Rs.1000 has a stringent interpretation, Even if auditor purchases goods worth more than ₹ 1000 from the company in which he is auditor on credit, irrespective of the fact that the company is **normally allowing credit** to other customers, Auditor will be **disqualified** on such occasion of credit purchases.

- On the other hand if the auditor is **receiving on progressive basis** from the company, although the audit is not over **he will not be treated indebted**. ***(Also Refer Guidance Note Issued by ICAI)***

SOME ISSUES

Query 1. Whether a partner is disqualified from appointment as auditor when the firm of which he is a partner is indebted to the company in excess of the limit prescribed and whether the firm is disqualified from appointment as auditor when a partner of the firm is indebted in excess of the prescribed limit ?

Response: In both cases disqualification will apply because when a firm is appointed as an auditor, each partner is deemed to be so appointed and when a firm is indebted each partner is deemed to be indebted.

Query 2. Can an internal auditor be appointed as statutory auditor?

Response: A statutory auditor of a company cannot be its internal auditor because of the following reasons:-

(a) The statutory auditor is appointed by the company in accordance with the provisions of section 224, and the auditor is required to perform the duties enjoined on him under section 227 and rules/orders issued there under.

(b) The internal auditor is appointed by the management and hence is in the position of an employee. Being an officer or employee of the company is a disqualification for auditor under sub-section (3) (b) of section 226.

The auditor is also required to report whether there is adequate internal control procedure commensurate with the size of the company and the nature of its business. If statutory auditor of the company is also the internal auditor, it will not be possible for him to give an independent and objective report under section 227.

Circular No. 29/76[I/I/76-CL-V], dated27/8/1976as corrected by Circular No. 5/77[1/1/76-CL-V], dated 8/4/1977

Query 3. Can statutory auditor accept the assignment of ***writing books of accounts*** of the same company in which he is auditor?

Response: As per council's view such person can't be auditor of that company.

Query 4. There may also be situations in which, though the appointment is made in the individual name of a partner, the work is in fact carried out by the firm and the fees are credited to the account of the firm?

Response: In such situations, the firm will be deemed to be acting as auditor and the disqualification will be attracted in the case of indebtedness either of firm or a partner.

Query 5. Can a ***Cost auditor*** be appointed as statutory Auditor of the Company?

Response: As per ***Council General Guidelines – 2008, Chapter no. III,*** Cost Auditor can't be appointed as Statutory Auditor of the Company. In fact even the employee of Cost Auditor who is Chartered Accountant can't be appointment as Statutory Auditor of the Company u/s 224.

Query 6. Can an ***Ex – Director*** of a company be appointed as a Statutory Auditor of the Company?

Response: As per Company Act, 1956 there is no restriction on such appointed but one must also take care of Code of Ethics – 2009, Part – I ***(i.e. IFAC Norms – Thread of Self Review).***

Query 7. Can a Chartered Accountant or Firm of Chartered Accountants take an appointment in a Company as a Statutory Auditor of the Company where Mr. A ***(Manager of the Company) who is father of Mr. D who is Audit assistant/Article Assistant*** of the Firm ?

Response: As per Company Act, 1956 there is no restriction on such appointed but one must also take care of Code of Ethics – 2009, Part – I ***(i.e. IFAC Norms – Thread of Familiarity).***

Query 8. Can a Chartered Accountant or Firm of Chartered Accountants take an appointment in a Company as a Statutory Auditor of the Company where such Chartered Accountant or Firm was ***representing the Company in some Litigation or Dispute related matters against Third Party***?

Response: As per Company Act, 1956 there is no restriction on such appointed but one must also take care of Code of Ethics – 2009, Part – I ***(i.e. IFAC Norms – Thread of Advocacy).***

Query 9. Can a Chartered Accountant or Firm of Chartered Accountants take an appointment in a Company as a Statutory Auditor of the Company where Mr. A (Director of the Company) who is ***Ex – Partner*** of the Firm?

Response: As per Company Act, 1956 there is no restriction on such appointed but one must also take care of Code of Ethics – 2009, Part – I ***(i.e. IFAC Norms – Thread of Familiarity).***

Query 10. Can a Chartered Accountant or Firm of Chartered Accountants take an appointment in a Company as a Statutory Auditor of the Company where such Chartered Accountant or Firm has given ***Loan to Company/Directors/Officers of the Company***?

Response: As per Company Act, 1956 there is no restriction on such appointed but one must also take care of Code of Ethics – 2009, Part – I *(i.e. IFAC Norms – Thread of Self Interest).*

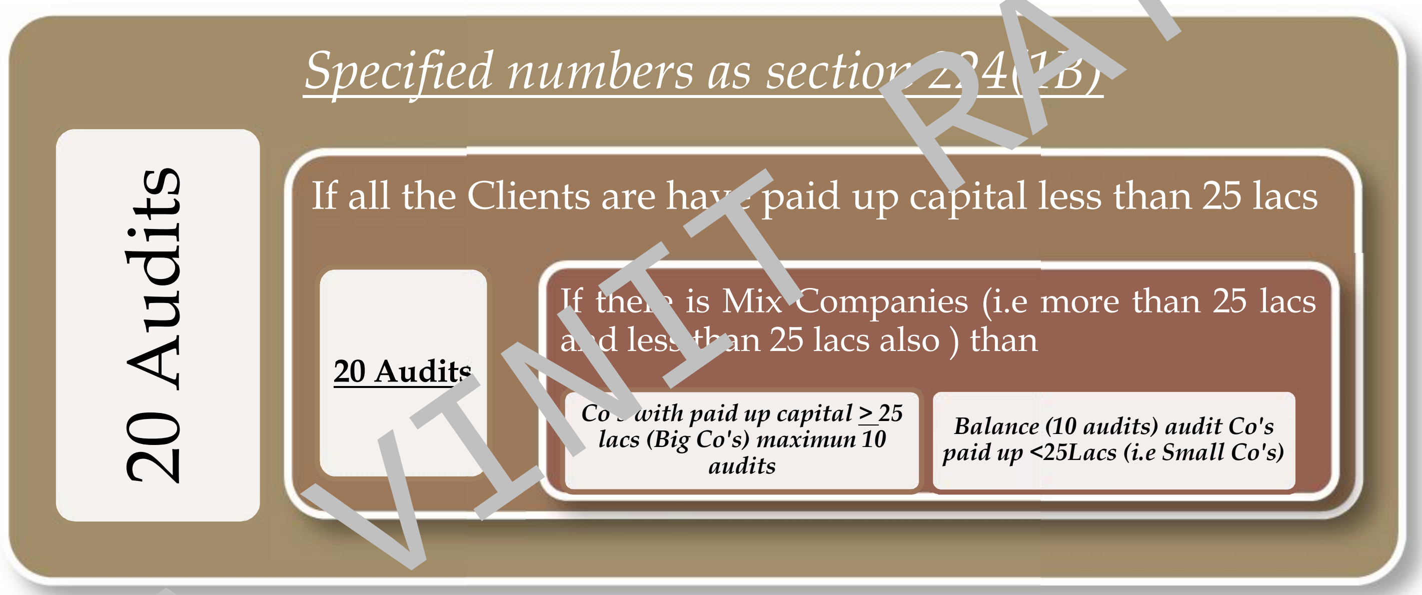
> **Note →** ***while reading above Disqualifications u/s 226 one must also read section 8 of Chartered Accountant Act, 1949 which deals with Ineligibility to become member of ICAI. (Read in Code of Ethics – 2009 Chapter)***

Ceiling Limit section 224 (1A)/(1B)/(1C)

Despite a person not holding any disqualification and holding all qualification mentioned in section 226, if already having specified no of audits or more than specified no of audits he cannot be appointed as auditor of the company. This additional disqualification is wide sec. 224(1B) and Chartered Accountants regulation act, 1949

Section 224 (1B)

Introduces a ceiling on the number of companies of which a firm or a person could be the auditor. According, No company or its Board of Directors shall appoint or reappoint any person or firm as its auditor if such person or firm is, ***at the time of appointment or reappointment,*** holding appointment as an auditor equal to or more than the "specific number" of company as a post of auditor. Here "specified number" means



Points to be remember while calculating limit u/s 224(1B)

1. In the case of a firm of Chartered Accountants having two or more partners, the specified number shall be counted ***per partner of the firm***.

   For example if there are three partners, the firm can hold the audit of 3 x 20 = *60* companies of which not more than *30* companies shall have a paid-up capital of Rs. *25* lakhs or more.
2. When one person is a **partner in more than one firms**, or partner in a firm and also practicing individually, he is allowed to have same *20* audit assignments. In this case he has a choice to divide these *20* assignments into firms, or individually at his will. **(please also refer "Explanation of Chapter VIII of Council General Guidelines, 2008 No. 1-CA(7)02/2008 dated 8th August 2008")**
3. While counting the "specified number", the **audit of a branch** cannot be included as a branch cannot be equated to a full company.
4. **Companies limited by guarantee not having share capital** are not to be taken into account while computing the specified number.
5. In **case of joint audit**, each of the joint auditors should consider a unit at his part for the purpose of calculating the ceiling of audits.
6. Most important to note that after amendment under companies act w.e.f. 13.12.2000 **Private companies** will also ***be excluded*** from the specified limit.
7. The ***number of partners of a firm on the date of acceptance*** of audit assignment shall be taken into account.

8. A Chartered accountant in full time employment elsewhere shall not be taken into account ***(Part – Time COP)***.
9. The Audit of ***Head Office and Branch Offices*** of a company by one Chartered Accountant or Firm of such Chartered Accountants in Practice shall be regarded as ONE Audit Assignment.
10. The audit of ***One or More Branches of the same company by one Chartered Accountant*** in Practice or Firm of such Chartered Accountants in Practice in which he is partner shall be constructed as ***ONE Audit Assignment ONLY.***

Audit not to be excluded

- ✓ Audit of Government company
- ✓ Audit of Sec. *25* Company
- ✓ Audit of Guarantee company limited by share

Query 11. Whether an auditor can conduct as many audits as he can of Private companies as they are out of sec.224 (1B)?

Response: - The Companies (Amendment) Act, 2000 has also amended Section 224(1B) dealing with ceiling on company audits. Pursuant to this amendment, the private companies will be excluded while computing the ceiling limit of 20 companies, as the case may be. Consequently, the auditor can accept audit of any number of private companies subject to the overall limits laid down by guidelines of the Institute. The guidelines finalised by the Council are reproduced below:

"Chapter VIII of Council General Guidelines, 2008 No. 1-CA(7)02/2008 dated 8th August 2008: In exercise of the powers conferred by clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India hereby specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 224 and /or Section 228 (Branch Audit) of the Companies Act, 1956".

As per a notification issued by ICAI, a chartered accountant can accept a maximum of ***30*** *audits including the audits of private companies.*

Non-observance of this ceiling would amount to professional misconduct [ICAI Notification dated 08.05.2001].

"A Harmonious Construction"

Overall Limit

Companies	As per Companies Act	As per C.A. Act	Applicable
Accepting only Public Co's Audits	20	30	20
Accepting only Pvt. Co's Audit	Unlimited	30	30
Accepting only Independent Branch Audit	Unlimited	30	30

Some Important Circular/Letter for DCA/MCA

- *Branch Audits not included in computing the limits prescribed under 224(1B)*
  DCA-Circular No.21 of 75 dated 24-9-1975
- *Guarantee companies having no share capital also excluded from 224(IB)*
  DCA-Letter No. 8I12I (224) I74-CL- V dated28-9-1974
- *Foreign company's audit - not included in computing the limits prescribed under 224(1B)*
  DCA-Circular No.21 of 75 dated 24-9-1975

"List Of AuditsExcluded":

1. Audit of a private company*
2. An audit of a guarantee company having no share capital.
3. An audit of a foreign company.
4. An internal audit.
5. Audit of cooperative societies, trusts and corporations.

6. Tax audits under Income Tax Act, 1961
7. Special audit and investigations.
8. Audit of Branch*
9. Special audits in other acts.
10. Audits of non-corporate bodies

**Remember ICAI Guideline's*

How a Auditor is Appointed

Appointment of Auditor

224(5)	Appointment of First Auditor
224(1)	Appointment of Subsequent auditor or Appointment by Shareholder or Appointment by Company.
224(2)	Reappointment.
224(3)	Appointment By Central Govt.
224(6)	Appointment under Casual Vacancy.
224A, 314	Appointment by Special resolution.
228	Appointment of branch auditor.
619	Appointment of auditor of Govt. Co.

Appointing Authorities

- **BOD's**
  - First Auditor *and* Casual Vacancy other than Resignation
- **Shareholders i.e Company**
  - Casual Vacancy due to resignation *and* Appointment at AGM
- **Central Govt.**
  - In case both Shareholders and Board failed to appoint the Auditor *or* Special Audits *and* Pass OR instead of SR
- **CAAG**
  - In case of Government Companies

"THE FIRST AUDITOR: - [Sec. 224 (5)]

224(5) The First auditor or auditors of a company shall be appointed by the BOD within **one month** of the date registration of the company; and the auditor or auditors so appointed shall **hold office** until the **conclusion of the first AGM:**

Provided that—

(a) The company may, at **GM**, remove any such auditor or all or any of such auditors and appoint in his or their places any other person or persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the member of the company not less than fourteen days before the date of the meeting; and

(b) If the **Board fails** to exercise its powers under this sub- section, **the company in the GM** may appoint the first auditor or auditors.

Explanation

S. No.	Points	Details
1.	Appointment By Board	Section 224(5) specifies that the BOD's can appoint the First Auditor(s) of a Company.
2.	Time of Appointment	The Appointment shall be made by the Directors, within one month from the date of incorporation of Company.
3.	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.
4.	Members' power of removal	The Company may, at a general meeting, remove such a Auditor or all or any of them and appoint another or others in his or their place, on a nomination being made by any member of the Company. ***(To be Discussed later in chapter of Removal)***
5.	Provision in Articles	An Auditor cannot be appointed as First Auditor(s) simply because his name has been stated in AOA.
6.	Intimation	The Company need not sent any statutory intimation to the First Auditor(s), within 7 days of their appointment. Notice of appointment can be sent in the ordinary course of business within reasonable time. ***(See Annexure – I)***
7.	Acceptance	The First Auditor(s) are themselves not reqd. to inform ROC about their acceptance or refusal of such an appointment.
8.	Resolution	Resolution by circulation (u/s 289) will be valid mode of appointment of First Auditor. ***(See Annexure – I)***
9.	Tenure of Office	The First Auditor(s) shall hold office from the date of appointment to the conclusion of the first AGM of the company.

"Appointment of Subsequent Auditors" [Sec. 224(1)]

224 (1) **Every Company** shall, at **each AGM**, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next AGM and shall, **within seven days** of the appointment, give intimation thereof to every auditor so appointed:

***Provided* that** before any appointment or re-appointment of auditor or auditors is made by any company at any AGM, **a written certificate** shall be obtained by the company from the auditor or auditors proposed to be so appointed to the effect that the appointment or re-appointment, if made, will be in accordance with the **limits specified in the sub-section(1B).**

224(1A) Every auditor appointed under sub-section (1) shall **within thirty days** of the receipt from the company of the intimation of his appointment , inform the **Registrar in Writing** that he has accepted, or refused to accept, the appointment.

SEE FORM NO. 23B

Mob. No. 7737345000

Explanation

S. No.	Points	Details
1.	Appointment	Under section 224(1), every Company shall, at each AGM, 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).**(See Annexure – II)**
3.	Failure	If the Shareholder fails to appoint the Auditors, the Central Government is empowered to make the appointment. ***[section 224 (3),(4)]***
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 are any professional reason why the appointment should not be accepted. This Forms part of Chartered Accountant's Code of Ethics. **(To Be Discussed Later in COE)**
6.	Acceptance	The Auditor, on receipt of the intimation from the company about his appointment, is reqd. to send a written communication to the ***ROC in Form 23B within 30 days (See Annexure – II)*** of the receipt of intimation stating whether he has accepted or refused to accept the appointment. Incoming auditor must also see clause no. 8 & 9 of COE – 2009.
7.	Tenure of Office	The Auditor(s) shall hold appointment from the conclusion of that AGM (in which he is appointed) till the conclusion of the next AGM.

Important to note that the appointment of auditors is made in terms of the period and not for any financial year and not for particular Balance Sheet (refer Section 227 (2).

"Appointment by Central Government" - [Sec. 224 (3) and (4)]

224(3) Where at an AGM no auditors are appointed or re-appointed, **the Central Government may appoint a person to fill the vacancy.**

See Form no. 24A

Powers are now delegated to Regional

224(4) The company shall **within seven days** of the **Central Government's power** under sub section (3), becoming exercisable, give **notice of that fact** to that Government; and, if company fails to give such notice, the company, and every officers of the company who is in default, shall be punishable, with fine which may extend to **[five thousand] rupees**.

Before the amendment on 13/12/2000 the fine was of

Explanation

S. No.	Points	Details
1.	Appointment By Central Govt.	The Appointment can be done by Central Govt. only if Company has failed at its AGM to appoint.
2.	Defective Appointment	Where the appointment of a person as the Auditor in the AGM is **Void ab intio**, section 224(3) will be attracted and central Govt. can be appoint the Auditor.

3.	Appointment by Special resolution	Where a Company is reqd. to appoint an Auditor at an AGM by passing an S R, 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 the section 224(3) of the Act will be attracted. **[Section224A(2)] (See Annexure – I)**
4.	Notice	The Company shall give notice of the fact within 7 days to the Central Govt., of its power becoming exercisable. **(See Annexure – I and II)**

"Appointment in case of CAUSAL VACANCY"- [Sec. 224 (6)]

224(6) (a) **The Board may fill any Causal vacancy** in the office of an auditor; but while any such vacancy continues, the remaining auditor or auditors, if any, may act:

Provided that where such vacancy is **caused by the resignation** of an auditor, the vacancy shall be filled by the company in GM.

224(6) (b) Any auditor appointed in a causal vacancy shall **hold office until the conclusion of the next AGM.**

Explanation

S. No.	Points	Details	
1.	Meaning of Casual Vacancy	Casual Vacancy has not been defined in the Companies Act, It stands for a vacancy created by the Auditor ceasing to act after he was validly appointed and the appointment was accepted. This may arise due to a variety of reasons like resignation, disqualification, dissolution of the CA firm, etc.	
2.	Filling up Casual Vacancy	***Reason other than Resignation*** Board of Directors (Board Resolution) **(See Annexure – I)**	***Reason is Resignation**** Company in a GM [S R if sec. 224A is applicable, otherwise O R will be sufficient. **(See Annexure – I)**
3.	Tenure	The Auditor(s) appointed in a casual vacancy shall hold office from the date of his appointment till the conclusion of the next AGM.	

"* This is done to preserve the independence of auditor".

Other points

1. **1.** 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.

2. A casual vacancy is not a vacancy created by the any deliberate omission on the part of the Company to appoint an Auditor in its AGM. **[ICAI vs. Jananendra Nath Saikia 25 CC 53 (Assam)]**

3. 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.

4. When there 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 BOD ca appoint the new reconstituted Firm.

5. In the case appointment is Void – ab – into that it is not a casual vacancy rather it is case of Failure to appointment.

6. The auditor appointed to a causal vacancy shall hold office till the conclusion of the next annual general meeting.

"Appointment by SPECIAL RESOLUTION" (Sec. 224 A)

Auditor not to be appointed except with the approval of the company by special resolution in certain cases.

224A (1) In the case of a company in which **not less than twenty-five percent** of the **subscribed share capital** is held, whether **singly or in any combination**, by—

(a) A PFI or a Government Company or Central Govt. or any State Govt., or

PFI meaning as per SEC. 4A

Means u/s

(b) Any financial or other institution established by any Provincial or State Act in which a State Govt. holds not less than 51% of the **Subscribed Share Capital**, or

(c) A Nationalised Bank or an Insurance Company carrying on general insurance business.

The appointment or reappointment at each AGM of an auditor or auditors shall be made by a **Special Resolution**.

224A (2) Where any company referred to in sub-section (1) omits or fails to pass at its AGM any SR appointing an auditor or auditors, it shall be deemed that no auditor or (s) had been appointed by the company at its AGM, and thereupon the provisions of **sub-section (3) of section 224** shall become applicable in relation to such company.

i.e. Central Govt.

Explanation

S. No.	Points	Details
1.	Relevant or Material Date	For determining the 25% holding, the material date shall be the **DATE OF THE AGM** in which the special resolution is reqd. to be passed.
2.	Omission by the Company	Where a Company is reqd. to appoint an Auditor at an AGM by passing an S.R., 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 the section 224(3) of the Act will be attracted. **[Section224A(2)]**
3.	Capital	Shareholding as a % of **Subscribed Share Capital** has to be considered, and **not of PAID UP CAPITAL.**

"Points to be remembered"

QUERY 1. **What will happen if at the date of sending notice subscribed capital was < 25% and at the date of AGM if increased upto 25%?**

Response: - The material date for the purpose of applicability of provisions of section 224A is the date of the annual general meeting at which the special resolution is required to be passed. ***[Circular No. 2/76(1/1/76-CL-V), dated 5/6/1976].*** Therefore, if any change has taken place in the shareholding pattern of the company after the issue of notice of annual general meeting the company shall adjourn the meeting to another date, and later issue the required notice in accordance with law and thereafter pass the special resolution required under this section.

QUERY 2. **Whether Shareholding as trustee etc. will be counted for 25% or more limit?**

Response: - Irrespective of the circumstances in which a nationalized bank is holding shares, if the name of the bank is entered in the register of members of the company as holder of shares whether as a trustee or as a secured creditor etc. (whether beneficially or as security for loan advanced to constituents) such holding of shares will have to be taken into account for the purposes of section 224A. ***[Circular No. 18/74, dated 12/12/1974]***

Note→ **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. Circular No. 1412001 dated on 16.07.2001**

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

Company	% of Shareholding in Subscribed Share 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 Auditor	***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 add this as 25% or more].*** Further, Subscribed Capital includes Preference Share Capital also.			Subscribed Capital exceeds 25%

"Appointment of Auditors for GOVERNMENT COMPANIES"- (SECTION 619)

Appointment of auditors in case of a Government Company is subject to the provisions of Sec 619 which overrides Sec 224 to Sec 233 dealing with appointment, etc., of the auditors in the case of non-government companies. The auditor of a Government Company shall be appointed or reappointed by the Comptroller and Auditor General of India, **however the appointment shall be subject to ceiling limits as per Sec 224 (IB)., (TO BE DISCUSSED IN GOVT. CO. Audit)**

"COMPULSORY REAPPOINTMENT OF RETIRING AUDITOR"- [SECTION 224(2)]

Subject to the provision of **sub-section (1B) and section 224A**, at **any AGM, a retiring auditor, by whatsoever authority appointed, shall be re-appointed**, unless—

(a) He is **not qualified** for re-appointment;
(b) He has given the company notice **in writing of his unwillingness** to be re-appointed;
(c) A resolution has been passed at the meeting **appointing somebody instead of him** or providing expressly that he **shall not be re-appointed**; or
(d) Where notice has been given of an intended resolution to appoint some person or persons in the palace of a retiring auditor, and **by reason of death, incapacity or disqualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with**.

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

Some Issues

QUERY 1. Whether Compulsory re appointment is automatic reappointment?

Response: The reappointment of an auditor is not automatic. The expression 'shall be reappointed' postulates some action on the part of the company resulting in the reappointment. As such, a specific resolution appointing an auditor must be passed **[Department Circular No. 5/72, dated 21.02.1972]**, Appointment or reappointment of an auditor is a specific item in the agenda of the general meeting and therefore passing of a resolution for his reappointment is necessary.

QUERY 2. What is additional requirement in case of Reappointment of auditor in case of Listed Co's.?

Response: Three copies of the notice and proceeding of AGM should be sent to the Stock Exchange. Where such shares of the company are listed.

QUERY 3. Whether in case of Compulsory re appointment is company required to obtain again certificate of ceiling limit u/s 224(1B)?

Response: A Company Auditor is normally being reappointment at the AGM. The Company should therefore obtain a written certificate from the retiring auditor to the effect that the re – appointment. If made, will be in accordance with the limits specified in section 224(1B) of the Co. Act, 1956.

General Note → **It should be noted that the auditor shall hold office until conclusion of the next AGM meaning thereby that non- holding of the next AGM or its adjournment without considering the business of the appointment or re – appointment of auditor/s, shall no way affect the factual conclusion of the next AGM of the company.**

Notionally, it cannot be presumed that the auditor/s team expires on the date on which the AGM ought to have been held

HOW AUDITORS IS REMOVED

Removal of first auditors before expiry of term [Section 224(5)]

224(5) The First auditor or auditors of a company shall be appointed by the BOD within **one month** of the date registration of the company; and the auditor or auditors so appointed shall **hold office** until the **conclusion of the first AGM:**

Provided that—

(a) The company may, at **GM**, remove any such auditor or all or any of such auditors and appoint in his or their places any other person or persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the member of the company not less than **fourteen days** before the date of the meeting; and

(b) If the **Board fails** to exercise its powers under this sub- section, **the company in the GM** may appoint the first auditor or auditors.

Removal of subsequent auditor before expiry of their term Section 224 (7)

Except as provided in the proviso to the sub-section (5), any auditor appointed under this section may be removed from office **before the expiry** of his term only by the company in the GM, after obtaining the **pervious approval of the Central Government in this behalf.**

See e form no. 24A ← *This power now has been delegated to RD*

Comparative analysis of Removal of Auditor before expiry of First and Subsequent.

S. No.	Particulars	Removal of First Auditor	Removal of Subsequent Auditor
1.	Provision	Sec. 224(5) Proviso	Sec. 224(7)
2.	Authority to remove	Company at its G.M.	Company at its G.M.
3.	Approval of Central Govt.	Previous approval of Central Govt. is not Reqd.	Previous approval of Central Govt. is Reqd.
4.	Procedure	• Obtain Nomination of new auditor by any member of the Company. • Send special Notice of atleast 14 days to all members and the existing Auditor, intimating the proposed change. • If the member's nomination for a new Auditor is accepted, a resolution to this effect should be passed.	• Obtain Nomination of new auditor by any member of the Company. • Send special Notice of atleast 14 days to all members and the existing Auditor, intimating the proposed change. • If the member's nomination for a new Auditor is accepted, a resolution to this effect should be passed.

Note → In the case where BOD fails to appoint First Auditor and is being appointment made by the Shareholder at GM (i.e. EGM) than in such a case Removal of such auditor before expiry of the tenure will be governed by section 224(7)

"Removal at an AGM of first or subsequent auditor Section 225"

See section 190 (2)

(1) **Special Notice** shall be reqd. **for a resolution at AGM** appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

(2) On receipt of notice of such a resolution, the company shall forthwith **send a copy thereof to the retiring auditor.**

(3) Where notice is given of such a resolution and the **retiring auditor makes with respect thereto representation in writing to the company(not exceeding a reasonable length)** and requests their notification to the members of the company, **the company shall**, unless the representation are received by it too late for it to do so,--

(a) In any notice of the resolution given to members of the company, **state the fact of the representation having been made**; and

(b) **Send a copy of the representation to every member** of the company to whom notice of the meeting is sent, whether before or after the receipt of the representations by the company;

And if a **copy of the representations is not sent** as aforesaid because they **were recd. too late or because of the company's default** the auditor may (without prejudice to his right to be heard orally) require that the representations shall be **read out at the meeting:**

THERE IS ONE PROVISO BE DISCUSSED IN THE INTERVENTION BY CG POINT

(4) Sub section (2)/(3) shall apply to a resolution to remove the first auditors or any of them under the sub section (5) of section 224 or to the removal of any auditor/(s) under sub section (7) of that section, as they

Explanation

S. No.	Points	Details
1.	Special Notice	Special Notice is Reqd. for a resolution at an AGM for— 1. Appointing as Auditor, a person other than the Retiring Auditor. 2. Providing expressly that the Retiring Auditor shall not be re-appointed.
2.	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 ensuring AGM, at least 14 days before such meeting.
3.	Circulation of Notice	On the receipt of such 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)
4.	Retiring Auditor Rights	1. To make Representation of Reasonable length. 2. To request that such representation be circulated among the members. 3. To require that the representation be read out at the AGM and be heard orally at the AGM.
5.	Companies 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— 1. State the fact of representations being made, in any notice of the

		resolution given to members of the Company. 2. Send a copy of representation to every member of the Company to whom the Notice of meeting (AGM) is sent. *Note → In case it is not possible to send special notice and representation in the notice of the AGM, then the Company should inform the shareholders by advertisement in the newspaper having appropriate circulation or by any other mode as allowed by the Article of Association not less than 7 days before such AGM.*
6.	Procedure at AGM if point no. 5 is not complied	If a copy of the representation is not sent as the same was received too late or because of the companies 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 special resolution is reqd. in terms of sec. 224A, the same should be duly passed.
7.	Certificate from Appointed Auditor	Same as discussed in chapter - 2

1. Note→ Where a company has joint auditors and at an annual general meeting, the company intends not to reappoint any one of them, it would amount to a change in the office of auditors, i.e., removal of auditors at an annual general meeting. Therefore, it would require a special notice and compliance with section 225(2) and (3).

2. Note→ 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. Circular No. 35/6/68 CL – III.

3. Note→ It must be noted that if Auditors representation contains matters which seems to be like soliciting or seems to Advertisement of his Professional Attainments or Securing the professional work he will held guilty for Professional Misconduct under COE – 2009, Sch. – I, Part –I, Clause No. – 5/6/7

Removal of auditor by Central government

According to Sec. 408 central government can remove the auditor by issuing directions in this behalf to prevent oppressions and mismanagement. **(See in your LAW Module OF DETAILS)**

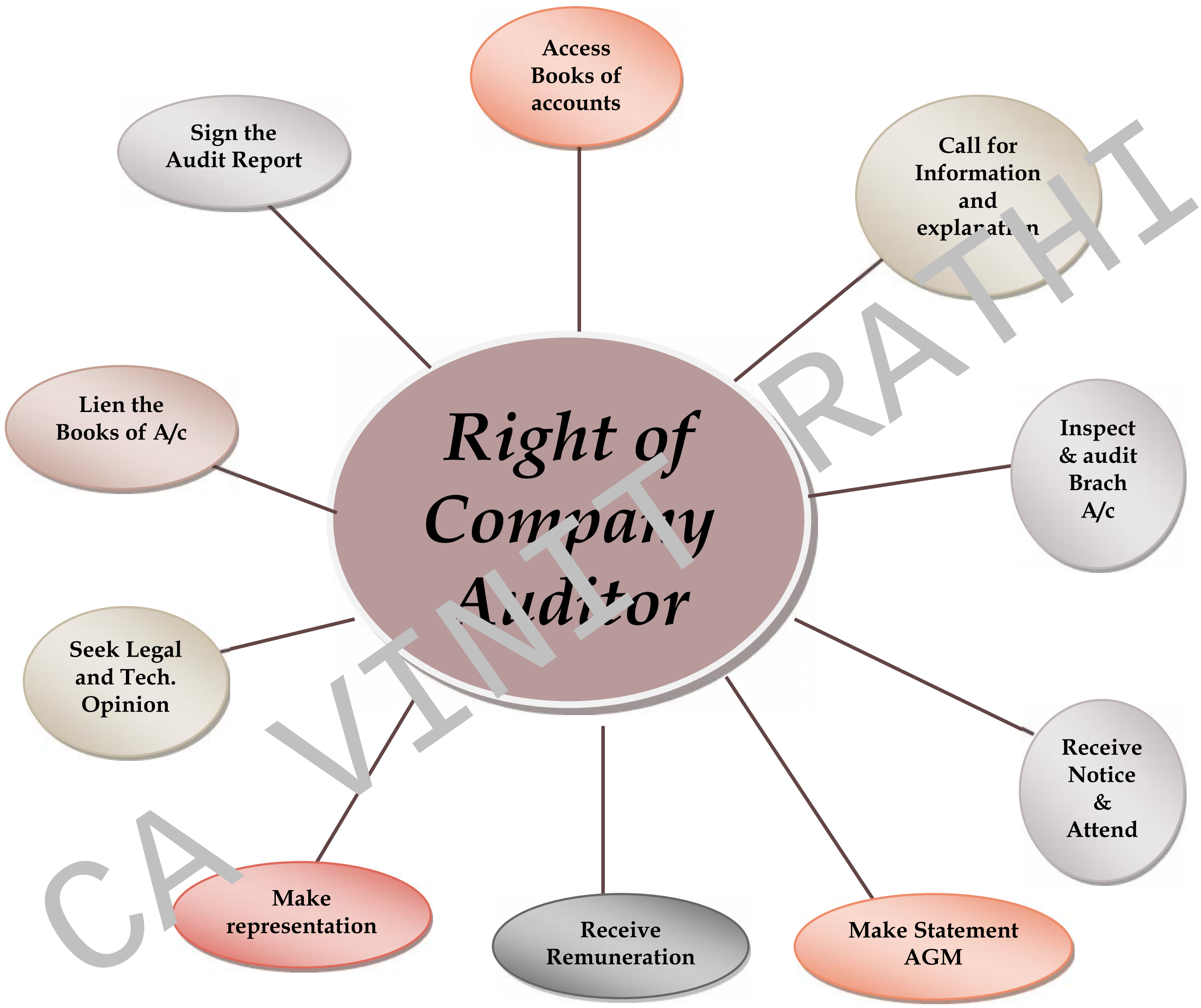
Intervention by Central Government

Proviso to sub section (3) of section 225

Provided that **copies of the representations need not be sent out** and the representations **need not be read out** in the meeting if, on **the application** either of the company or of any other person who claims to be aggrieved, the **Central Government is satisfied that the rights** conferred by this sub-section are being **abused to secure needless publicity for the defamatory matter**; and the Central Government may order the company's costs on such an application to be paid in whole or in part by the auditor, notwithstanding that he is not a party to the application.

Prescribed fees is 500/-

RIGHTS OF AUDITORS



FOLLOWING ARE THE RIGHTS AVAILABLE TO THE AUDITOR:-

1. ***Right to access to books of account {227(1)}***

An auditor of a company shall have a right of access **at all times** to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere.

- **With reference to the above here -**

a. Books include financial, statutory and cost records.

b. Voucher includes all documents, statements, correspondence and agreements with reference to financial statements.

c. All times refers to working hours and working days,

2. *Right to obtain information and explanations {227(1)}*

An auditor of the company is entitled to require from the officers of the company such information and explanation as he may think necessary for the performance of his duties as an auditor.

- **If unable to obtain information and explanation from officers and employees it will constitute a limitation on the scope of audit in terms of SA 200 (R) / 210 (R)**

3. *Right to visit branch offices and access to branch account [Sec. 228(2)]*

Where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor is entitled to visit the branches, if he deems it necessary to do so for the performance of his duties as an auditor.

- **In case of foreign branches of the banking company auditor's right is restricted to obtain copies and extracts of the books of foreign branch.**

4. *Right to receive notice and attend general meeting [Sec. 231]*

The auditor has the right of:

1. Receiving all the notices and other communications relating to any general meeting of a company which any member of the company is entitled to have (**sec. 172 and 231**)
2. He is entitled to attend any general meeting and (**sec. 231**)
3. He is entitled to be heard at any general meeting which he attends on any part of the business which concerns' him as an auditor. (**sec. 231**)

- **Intentional omission in forwarding the notice to the auditor could result in an invalid meeting.**

5. *Right to make representation [Sec. 225]*

The retiring auditor is:

1. Entitled to receive a copy of the special notice intending to remove him or proposing to appoint any other person as auditor.
2. Further, the retiring auditor sought to be removed has a right to make his representation in writing and request that the same be circulated amongst the members of the company.
3. In case, the same could not be circulated, the auditor may require that the representation shall be read out at the general meeting. The auditor also has the right to be heard at the general meeting.

6. *Remuneration of the Auditor [Section 224(8)]*

Auditor is entitled to receive remuneration as follows

(a) In case of an auditor appointed by the Board or the Central Government, may be fixed by the Board or the Central Government as the case may be; and

(b) Subject to clause (a) above, shall be fixed by the company in General meeting or in such manner as the company in general meeting may determine.

For this purpose, the expression "remuneration" should be deemed to include any sums paid by company in respect of the auditor's expenses.

Section 224(8)(aa) has been inserted whereby it is provided that, in the case of an auditor appointed under *section 619* by the Comptroller and Auditor General of India, the remuneration shall be fixed by the company in a general meeting or in such manner as the company in general meeting may determine. Earlier this power was vested in the Central Government.

1. Note→ Students may note that the Act does not require that the remuneration should be fixed at the same meeting of the company at which the appointment is made. It may, therefore, be fixed at a subsequent meeting. Where a retiring auditor has been re-appointed, his remuneration in the absence of any resolution fixing a different remuneration is considered to be the amount already fixed, in respect of the previous appointment.

3. *Note*→ The Council of the Institute of Chartered Accountants of India in the 'Statement on Payment to Auditor for the Other Services' has recommended that the fees paid to the Auditors for Other Services rendered Should be disclosed in the Profit and Loss account of the Companies under following heads in order to give precise and correct information to shareholders and others who read the accounts:

(i) Tax representation;
(ii) Company Law Matters;
(iii) Management Services;
(iv) Other Services.

In case of Joint Audit, if other services were rendered by one of the joint auditors or in case of a company having branch, the other services were rendered by the branch auditor, a disclosure should be made accordingly

4. *Note*→ Beside remuneration for audit work, as per Revised Sch. VI, the auditor may also be paid extra remuneration as for services rendered in any other capacity. It is necessary to disclose in the profit and loss account of the detailed information in regard to amounts paid to the auditor whether as fees, expenses or otherwise for services rendered.

1) As auditor;
2) For taxation matters;
3) For company law matters;
4) For management services;
5) For other services;
6) For reimbursement of expenses.

5. *Note*→ On completion of his work, an auditor is entitled to receive his remuneration. The right of he auditor cannot be limited by any resolution of he member passed in he general meeting. (Homer vs. Quitler)

7. ***Right of Lien***

a) The books must belong to the company.

b) The documents must have come into his Possession of auditor with the authority of the Board.

c) The auditor has done work assigned to him on such documents.

d) Such of the books can be retained which are connected with the work on which fees has not been paid

8. ***Right to sign audit report (Section 209)***

Only the person appointed as an auditor of the company, or where a firm is so appointed, only a partner in the firm practicing in "India", may sign the auditor's report, or sign or authenticate any other document of the company which is required by the law to be so signed or authenticated by the auditor.

9. ***Right to seek Legal and Technical advice***

The auditor of a company is entitled to take legal and technical advice, which may be required in the performance of conduct of audit or discharge of his duties. (London and General Bank Case)

10. ***Right to be indemnified***

For different purposes, an auditor is considered to be an officer of the company. As an officer, he has the right to be indemnified out of assets of the company against any liability incurred by him in defending himself against any civil or criminal proceedings by the company, if he is not held guilty by the law.

General Note→ *The rights of the auditor cannot be limited or abridged either by the AOA or by any resolution of the members (Newton v Birmingham small Arms Co. ltd.)*

Case Study – The above case can be explained with the help of following example:

PQ Private Ltd. Is having only two members P and Q. During the audit of accounts for the year ended 31st March, 2013 , you as an auditor find that:

1. P, who is in charge of purchases, has introduced fictitious purchase bills of ₹ 50 Lakhs.

2. Q, who is in charge of sales, has sold goods worth ₹ 2 Crores without bringing the same into the books of accounts.

You raise the matter with P and Q in their capacity as directors. They contest that as this is a position known to them and within their own fold, you should not report the same under the Companies Act, 1956.

Now the question is whether the above arguments are acceptable under the Companies Act, 1956 for Non – Reporting?

Mob. No. 7737345000

DUTIES OF AN AUDITOR

1. Duty as to Enquiry [Sec. 227(1A)] – To be discussed in Audit Report Topic.

2. Duty to make report to the shareholders [S. 227(2)] – To be discussed in Audit Report Topic.

3. Duty to give specific statement in report [S. 227(3)] – To be discussed in Audit Report Topic.

4. Reason of Qualification [S. 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. Duty to annex an annexure to the Audit Report (CARO) [S. 227(4A)] – To be discussed in Audit Report Topic.

6. Duty to attend the meeting of Audit Committee [Sec. 292A (5)]

In case of public company requires to form audit committee in terms of sec 292A, Auditor of such company shall attend and participate at meeting of audit committee. ***(To be discussed detailed in Corporate Governance Topic)***

7. Duty as to Statutory Report [Sec. 165(4)]

After the Statutory Report has been certified as correct by the reqd. number of directors, the auditor of the company must certify it as the extent it relates to:-

- Share allotted by the company;
- Cash recd. in respect of such shares;
- Receipts and payments of the Company.

8. Duty to assist the inspector appointed by the Central Government to investigate the affairs of the company [Section 240].

9. Duty to report on profit and loss account for the period from the lat closing sate to the date of declaration of insolvency by the directors and also on the balance sheet [Section 488].

10. Duty to report on report on prospectus on the accounting part [Section 56}.

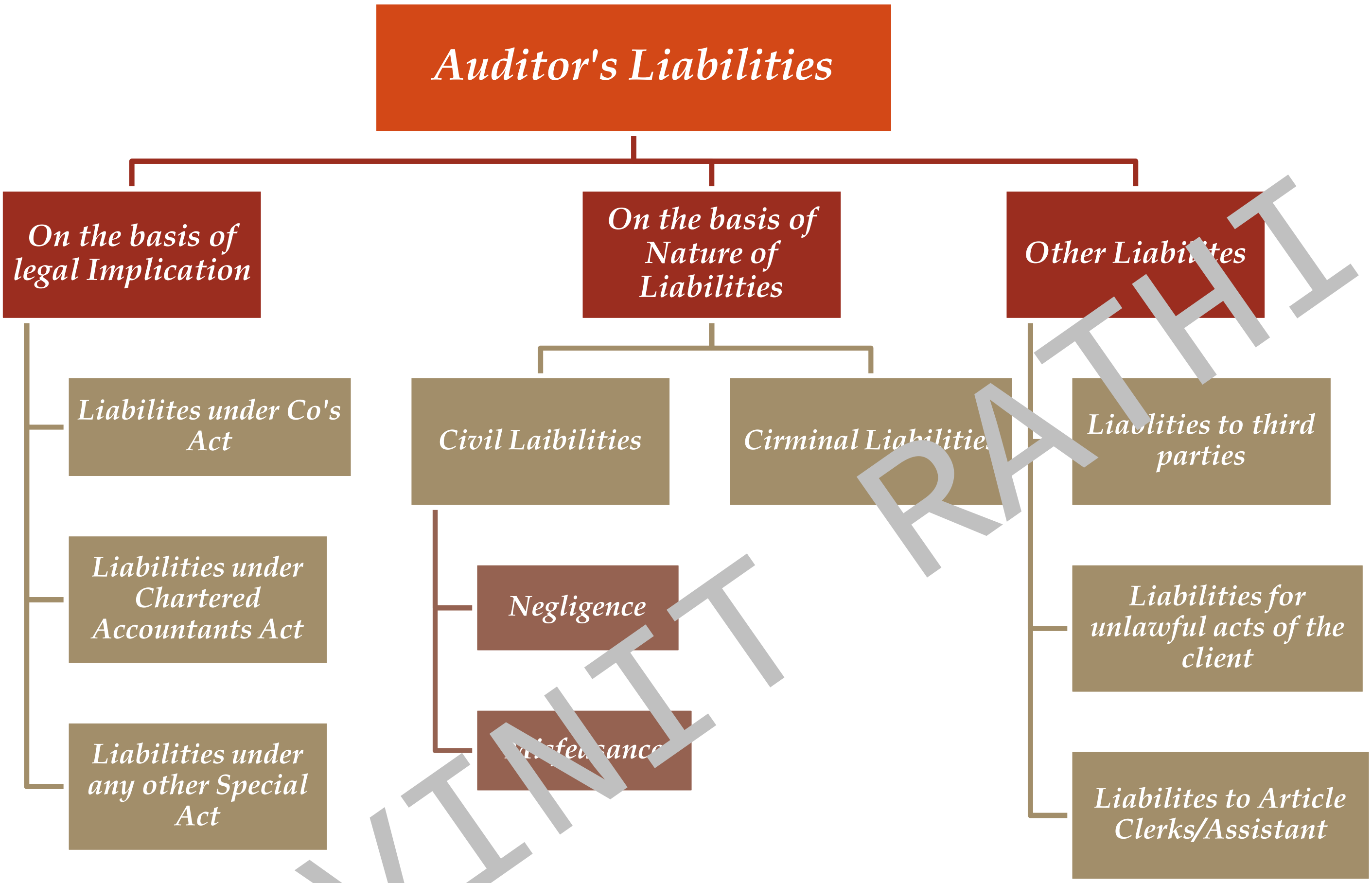
11. Duty to have Reasonable Care and Skill

An auditor of a company must be honest and must exercise reasonable care and skill to perform his audit work; otherwise he may be sued for damages. It was observed in he Kingston Cotton Mills Case (1896) that the auditor should perform his audit work with such care, skill and caution that a reasonably competent, careful and caution auditor will use.

12. Duty to the profession itself

It is duty of the auditor of the company auditor to follow the Code of Conduct and his professional Ethics.

LIABILITIES OF AUDITOR



1. Liabilities on the basis of legal implication

On the basis of legal implication, liabilities may be divided into three categories, namely:

I. Liabilities under the companies act under the companies act, the liabilities of an auditor may arise in the following cases:

i) ***Misappropriation and retention of the client's money:*** if an auditor has misapplied or retained or become liable or accountable for any money or property of the company, or has been guilty of any misfeasance or breach of trust in relation to the company, the court may compel him to repay or to restore the money or property of or any part thereof with interest at certain rate or to contribute such sum to the assets of the company by way of compensation (sec 534)

ii) ***Misstatements in the prospectus:*** he shall be liable with regard to mis-statements in the prospectus of the company u\s 62. The auditor is liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus issued by the company for any loss or damage he may have sustained.

iii) ***False statement in return, reports, etc.:*** he shall be liable if he makes a false statement with material particulars in returns, reports or other statements knowing it to be false or omits any material fact knowing it to be material (sec.628) *iv)* ***Intentional false evidence:*** he shall be liable if he gives false evidence intentionally upon any examination upon oaths or solemn affirmations, authorised under this Act or in any affidavit, deposition or solemn affirmations, in or about the winding up of any company under this Act (sec.629)

v) ***Liability for delinquency:*** the liquidators may prosecutes an auditor as an officer of the company during the course of winding up of the company for delinquency (sec.545)

vi) ***Willful default in report making:*** he will be held liable if he willfully makes a default in making his report to the shareholders according to the provisions of sec 227 and 229 (sec.233)

vii) ***Destruction, alteration of books, etc.:*** if he is found guilty of destruction, mutilation, alteration, falsification or secreting of any books, papers or securities or if he makes any false or fraudulent entry in any register, book of accounts or documents of the company, he may be held liable (sec.539)

viii) ***Authorizing false statements in the prospectus:*** if he authorizes the issue of the prospectus of a company containing a false and untrue, he will be held liable (sec. 63)

ix) ***Party to the issue of prospectus:*** he may be held liable if he is party to the issue of prospectus including statements purporting to be made by him as an expert, unless he is not interested in the formation or promotion or in the management of the company (sec. 57, 58 and 59)

x) ***Inducing fraudulently to invest money:*** he will be liable if he induces a person fraudulently to invest money by knowingly or recklessly making a statement or promise which is false or misleading, or if he dishonestly conceals the material fact (sec.68)

II. Liabilities under the Chartered Accountants act

Liability of Chartered Accountant, acting as an auditor, may be in the form of disciplinary proceeding under the chartered accountants act, 1949. If may arise on account of professional misconduct on the part of the auditor.

There are separate provision for professional misconduct in relation to (a) chartered accountants in practice (b) member of the institute in service and (c) members of the institute in general.

The Council, under Sec.21, refers the case of professional misconduct on the part of the members to the Disciplinary Committee. The latter holds the enquiry and reports its finding to the Council. In case the Council finds, on the basis on its report that the member is guilty of professional misconduct, it gives chance to the member to explain his conduct. On the basis of hearing the Council takes necessary actions. But if the misconduct on the part of the member is other than that specified in the first schedule of the Chartered Accountants Act, 1949 the Council has to refer the case to the High Court its recommendations thereon.

III. Liabilities under any special Act

In addition to the Companies Act and the Chartered Accountants Act, the auditor is also held liable under different special Acts, which are stated below:

i) ***Under Banking Companies Regulation Act, 1940:***

a) ***Under section 46 of the Banking Regulations Act, 1940***, if an auditor in any return, balance sheet or other document, willfully makes a statements, which is false in any material particular, knowing it to be false, or willfully omits to make a material statements, he will be held responsible.

b) ***Under Section 45G***, an auditor of a banking company may be publicly examined in the winding up proceedings. On such examination, the High Court may make an order, if he is not found fit to act as an auditor, that he will not act as auditor of any company for such period not exceeding five years as may be specified in the order.

ii) ***Under the Life Insurance Act, 1956:*** Under section 104 of LIC Act, 1956 an auditor may be sentenced to imprisonment or fine, or both, if he gives a false statement knowingly in any return, report or other such forms to be issued under the Act.

iii) ***Under the IPC:*** Under Section 197 of the IPC, if any person including auditor issues or signs a certificate required by law to be given or signed, or relating to any fact of which such certificate is by law admissible in evidence, knowingly or believing that such certificate is false in any material point, he shall be punishable in the same manner as if he gave false evidence.

iv) ***Under the Income Tax Act:*** Under section 278 of the Income Tax Act, 1961, if any person including an auditor abets or includes in any manner another person to make and deliver an account, statement or declaration relating to nay income chargeable to tax which is false and which he either knows to be false or does not believe to be true, he shall be punishable.

2. Liabilities on the Basis of Nature of Liability

On the basis of nature of liability, it can be divided into two groups:

I. Civil Liability

The civil liability of an auditor can be for (a) negligence or (b) misfeasance. In these cases he may be called upon to pay damages as decided by the court

i) ***Liability for negligence:*** an auditor is appointed to perform certain duties To the extent of his duties as an auditor, he acts as an agent of his client. In this capacity, he must exercise reasonable care and skill to perform his duties for which he is employed. If he acts negligently on accounts of which the client has to suffer loss, the auditor may be held liable and may be called upon to make good the damages. Which the client suffered due to his negligence.

It should be noted that if an auditor fails discover frauds; he might not be failing in his duty. In fact, fraud and other irregularities may not be disclosed by an annual audit and even a detailed audit may not discover certain types of fraud. Under such circumstances, whether the auditor will be held responsible depends on the fact that whether the auditor should have been able to discover that fraud if he applies reasonable care and skill. If he could, he will be held responsible, otherwise not.

ii) ***Liability for misfeasance:*** The term 'misfeasance' implies breach of trust or breach of duty. An auditor has to perform certain duties, which may arise out of a contract with the client as in the case of sole – proprietor or partnership or it may be statutory as laid down under various statutes. The duties of the company auditor have been statutorily laid down in the Companies Act, 1956. If the auditor does not perform his duties properly and as a result his client suffers, he may be held liable for misfeasance ***(Please refer section 543 of the Companies Act).***

II. Criminal Liabilities

The circumstances in which an auditor can be prosecuted under the Companies Act, and the penalties to which he may be subjected are briefly stated below:

(i) ***Under section 63:*** An auditor is criminally liable for making any misstatement (untrue statement in a prospectus) and can be sentenced to a term of imprisonment extending to two years or a fine of ₹ 50,000 or to both. But he can be so charged only if he has authorised the issuance of the prospectus. The charge may also fail if he is able to prove that the statement complained of is either immaterial or that he had reasonable ground to believe, and in fact he did believe up to the time of issue of the prospectus, that the statement was true.

(ii) ***Under section 628:*** An auditor is liable for criminal prosecution, if he in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material. If convicted, he can be punished with imprisonment for a term extending to two years and also with a fine.

This section, presumably, is applicable only to false statements which are not specifically punishable under any section of the Act. It penalises the making of a false statement in any document required by or for the purposes of complying with the provisions of the Act.

3. Other Liabilities

To be discussed later

Practical Problems

P 1. You have been appointed the sole statutory auditor of a company where you were one of the joint auditors in the immediately preceding year. The concerned joint auditor has not been reappointed. What are the various steps you would take to ascertain the compliance of the requirements of the Companies Act, 1956 before accepting the audit?

Ans:- ***Compliance with Requirements of Companies Act, 1956*****:** When one of the joint auditors of the previous year is appointed as the sole auditor for the next year, it is similar to new re- appointment of one of the retiring joint auditors. The provisions of section 228 of the Companies Act, 1986, relating to non-reappointment of the other person also need to be considered. The following points should be taken into account:

Aspect	***Auditor's Duties***
Special Notice	✓ Special notice u/s 225(1) was duly received by the company from a member at least 14 days before AGM containing a proposal for appointing a sole auditor expressly. ✓ Ascertain that the Notice contains an express intention of a member for proposing the resolution for appointing a Sole Auditor, in place of both Joint Auditors who retire at the Meeting but are eligible for re – appointment.
Circulation of Notice	✓ Verify notice sent to all the members at least 7 days before the AGM. [u/s 190(2)] ✓ Verify that special notice has been sent to retiring auditor forthwith. [u/s 225(2)]
Circulation of Representation	✓ Any representation received from the retiring auditor was sent to the members [u/s 225(3)].
Conduct of Resolution at AGM	✓ Verify from the minutes whether the representation received from the retiring joint auditor was considered at the AGM. ✓ Examine that proposed resolution was properly passed. ✓ Ensure that provisions of section ***224 (1B) and (2) are complied fully***. ✓ Ascertain ***special resolution*** u/s 224A, if any, is passed accordingly.
Company's Communication to Auditor	✓ Obtain a certified copy of the relevant minutes of AGM and a written communication of the appointment within 7 days.
Incoming Auditor Communication with Outgoing Auditor	✓ Communication with previous auditor, to ascertain if there are any professional reasons for not accepting the appointment. ***(COE – 2009)***

P 2. Mr. Rajesh is appointed as the auditor of NDIDA Travels Ltd. with audit fees of ₹ 35,000. He purchased air ticket from Delhi to Kolkata and back for ₹ 18,000 from the client for his personal work and the amount remains unpaid at the end of the year as it is a general practice of the client to give credit to all. Mr. Rajesh claims that he does not incur any disqualification as contained in Section 226(3) (d) of the Companies Act.

Ans: - ***Disqualification of auditors:*** The guidance note on "Independence of Auditors" issued by the ICAI in this context recommends that "a question of indebtedness may also be raised where an auditor of a company purchases goods or services from the company audited by him. In such a case, if the amount outstanding exceeds ₹ 1000, irrespective of the nature of the purchase or period of credit allowed to other customers, the provisions concerning disqualification of auditor as contained in sec 226 (3) (d) will be attracted." This is applicable in the case of purchase of air tickets for personal work by the auditor of a company on normal terms and conditions of the business of the company as the amount outstanding at the end of the year exceeded ₹ 1000. Therefore, the contention of Mr. Rajesh that he does not incur disqualification is not correct as he has purchased a ticket of the value of ₹ 18,000. The provisions concerning disqualifications of auditor as contained in Sec 226 (3) (d) will be attracted.

P 3. The BOD of a Company have filed a complaint with the ICAI against their Statutory Auditors for their failing to attend the AGM of the Shareholders in which audited accounts are considered. As an auditor, Comment?

Ans: - ***Right of Auditors:*** The Company Auditor has the right to receive notices and to attend AGM u/s 231 of the Companies Act, 1956. But it is not duty of the Company Auditor to do so.

Exception – Effect of Material Events: However, if the Auditor has finalizes his report and after having given an opinion, if he finds any material events which according to his judgements if he would have across such a material event before giving the opinion, he would have changed his opinion otherwise given in the report, should attend the AGM, to protect the interest of the Members.

Conclusion:

P 4. 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 ₹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 ₹ 1,000 the auditor shall vacate his office.

P 5. 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.

5. *Conclusion*

P 6. 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.*

A. 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.

B. 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.

C. Conclusion

P 7. 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. Advice.

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 8. Ram & Company was appointed as auditor of ABC Limited at the Annual General Meeting held on 30th September, 2012. 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, 2013, but adjourned without considering the business of appointment or re-appointment of auditor?

OR

At an AGM held on 25.09.2012 the Auditor was appointed to hold office upto the conclusion of next AGM. The next AGM was convened on 20.09.2013, 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, 2013, but is adjourned without considering the business of appointment or re-appointment of auditor, Ram & Company shall continue as auditor.

P 9. 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 the appointment of auditors will 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 differs, 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 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 11. The Subscribed Share Capital of AJR Company Ltd at the end of the financial year ending 31.03.2012 was ₹ 20 Crores, out of which two Public Financial Institutions were holding Share Capital amounting to ₹3 Crores. During the financial year 2012-13 the Company through public issue of shares raised its Subscribed Capital by additional ₹ 60 Crores. Out of ₹ 60 Crores, the two Public Financial Institutions were further allotted shares amounting to ₹ 20 Crores, raising the total contribution of these two institutions to ₹ 23 Crores before the date of the Company's closure of books for AGM scheduled for 15.09.2013, 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 10.09.2012. 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 15.09.2013?

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

Ans: - *__Note:__ __Refer to provisions of Sec. 224A given above.__*

1. For AGM held on 10/09/2012, the holding of Public Financial Institution was ₹ 3 Crores + ₹ 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 15/09/2013, the holding of Pubic Financial Institutions will be ₹ 23 Crores + ₹ 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 ₹ 10 Crores out of \80 Crores, the holding is only 12.5%. In such case, special resolution u/s 224A is not required.

3. *__Action by Company:__* *see page no. 11*.

AUDIT REPORT

Overview of matters to be included in company Auditors Report under section 227

1. Matters to be "Inquired" Into Under Section 227(1A) Of the Companies Act, 1956

Meaning of the word 'INQUIRE' in section 227(1A)

Section 227(1A) of the companies Act, 1956 requires the auditor to inquire into the matters specified in clauses (a) to (f) of the said section.

Following Points must understand before we start section 227 (1A):-

- The word used in section 227(1A) is 'INQUIRE'.
- This is different from sub- section (2), (3), (4A) of section 227 where the expressions "make a report", "state" or "contain a statement" are used.
- The word "Inquire" suggests that auditor need not to make a statement for the matters provided in section 227 (1A) if he is satisfied as a result of his inquiry.

- He (auditor) is reqd. to make a statement only if the findings as a result of his inquiry are adverse.

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

S. No.	*Key words of clause*	*Points to be consider*
1.	**Loans and Advances**	1. L & A has not been defined anywhere in the Companies Act, 1956. 2. Having regard to the requirement of clause (d) of section 227 (1A) a distinction is obviously intended to be made between "L & A" and "Deposits". 3. A "deposit" involves placing money or money's worth with a third party for safe-keeping or as security for the performance of depositor's obligations or for the purpose of earning interest. If purpose is to earn interest, deposit is placed with a party who customarily accepts deposits. 4. All items which is reqd. by Sch. VI of the Companies Act, 1956 to be disclosed in B/S under head " Loans and Advances" exception those items which are "deposits" should be regarded as " Loans and Advances" for the purpose of clause (a).
2.	**Security**	1. ***Meaning of Security*** → security include any movable or immovable property, whether belonging to the borrower or not, of which either physically possession or over which legally effective charge is given to lender.
3.	**Properly Secured**	1. The Auditor should make inquiries to ascertain that Prima Facie:- ☛ The Company holds a legally enforceable Security, and ☛ The value of the security fully covers the amount of the loan or advance and is reasonably ascertained. ☛ The Loan agreement or correspondence in regard to the terms of the loan or advance should be seen. ☛ Where the loan or advance is made to a company, any charge on the assets of such company should have been registered under Section of 125 of Co's Act, 1956 in order to constitute an effective security.
4.	**Terms**	1. Terms on which the loan or advance is made would primarily include the security, the interest charged and the terms of repayment. 2. It must be noted that it is very difficult to say that whether interest rate charged is reasonable or not for this many things we have considered, but when a loan is given only with a view to earn interest, the interest charged would be commercial rate.
5.	**Not Prejudicial to the interest of the Company or members**	1. Particular attention should be paid to loans or advances to concerns in which the directors of the company or their associates are interested. 2. The auditor is not to inquire as to how such transactions of the company affect the interests of individual members in their personal capacities. 3. The auditor should check for the purpose of the members that the prejudicial to the interest of the members will only proved when the members are in capacity of member and not in personal.

Some Queries related to Clause (a)

Query 1. Whether the Loans or Advances is "Properly Secured" would have to be considered at the end of each accounting year?

Response: - Clause (a) applies to all loans and advances made by the company during the Financial Year under audit whether they are outstanding at the Balance Sheet date or not.

Query 2. Whether a loan is "Prejudicial to the interest of the company or its members" would have to be considered only at the time when the loan is given, or renewed?

Response will be same as given in the Query 1.

Query 3. What will be the role or prudence to keep by the auditor where the Loans and Advances are given without security?

Response: - The auditor is not required to make any adverse comments in his report regarding this and as a matter of prudence, Auditor is not concerned with prudence or imprudence of making loans without security (London and General Bank Ltd. case).***The auditor is concerned only to those matters where loans and advances are made with security.***

Clause (b):- "Whether **transactions** of the company which are represented merely by **book entries** are not prejudicial to the interest of the company".

S. No.	Key words of clause	Points to be consider
1.	**Transactions**	1. Transactions of the company are ordinarily matters of fact. 2. The clause is therefore intended to cover transactions of the company for which the only evidence or the principal evidence, is the entry regarding the transactions in the books of accounts
2.	**Book Entries**	1. The purpose of book entries is to correctly record transactions which have, in fact, taken place. 2. If a book entry are passed which is not in accordance with the facts of the transaction, or is contrary thereto, this should be set right or reported upon by the auditor.

Clause (c):- "Where the company is not an **investment company** within the meaning of section 372 or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been **sold at a price less** than that at which they were purchased by the company

S. No.	Key words of clause	Points to be consider
1.	**Investment company**	1. Investment Company meaning:- is a Company whose principal business is the acquisition of shares, stocks, debentures or other securities (proviso to section 372) 2. It must be noted that clause (c) applies to a company whose principal business is not dealing in shares, stock, debentures or other securities.
2.	**Sold at price less than purchase (cost)**	1. If, as a result of his inquiries, the auditor is satisfied that the sale is bona fide and the price realised is reasonable, having regard to the circumstance of the cases, he has no further duty to report on the matter.

Some Queries related to Clause (c)

Query 1. How price of securities can be ascertained where the investment is consist of securities of the same class, purchased at various times and various price?

Response: - In such a case the price should be determined in accordance with accepted accounting practice consistently followed by the company.

Query 2. How the price of securities is ascertained where the cost of shares or debentures or other securities sold is not ascertainable?

Response*: -* The Book Value thereof at the date of sale may be treated as the cost for the purpose of this clause.

Query 3. What will be the treatment of Bonus Shares?

Response: - The Average Cost is to be used.

Clause (d):- "Whether Loans and Advances made by the company have been shown as deposits".
Read with Clause (a)

Clause (e):- "Whether **personal expenses** have been charged to revenue account".

S. No.	*Key words of clause*	*Points to be consider*
1.	**Personal Expenses**	1. Where the company is having some contractual, or in accordance with accepted business/commerce/trade practice, (for eg. medical, leave travel, rent free quarters, conveyance for personal use, maternity benefits, canteen facilities, etc) is perfectly normal and legitimate and does not call for any special comment by the auditor. 2. Where personal expenses not covered by point no. 1 is reqd. attention (i.e. reporting), but reporting must be subject to materiality.

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

S. No.	*Key words of clause*	*Points to be consider*
1.	**Books and Paper**	1. Papers would presumably refer to the Return of Allotment filed by the Company under section 75 of Company Act, 1956.
2.	**Allotment for cash**	***1.*** Where the consideration for the issue of shares is an adjustment against a bona fide debt payable in money on demand by the company, the shares are deemed to have been subscribed in cash. ***(Decision Spargo's Case, 1873, 8 Ch. A, 407).*** 2. A company may have taken on condition that in the event of default in repayment, loan would get converted into shares. Such conversion of loan into shares could be considered as allotted for cash [ICAI's Guidance Note on Audit of Capital and Reserves].

Now to Memories all of above clause of section 227(1A)

Clause	**Memory trick**	**Key words**
a	*S*	*Secured*
b	*B*	*Book entry*
c	*I*	*Investment Company*
d	*D*	*Deposits*

e	P	Personal Expenses
f	S	Share Allotted for Cash

2. Reporting under section 227 (2)

The ***auditor shall make a report to*** the members of the company on the accounts examined by him, and on ***every*** balance sheet and profit and loss account and on ***every*** other document declared by this Act to be part of or annexed to he balance sheet or profit and loss account, ***which are laid before the company in general meeting during his tenure of office***, and the report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said accounts give the information required by this Act in the manner so required and give a ***true and fair view –***

(i) In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

(ii) In the case of the profit and loss account, of the profit or loss for its financial year.

Some Queries related to section 227(2)

Query 1. What is meaning and significance of the Phrase ***"True and Fair"?***

Response: - Term True and Fair has not defined in any legislation, but there is Reporting Requirement section 227 (2) and Legal Requirement section 211(5).

- ***Reporting Requirement:*** The Statutory Auditor of a company has to express an opinion in his report on the true and fair view shown by the Balance Sheet and Profit and Loss Account.
- ***Legal Requirement:*** Section 211(5) provides that the accounts of a Company, shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be discussed–

(a) By virtue of Provision of Revised Schedule VI of the Act, or

(b) By virtue of a notification or an order of the central govt. modifying the disclosure requirement.

Query 2. When it can be said that ***"True and Fair"*** holds good?

Response: - Financial statements are reported to be as true and fair when all of the following hold good –

1. Reasonable evidence is obtained in support of the transactions recorded in the books of accounts;
2. Accounting entries passed in the books of account are in conformity with the applicable accounting principles and standards followed consistently;
3. The financial statements prepared represent a true summary of transactions that took place during the year;
4. The process of classification and aggregation followed in preparation of the financial statements is fair and does not hide a material fact nor does it highlight something which may distort the real state of affairs. The form of accounting statement is in the required form, if any;
5. The accounting statements do not contain any misstatement;
6. The material transactions recorded in the books are neither illegal nor beyond the legal powers of the client; and
7. All statutory and relevant disclosures have been made.

Query 3. Is there any General Requirement on ***"True and Fair"?***

Response: - To ensure a true and fair view, an Auditor has to see the following—

S. No.	**Particular**	**Details**
1.	Assets	1. The assets are neither undervalued nor overvalued, as per the applicable accounting principles, 2. No material assets is Omitted, 3. Charge, if any, on assets is Disclosed.
2.	Liabilities	1. Liabilities are not understated or overstated, and the same are properly classified, 2. Material Liabilities should not be omitted.
3.	Accounting Aspects	1. Appropriate accounting principles and acceptable accounting policy have been followed consistently, and 2. All unusual, exceptional, none—recurring items, and material deviations have been disclosed separately.
4.	Legal Requirement	1. The P&L a/c and the Balance Sheet disclose all the matters required to be disclosed by Revised Schedule VI of the Companies Act, 1956 or any other applicable Act.

3. Reporting Under Section 227(3)

S. No.	*Cl. No.*	*Clause*	*Memory Trick*
1.	***(a)***	Whether he has obtained all the ***information and explanations*** which to the best of his knowledge and belief were necessary for the purposes of his audit.	**I**
2.	***(b)***	☛ Whether ***proper books of account*** as required by law have been maintained so far as appears from an examination of those books; and ☛ Whether ***proper returns adequate*** for the purposes of audit have been recd. from branches not visited by him.	**B**
3.	***(bb)***	☛ Whether ***audit reports of all branches*** whose audit has been done by some other auditor have been forwarded to him; and ☛ Whether he has dealt with them in his report as he considers necessary. **Note**: **-** Statutory auditor is to refer to branch audit only when branch accounts are audited by a person other than himself- source: Letter No. 8/46(1)/61- PR, dated 9/5/1961.	**B**
4.	***(c)***	Whether the Balance Sheet and Profit and Loss account are in ***agreement with the books*** of account and branch returns.	**B**
5.	***(d)***	Whether the Balance Sheet and Profit and Loss account ***comply with the accounting Standards*** referred to in section 221(3C).	**A**
6.	***(e)***	In ***thick type or italics***, the auditor's observations or comments which adversely affect the functioning of the company. ***(To be Discussed later in detail)***	**B**
7.	***(f)***	Whether any of the directors of the company have been ***disqualified under section 274 (1) (g)*** of the Companies Act, 1956. ***(To be Discussed later in detail)***	**D**
8.	***(g)***	Whether the ***cess payable under section 441A has been paid*** and if not the details of amount of cess not paid.	**C**

Note → *The companies (Second Amendment) Act, 2002 provides for section 441A which states as follows:*

(i) Access on companies will be levied for purpose of rehabilitation or revival of sick industrial Co.

(ii) These provisions are made in sections 441A to 441F.

(iii) The amount to be collected must be in a range of .005% to .1% on value of annual turnover annual gross receipts more as the Central Government may notify from time to time in official gazette.

(iv) The company shall pay the amount to Central Government within 3 months from close of every financial year.

Note:- Of the above, (a) Statements of Facts are – Items 1, 3, 4, 7 & 8, (b) Opinions are – Items 5 , 2 & 227(2).

4. Reporting Under Section 227 (4A) [CARO 2003]

4.1 Some Points Must be Understood before we begin with CARO, 2003.

S. No.	Points
1.	The Intention of CARO, 2003 is not to restrict the duties/ responsibility of Auditors. All that it does is to require a specific statement on certain matters. ☛ For example, auditor duties regarding Related party transaction as laid down in SA 550 (Revised) issued by ICAI. Auditor's Duties are not limited to considering transaction covered by section 301 [Para 4(v)]. ☛ The requirements of CARO, 2003 to make a statement on internal controls in specific areas does not mean that auditor does not have to evaluate other internal controls.
2.	The requirements of the Order are supplemental to the existing provision of section 227 of the Act regarding the auditor's report.
3.	The requirements of the Order are also supplemental to the direction given by the CAAG while conducting audit of Govt. Company u/s 619.
4.	Order Contains total ***Five Paras.***

Introduction

Pursuant to section 227(4A), the Central Govt. issued the Companies (Auditor's Report) Order, 2003 called CARO, 2003 vide notification No. G.S.R. 480(E) dated June 12, 2003. The Central Govt. vide Notification No. GSR. 766(E) dated November 25, 2004 amended the said Order and issued the Companies (Auditor's Report) (Amendment) Order, 2004.

It must be noted that after issue of CARO, 2003 earlier Order issued in 1988, viz., the Manufacturing and Other Co's (Auditor's Report) Order, 1988 (i.e. MAOCARO, 1988).

4.2 Applicability of CARO-2003

☛ ***The Order Applies to all Companies except certain categories of companies specifically exempted from the application of the Order [as per PARA 1(2)].***

Now let's understand the applicability & non- applicability of the Order by below table:-

S. N.	Particulars	Remarks/ Points to remember
1.	**Foreign Companies u/s 591 of Companies Act, 1956**	1. Order is applicable to Foreign Companies also. 2. According to section 591 of Companies Act, 1956Foreign Companies are companies incorporated outside India which have a place of business in India. It doesn't matter whether the place of business in India was established in India before on or after the commencement of the Companies Act, 1956. 3. As per ICAI Liaison Office of a foreign body corporate is a foreign company under section 591 of the Act. Hence, the Order would apply to it.
2.	**Branch of a Company**	1. As per section 228(3) (a) of the Companies Act, 1956 specified that auditor of branch has the same duties in respect of audit as the company's auditor. 2. By keeping the view of above point, ICAI's Statement on the Companies (Auditor's Report) Order, 2003 clarifies that CARO, 2003 is also applicable to the audit of branch of a company, except where the company is exempt from the applicability of the order.
3.	**Private unlimited**	1. Exemption from CARO, 2003 is not at all available.

	company	
4.	**Banking, Insurance and Section 25 Companies**	1. Exemption without any condition (i.e. Unconditional exemption). 2. There is no need to mention anything about the exemption in the audit report. 3. Companies specified in point number 4 are exempt irrespective of whether they are public companies or private companies.
5.	**Private Companies**	1. Conditional exemption from CARO, 2003. (Condition's for exemptions is discussed below)

Some Queries related applicability or non applicability.

Query 1. What will happen if an NBFC (Non- Banking Financial Company) which converts itself into a banking Company?

Response: - CARO, 2003 will not be applicable to such NBFC if as at the balance sheet date it is a banking company.

Query 2. What if a Private Co. converted into Public Co. or Public Co. into Private Co.?

Response: - ***To be Discussed in class.***

Conditional exemption from CARO, 2003 to Private Co's

Condition to be satisfied	***A Private Limited Company which satisfies all the following three conditions is exempt from CARO, 2003:-*** (a) ***Paid up capital + reserves*** of the company does not exceed ₹ 50 Lakhs ***at any point of time during the financial year.*** (b) Company does not have loan ***outstanding*** exceeding ₹ 25 Lakhs from any bank or financial institution ***at any point of time during the financial year.*** (c) Companies ***turnover*** does not exceed ₹ 5 Crores ***at any point of time during the financial year.***

Explanation of words terms used in above conditions

Aggregate paid – up capital and reserves	*Computation of aggregate paid – up capital and reserves*			
	Calculation of paid – up capital figure		*Computation of Reserves Figures*	
	As per statement on CARO, 2003 issued by ICAI, the paid – up capital should be calculated as under:		According to ICAI, reserves should be calculated as follows:	
	Called up equity share capital	XXX	All reserves like GR, Dividend Equalization reserves, Debenture redemption reserves, Securities Premium, Capital Reserves, CRR, Revaluation reserve (i.e., all reserves, whether free reserves or not and whether capital reserve or revenue.	XXX
	Add: Called up preference share capital	XXX		
	Less: Calls in Arrears	(XX)		
	Add: Shares Forfeited Account	XX	***Add:*** Credit Balance of P&L A/c, if any	XX
	Paid – up capital for the purposes of PARA 1 (2) (iv) of CARO, 2003.	***XXXX***	***Less:*** Debit Balance of P&L A/c, if any	(XX)
			Reserves for the purposes of PARA 1(2) (iv) CARO, 2003.	***XXX***
Some Points to be remembered while computing paid – up capital or reserves.				

- ✓ *Miscellaneous expenditures to the extent not written off or adjusted are not to be deducted from the total of paid – up capital and reserves.*
- ✓ *Debit balance of P&L A/c is to be deducted only from the figures of revenue reserves.*
- ✓ *If company does not have revenue reserves, the debit balance in the profit and loss account cannot be reduced from the total of paid – up capital and revaluation or capital reserves.*
- ✓ *If private company is converted into public or public into Private then what will happen to be discussed in class.*

Computation of loans outstanding	**<u>*Computation of loans outstanding to determine whether limit of ₹25 lakhs is exceeded*</u>** **(i) Actual Amounts outstanding (and not sanctioned limits) should be considered.** **(ii) Loan Outstanding is outstanding balance of all fund – based facilities (Term Loans, Demand Loans, export Credit, Cash Credit, Overdraft, Bills Purchased or discounted, Corporate credit card dues).** **(iii) Non- fund based facilities will be considered as loan outstanding only to the extent such facilities have devolved (e.g. guarantee has been invoked due to company's default) and have been converted into fund – based facilities.** **(iv) Interest Accrued but not due on term loan is not treated as loan outstanding.** **(v) The Limit ₹ 25 lakhs applies in aggregate to all loans from all banks and financial institutions and not bank wise or financial institution wise.** **(vi) Loan from private banks and foreign banks should also be considered for computing the aforesaid limit of ₹ 25 lakhs.**

Some Issues regarding Loan Outstanding
TO be discussed in Class

Turnover	<u>*Computation of Turnover to see if a limit of ₹ 5 Crores is Exceeded.*</u> ✓ **Turnover is the aggregate amount (i.e. gross consideration) for which the sales are affected by the company/ services are rendered by the company.** ✓ **For an agent, turnover is the amount of commission earned.** ✓ **Turnover should be calculated in accordance with the method of accounting regularly adopted by the company. That is to say, whether to include certain items such as sales tax / excise duty collected would depend upon the method of accounting regularly employed by the company.**

<u>*Some Issues regarding Turnover*</u>
<u>*TO be discussed in Class*</u>

Now we start discussion on CARO, 2003 PARA 4 and its Clauses

(Most important from exams purpose)

Para 4 (i) of CARO, 2003 Fixed Assets

Requirement of Para 4(i)	✓ ***Proper Records*** – Whether or not the company has maintained proper records showing full particulars including quantitative details and situation of fixed assets. [Para 4(i) (a)] ✓ ***Physical verification*** – Whether these fixed assets have been physically verified by the management at ***reasonable intervals;*** Whether any material discrepancies have been observed on such verification and if so, whether the same has been properly dealt with in the books of account. [Para (i) (b)] ✓ ***Sale of substantial part of fixed assets*** – If substantial part of fixed assets has been disposed of during the year whether it has affected the going concern. [Para (i) (c)]

Explanation of Words used in Clause no (i)	
Proper Records	CARO, 2003 does not define the term 'proper record'. What constitutes "proper records" is a matter of auditor's professional judgement in the facts of the case. Here I call it as ***"Call Of Judgement"***
Full Particular	***The records should contain full particulars about the F A including:-*** ✓ **Description (colour, model, etc.) for easy identification (Tagging)** ✓ **Classification (i.e. relevant account head)** ✓ **Situation (i.e. Location)** ✓ **Original Cost (determined as per AS – 10, 12, 16, 19, 26)** ✓ **Year of purchase** ✓ **Details of depreciation of tangible assets (i.e. rate/ method of depreciation)** ✓ **Amortization of intangible assets (method of amortization, useful life)** ✓ **Quantity (No. of Units)** ✓ **Details of revaluation and** ✓ **Details of impairment provision and reversal thereof** ***Note: -*** **The records should contain full particulars as above, regarding all items of fixed assets, i.e. finance lease, fully depreciated / fully amortized / fully impaired assets, assets retired from active use and held for disposal. Thus, it should include all existing assets even if their balance in accounts books has become NIL.**

Quantitative details	***How quantitative details are to be incorporated in the fixed assets record-*** **This will depend on the nature of the assets. For instance, land should be shown and depicted by survey number / details of conveyance deed with area of the plot (i.e. Survey report), Vehicles by registration books or numbers (i.e. RC book). In case of furniture, reference numbers is painted on them and entry be made according to this number (i.e. tagging).**
Situation of fixed assets	**The logic behind the entering location is to facilitate physical verification. If assets are located at the residence of some official, his name and designation should be entered in the records. In that case, the auditor should ascertain whether there is a valid reason for doing so (e.g., car/furniture given as perquisite as per terms and condition of employment) [i.e. check Employment handbook (EHB)].**
Electronic fixed assets register	***Electronic Form of FAR – Whether proper records or not?*** The auditor may accept electronic FAR as " Proper Record" if the following conditions are satisfied: 1. ***Unalterable:*** The controls and security measures in the company are such that once the FAR is finalised, it cannot be altered; and 2. ***Can Be Retrieved In A Legible Form:*** The FAR is in such a form that it can be retrieved in a legible form i.e. it can be read on the screen or a hard copy can be taken. ***Note:*** *(a) If both the above conditions are not satisfied, a print – out with due authentication would be necessary (then it can also form part of Documentation SA 230).* *(b) If the auditor decides to rely on electronically maintained FAR – Auditor should:* ✓ **Evaluate control that seek to ensure the completeness, accuracy and unalterability of the register;** ✓ **Maintain adequate documentation evidencing such evaluation.**
Physical Verification	*According to the Order, physical verification is the responsibility of the Management and not that of the auditor. That does not mean that auditor has not got any duties with reference to physical verification.* ***Auditor's duties as regard the physical verification*** ✓ **Attend the physical verification conducted by management if feasible (for E.g., all Fixed assets can be verified on the same day or without or relatively short period time). But his attendance does not diminish management's responsibility. Nor is he reqd. to supervise the physical verification.** ✓ **Ascertain that the verifiers (whether staff or outside experts) are competent persons.** ✓ **Obtain a copy of the written instructions given to the verifiers. Assess whether if they are implemented accurate results will be obtained.** ✓ **Whether the method of verification adopted is reasonable in the circumstances of the case.** ✓ **In some cases, physical verification would be an exorbitant (very expensive / excessive) exercise involving huge loss of production (e.g. In process industries where assets are in continuous use or concealed in larger units). Auditor can rely on indirect evidence in such cases to ascertain the existence of fixed assets (i.e. if an oil refinery is producing at normal levels of efficiency, he may take that all units of that refinery are**

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<tr><td></td><td>in existence). This is because auditor requires only <u>persuasive evidence</u> and not conclusive evidence regarding the existence of fixed assets. However, if there are compelling circumstances, he may insist on physical verification being carried out by management.</td></tr>
<tr><td>Reasonable Intervals</td><td><u>This term has not been defined in the order. It depends on the circumstances of the case. But generally, the following (as per table below) may be treated as reasonable intervals.</u>
<table>
<tr><th>Sr. No.</th><th>Situation</th><th>What can be considered by the auditor as Reasonable Intervals</th></tr>
<tr><td>1.</td><td>Where assets are few and can be easily verified</td><td>Annual verification (i.e. Once in a year) of all fixed assets.</td></tr>
<tr><td>2.</td><td>Assets are numerous and difficult to verify</td><td>A verification, say once every three years by rotation so that all assets are verified at least once in three years.</td></tr>
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<tr><td>Material Discrepancy</td><td>If proper records are not maintained or if assets are not physically verified by management, it is not possible for the auditor to state whether there is any material discrepancy. In that case, the auditor should state that he has been unable to ascertain whether there is any material discrepancy along with reasons (i.e. absence of records/ physical verification not due) but one should also keep in mind Sch. II Part I Clause No. 5,6,7,8,9 of COE – 2009).</td></tr>
<tr><td>Substantial Part of Fixed Assets</td><td>1. <u>The expression "substantial part of FA's":-</u>
Not defined either in CARO, 2003 or in the ICAI's Statement on CARO, 2003. It is matter of auditor's judgment in the facts and circumstances of the case.
2. <u>Can we say that "if there is no substantial sale of fixed assets, there no need to consider the going concern question"? : -</u>
Certainly not. According to ICAI's statement on CARO, 2003 does not absolve the auditor of his responsibility under SA 570(Revised). As there will be several other indication of risk that going concern assumption is appropriate, the auditor, notwithstanding his comments under PARA 4(i)(c) of CARO, 2003, should also comply with SA 570(Revised).
<u>Note:- SOME MORE ISSUES TO BE DISCUSSED IN THE CLASS</u></td></tr>
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Para 4 (ii) of CARO, 2003 – Inventories

Requirement of PARA 4(ii)	***Physical verification –*** Whether physical verification of inventory has been conducted at reasonable intervals by the management. [Para 4(ii)(a)] ***Adequacy of physical verification procedures –*** Whether the procedures for physical verification of inventory are adequate in relation to the size of the company and the nature of its business. [Para 4(ii)(b)] ***Proper records –*** Whether the company is maintain proper records of inventory. [Para 4(ii)(c)] ***Rectification of material discrepancies –*** Whether the material discrepancies, if any, noticed on physical verification have been properly dealt with in the books of account. [Para 4(ii)(d)]

"Explanation of words used in Clause no. (ii)"	
Reasonable Intervals	***As per ICAI's Statement for judging "reasonable intervals" following points must be considered:-*** ✓ What constitutes "Reasonable Intervals" is a matter of judgment in the circumstances of the case. ✓ Normally, verification of all inventories at least once a year and if reqd., more often, should be treated as reasonable intervals. ✓ If company adopts ABC classification of inventories based on their value and verifies 'A' (highest value) items more often, 'B' items (moderate value) less often and 'C' (low value) items still less often, the auditor may accept this periodicity of verification as reasonable. ✓ Management should decide the intervals of verification after considering various factors such as: ➢ Nature of Inventory items (physical/chemical state) ➢ Their location – whether at one place or spread over several locations. ➢ The feasibility of physical verification If there is evidence that the management has considered these factors and fixed the intervals, auditor may treat these intervals as reasonable.
Adequacy of physical verification procedures	***The primary sources of evidence for reporting on the adequacy and reasonableness of procedures for physical verification of inventories under Para 4(ii)(b) of CARO, 2003 are:*** 1. Observation of physical verification of inventories; and 2. Examination of records of verification of inventory.
Proper Records of Inventories	1. The records should cover all the items of inventories 2. For each item, the record should contain: ✓ Name, item code, etc., ✓ Quantity of receipts, issues and balances, dates in chronological order. Cross – reference to documents evidencing receipts and issues be given. ✓ Location / Situation of items. ✓ In priced stores ledger, if maintained, the prices at which receipts and issues are recorded to be given. 3. Every entry in the stock records regarding receipts and issues should be duly supported by documents. 4. Records should be updated as and when transactions (receipts and issues) take place. 5. Records may be maintained either in manual form or in computerized form. 6. Records of movement / custody of inventory items should be kept. 7. Proper records for inventory in Para 4(ii)(c) implies proper records for WIP are reqd. to be maintained by the Company.

Material Discrepancy	***Refers to material difference between stock as per physical count and stock as per records.*** ***Now question arises that what if company does not maintain stock records?*** ***According to ICAI's Statement on CARO, 2003 –*** 1. In this case, the only way to determine book stock is by annual quantitative reconciliation of opening stock, purchase and consumption [i.e., opening stock (in units) + Purchases (in units) – Consumption (in Units) = Closing Stock (in Units)]. 2. The above reconciliation is possible only if the consumption in units can be correlated to the production or can be established reasonably, accurately. 3. If quantitative reconciliation is not possible, ascertain whether the item in question is material. If it is not material, discrepancy also may not be material. 4. If the item in question is material and quantitative reconciliation is also not possible, book stock cannot be determined and auditor should state the fact that it cannot be determined in his report.

Para 4 (iii) of CARO, 2003 – Loan to or from Director and Interested Parties

Requirements of Para 4(iii)	✓ ***Names & Amounts involved*** – Has the company granted or taken any loans, secured or unsecured to / from companies, firm or other parties concerned in the register maintained under section 301 of the Act? If so, give the number of parties and the amounts involved in the transactions. [Para 4 (iii) (a)] ✓ ***Terms and Conditions of loans*** – Whether the rate of interest and other terms and conditions of loans taken or given by the company, secured or unsecured from companies, firms / other parties covered in section 301 Register are ***prima facie*** prejudicial to the interests of the company. [Para (iii)(b)] ✓ ***Regularity of repayment*** – Whether receipt / the payment of the principal amount and the interest are also regular. [Para (iii)(c)] ✓ ***Steps for recovery of overdues*** – If overdues amount is more than Rs. 100000, whether reasonable steps have been taken by the company for recovery of the principal and interest. [Para (iii) (d)]

"Explanation of words used in Clause no. (iii)"	
Applicability of sub - clauses (b), (c) and (d)	**ICAI's Statement on CARO, 2003 states that sub – clauses (b) and (c) and only to loans to / from parties covered in the register maintained u/s 301 and sub – clause (d) applies only to loans to parties covered in the register maintained u/s 301.**
Para 4 (iii) (a)	***Number of parties & not number of loans*** – Clause 4 (iii) (a) requires the auditor to mention the number of parties and amounts involved and not the number of loans granted or taken to / from section 301 parties. ***Reporting "amounts involved"*** – Would mean reporting the maximum amount outstanding during the year as well as the year end balance. [as per ICAI]
Para 4 (iii) (b)	***Prejudiciality of the rate of interest and other terms and conditions – The following principles are important in this regard :*** ✓ "Other terms and conditions" include matter like security (given or obtained) repayment schedule, and restrictive terms and conditions if any.

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- ✓ Auditor not reqd. to state whether the rate of interest and other terms and conditions are in the "best interest of the company" or "most beneficial to the company".
- ✓ Auditor to state whether the rate of interest and other terms and conditions are prime facie prejudicial to the interests of the company.
- ✓ Thus, the requirement is not to judge whether the company has got the best possible deal but to judge whether it is such a bad deal (Prime facie) that no reasonable person would have gone for it.
- ✓ Merely the fact that better deals could have been obtained does not warrant the conclusion that the terms are prejudicial.
- ✓ Only if the difference between the terms obtained and terms obtainable is so wide that no reasonable person would have opted for these terms, should the auditor conclude that these are prejudicial.
- ✓ Before drafting his adverse remarks, he should obtain the information and explanation of the management as to why they think that these terms are not prejudicial to the interests of the company. Only after obtaining and evaluating management's explanations, auditor should draft his comments on the clause. If he is not stratified with management's explanation, he should state that terms and conditions are prejudicial.
- ✓ Auditor is not to pronounce on prejudicially using the hindsight. The terms obtainable which the auditor considers – these alternatives should have been present at the time the decision was taken and should have been reasonably in the contemplation of the management.
- ✓ The ICAI's Statement on section 227(1A) makes the following points which are relevant in evaluation of the Prejudiciality of the terms and conditions of the loans granted:-

1. Charging interest at a lower rate than market rate or even not charging any interest may be justified in the case of loans given for business considerations (e.g. loans to staff, loans to raw material suppliers).
2. However, if the loans are given solely to earn interest, they should have been made at the market rate of interest. If made at below market rate or interest free, the same should be regarded as prejudicial to the interests of the company.
3. If the loan has been approved by the C.G. u/s 295 or 372A, this is ***prima facie*** evidence that the loan given is not prejudicial to the interests of the company.
4. If loan has been granted by a public company to directors without the previous approval of C.G., it is ***prima facie*** prejudicial to the interest of the company.

If concessional rate of interest is charged on loan to an employee who is a relative of a director – The concessional rate of interest cannot be said to be prejudicial to the interest of the company if other employees of the company are also entitled to loans at such concessional rate of interest.

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Para 4 (iii) (c)

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<u>'Regular' –</u>

- ✓ According to ICAI's statement on CARO, 2003 the word 'regular' means that principal and interest should be received (on loans given) or paid (on loans taken) as and when they fall due as (per the terms of loan agreement).
- ✓ If due date for interest payment is not specified, it may be treated as falling due on each anniversary of loan.
- ✓ If there is no stipulation as regards repayment to loans, it will not be possible for the auditor to comment on the regularity of repayment. In that case, the auditor should state that he is unable to make comments regarding regularity because terms of repayment have not been stipulated.

<u>When does payment become due in case of loans repayable on demand?</u> The repayment of loan repayment at demand becomes dues as and when the lender demands the loans.

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Para 4 (iii) (d)	***What constitutes 'reasonable steps are a matter of auditors' judgment in the facts and circumstances of the case?*** ✓ In the context of amounts lent, reasonable steps for recovery do not necessarily mean legal steps. ✓ What is 'reasonable steps' depends upon the degree of delay in recovery, the amount involved and other similar factors. ✓ In certain less serious cases, even solicitor's notice or sending a reminder may be reasonable steps. ✓ The auditor should arrive at his opinion regarding 'reasonable steps' only after consideration of management's written representations in this regard. ✓ If the auditee is NBFC, the auditor should refer to the policy for demand loans / call loans framed under clause 6A of the NBFC's prudential Norms (RBI) Directions, 1998 while reporting under Para 4 (iii) (d).

Para 4 (iv) of CARO, 2003 Internal Control

Requirement of Para 4 (iv)	***Adequacy –*** Is there an internal control procedure commensurate with the size of the company and the nature of its business for the following transaction :- ✓ Purchase of inventory and fixed assets ✓ Sale of goods and services ***Continuing failure –*** Whether there is a continuing failure to correct major weakness in internal control.

"Explanation of words used in Clause no. (iv)"	
Two distinct requirements	The requirements under Para (iv) of CARO, 2003 relating to adequacy of internal control and continuing failure to correct major weaknesses are two distinct requirements and are not inter – related. If no major weakness in controls was noticed, the auditor cannot conclude that the internal control system is adequate.
Controls in other areas	***Auditor's responsibility to evaluate controls in other areas –*** This requirement should not be interpreted to mean that the auditor is not required to evaluate internal controls in areas other than purchase of inventory and fixed assets and sale of goods and services or that his responsibility to evaluate internal controls in other areas in any way is reduced. It only means that the auditor will have to give special emphasis on internal control procedures related to purchase of inventory and fixed assets and sale of goods and comment on it under CARO, 2003.
Continuing Failure	***What is order requires the auditor to do is:*** 1. Ascertain whether there are any weaknesses in the internal controls relating to purchase of inventory and fixed assets and sales of goods and service. 2. If so, whether any of these are "major weaknesses". 3. If so, whether there is a continuing failure to correct them as at the balance sheet date.
"Major Weaknesses"	✓ What constitutes "major weaknesses" is a matter of facts and circumstances of the case requiring the auditor's professional judgement. ✓ Ordinarily, any weakness in the internal control which exposes the company to risk of significant loss or to a risk of material misstatement (SA 315) (i.e. material fraud or error) in financial statements is a major weakness. ✓ Some weaknesses may not seem to be 'major' individually. But when they are evaluated alongwith others, they might become 'major'.
"Continuing	The auditor may have noted major weaknesses in internal controls while reviewing the

failure to correct"	internal audit reports or while reviewing the minutes of Board of Audit Committee – i.e. matters relating to internal control weaknesses placed before Board / Committee but not considered by them, or noted during his study and evaluation of the internal control system. The auditor should assess whether management has corrected these weaknesses as at the balance sheet date. If the weakness has not been corrected as at the balance sheet date, the auditor should report that there is a continuing failure, whether or not the management has made any effort to correct.
Auditor's duties	***Adequacy of the internal control procedures should be judged –*** Only after study and evaluation of internal control and testing them in operation [Mere study and evaluation is not enough]. The auditor should test the controls in operation to assess whether they are being implemented as desired in the light of: ✓ Size of Company ✓ Nature of its business ✓ Organization structure ✓ Also make reference of SA 315 and 330 Risk Assessment and Internal Control. ***Techniques for evaluating adequacy of the internal control procedures –*** Narrative description, flow charts, internal control questionnaire / checklist duly filled up and countersigned by responsible official of company. The auditor is at liberty to decide which technique or set of techniques he should use for this purpose. But whatever technique or set of he selects, he should maintain proper working papers regarding the evaluation. ***Evaluation of adequacy in computerized environment –*** The auditor may use Computer Assisted Audit Techniques (CAAT's) such as test data, data mining etc. for evaluation of internal controls. ***Action by auditor if weaknesses are observed –*** Reporting to management / TWCG as required by SA 265 / 260 (Revised).

Para 4 (v) of CARO, 2003 Transactions Covered By Section 301

Requirement of Para 4 (v)	***Completeness of section 301 register –*** Auditor to report whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the ***register required to be maintained under that section.*** [Para 4 (v) (a)] ***Reasonability of price –*** Auditor to report whether the transactions made in pursuance of such contracts or arrangements have been made ***at prices which are reasonable having regard to the prevailing market prices.*** (This information is required only in case of transactions exceeding the value of ₹ 500000/- in respect of any party and in any one financial year). [Para 4 (v)(b)]

"Explanation of words used in Clause no. (v)"	
Para 4 (iv) (a) (i.e. Completeness of Section 301 Register)	This part of the clause requires that the auditor should report whether the transactions that need to be entered into a register in pursuance of particulars of contracts or arrangements referred to in section 301 of the Act have been so entered. Section 301 of the Act requires that every company shall keep one or more registers in which shall be entered separately, particulars of all contracts or arrangements to which sections 297 and 299 of the Act apply. ***What is the role of auditor if Register is completed or updated or not maintained properly?*** If the company has not maintained or updated the register required to maintain under

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<td>section 301 of the Companies Act, 1956 and also necessary declarations from directions in Form 24AA are not on record, the auditor should report this fact while commenting under Para 4(iv) (a). (For e.g. In case the company is required to obtain prior approval of the Central Government but has not so obtained, the auditor should state the fact in his report under the Order.)

What is the role of auditor if company has made disclosure of non – compliance of provision in the financial statement?

A separate qualification may not be required in the main audit report provided the necessary provisions to meet the cost of non-compliance has been made and the fact of non-compliance (including the amounts involved) has been appropriately disclosed in the financial statements.
<u>Note:-</u>
✓ It is suggested that the auditor should acquaint himself with all the requirements of sections 297, 299 and 301 of the Act.
✓ Loan Transactions with parties covered by section 301 of the companies Act. 1956 fall within the ambit of Para 4 (iv) (a).
✓ The auditor should also obtain a written representation from the management concerning the completeness of the information so provided to the auditor.
✓ The auditor should also examine, wherever applicable, secretarial compliance certificate issued under section 383A of the Act in regard to the completeness of the register maintained under section 301 of the Act.
✓ The auditor may also rely upon such a certificate issued by a company secretary provided the auditor complies with the requirements of Standard on Auditing (SA) 620(R), "Using the Work of an Expert</td>
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<td>Para 4 (iv) (v)(b) [Reasonability of Price]</td>
<td>How auditor can judge the reasonability of price?
1. Basis of Judging and reasonableness of prices – The auditor is required to determine the reasonableness of prices having regard to the prevailing market prices at the relevant time. "AT THE RELEVANT TIME" means at the time the transaction was entered into.
2. Roving Market Enquiry not expected:- The auditor is not expected to make a roving market enquiry to determine the market prices prevailing at the time the transactions were entered into.
3. Different methods / approaches to determine reasonableness of prices:-
✓ Examine information such as price lists, quotations, and records relating to prices at which similar transactions have been entered into with other parties, etc., at the relevant time.
✓ Based on the information collected in the above approach and any explanations given by the management, the auditor has to satisfy himself whether the prices at which various transactions have been made are reasonable.
✓ The auditor should take into account all the factors surrounding the transactions such as the delivery period/schedule of implementation, the quality and the quantity of the product/service, the credit terms, the previous record of supplier/buyer/client, etc.
✓ In a transaction of purchase, it is not necessary that purchases be made in all cases at the lowest rates. When the rates paid are higher than the prevailing market prices, the auditor have to use his judgement to determine whether the difference in rates is reasonable having regard to the other factors mentioned above. This may often be the case where the company wishes to have more than one source of supply or where there is limit to the manufacturing capacity of the supplier who quotes a lower price. Thus, the intention of the clause is to require the auditor to examine and comment on the reasonableness of the prices at which the transactions have been entered into.</td>
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	✓ In cases where transactions are entered with sole suppliers (i.e. section 301 party is a monopolist in that product / services). In such cases, the auditor may examine the reasonableness of prices paid with reference to list prices of the supplier concerned, other trade terms of the supplier, etc.

Para 4 (vi) of CARO, 2003 Public Deposits

Requirement of Para 4 (vi)	In case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections 58A, 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable have been complied with. If not, the nature of contraventions should be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal whether the same has been complied with or not? [Paragraph 4 (vi)].
"Explanation of words used in Clause no. (vi)"	
Audit Procedure to verify compliance with section 58AA	1. Whether there is a default in any repayment of deposits from small deposits. This would require the auditor to examine all the accounts related to small depositors. 2. In case where a company has large number of deposits accepted from small depositors, it may not be feasible for the auditor to first verify each account for default in repayment and then check whether the company has complied with the requirements of section 58AA of the Act. The auditor, in such a case, should examine the internal control in place in this regard and determine its efficacy. 3. The auditor should obtain a schedule of repayment of loans taken from small depositors from the management of the company. 4. The auditor, thereafter, should make reasonable test checks of the repayments made by the company. 5. In case the results of the test check reveal that the management has defaulted in repayment of deposits made by small depositors or part thereof or interest thereupon, the auditor should examine whether the same has been intimated to the Company Law Board.
Inquires of management	1. The auditor should also enquire of the management ✓ About the possible instances of non- compliance with sections 58A, 58AA or any other relevant provisions of the Act and the relevant rules. ✓ about any order passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal for contravention of sections 58A, 58AA or any other relevant provision(s) of the Act and the relevant rules. ✓ The auditor should obtain a management representation to the effect whether: a) The company has complied with the directives issued by the Reserve Bank of India and the provision of section 58A and 58AA of the Act and the relevant rules; and b) Where an order has been passed by any of the relevant authorities mentioned in the clause, the company has complied with the requirements of the Order.
Miscellaneous Points must be remember	✓ The auditor should also report the nature of contraventions in case the company has not complied with the relevant directives of the Reserve Bank of India or the provisions of section 58A or with the provisions of section 58AA of the Act and the relevant rules. ✓ Where any of such authorities (i.e. CLB, Tribunal, etc,.) has passed an order, the auditor should examine the steps taken by the company to comply with the said

	order. If the company has not complied with the order, the same is to be reported stating therein the nature of contravention and the fact that the company has not complied with the order issued by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal.

Para 4 (vii) of CARO, 2003 Internal Audit

Requirement of Para 4 (vii)	In the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crores rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business.[Para 4 (vii)]

"Explanation of words used in Clause no. (vii)"	
Applicability of clause to listed companies	This clause has a mandatory application for the listed companies irrespective of the size of paid-up capital and reserves or turnover. It may be noted that the Order does not specify the date with reference to which the listing status of the company should be determined. In this regard, it is clarified that if the company is listed on a recognised stock exchange on the last day of the financial year under audit (i.e. As on the date of the balance sheet), it should be considered as listed for the purpose of this clause.
Applicability of clause to unlisted companies	✓ For unlisted companies requirement applies only if either the paid – up capita + reserves (not merely equity capital) as at the commencement of the financial year concerned exceeds ₹ 50 Lakhs or average turnover for three consecutive immediately preceding financial years exceeds ₹ 5 Crores. ✓ An Unlisted Company cannot be covered by this clause on the basis of average annual turnover criteria during the first three financial years of its coming into existence.
Evaluation of Internal Audit	***Factors to be considered by auditor in assessing whether the Internal Audit System (IAS) is commensurate with the size of the company and the nature of its business:*** a) Is the Internal Audit Department (IAD) adequately staffed keeping in view the nature of the business, number of operating locations, extent of decentralization etc.? b) Is there adequate number of qualified and competent personnel in the IAD? c) Does the Internal Audit Report (IAR) to a sufficiently high level of management (preferably top management i.e. TWCG)? d) What areas are covered by the Internal Audit? Does it cover examination of operating systems to ensure that these are adequate and functioning properly? e) If the operations of the company are highly technical, does the Internal Auditor have adequate technical assistance? f) See the report submitted by the Internal Auditor i.e. Quality of Internal Audit Observations. g) Follow up on the report / observation of Internal Auditor (i.e. commonly known as Action Taken Report) h) Auditor should also see the minutes of meetings of Board of Director and Audit Committee.

Para 4 (viii) of CARO, 2003 Maintenance of Cost Records

Requirement of Para 4 (viii)	Where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of Section 209 of the Act, whether such accounts and records have been made and maintained. [Para 4(viii)]

"Explanation of words used in Clause no. (viii)"	
Companies (Cost Accounting Records) Rules, 2011 (CARR, 2011)	The Central Government has notified the Companies (Cost Accounting Records) Rules, 2011 vide Notification No. G.S.R. 429(E), date 03-06-2011. These replace 36 of the 44 existing product / activity specify CARR. The New rules apply to all companies including Foreign Companies as defined under section 591 of the Act. Thus all companies except Companies which are SMEs (Net Worth not exceeding Rs. 5 Crores and turnover not exceeding Rs. 20 Crores in the immediately preceding financial year) and Companies governed by special Acts (e.g. Banking Companies / Insurance Companies) have to maintain cost records in accordance with the Cost Accounting Standards (CASs) issued by ICWAI (now known as ICMAI) w.e.f. financial year 2011 – 2012. Compliance with CASs replaces compliance with product – specific Cost Accounting Records Rules for all activities / products except for 8 products / activities for which old CARRs continue to remain in force.
Compliance report from Cost Accounting	The Companies CARR, 2011 requires every company to which it applies to obtain a compliance report in Form – B from the member of ICWAI who is permanent employee of company or who holds a valid certificate of Practice under the ICWA Act, 1959. It appears that the auditor may rely on this compliance report except where the Cost Accountant is permanent employee. ICAI needs to clarify on this.
Detailed audit of cost records by auditor	Not required. The auditor need to make only a general review of the cost records to ensure that prescribed cost records have been maintained. In his comment, he should clearly mention the fact that he has made only general review of cost records and that he has made any detailed audit of cost records and also fact of any reliance placed on the compliance report of cost content.
If records are not written up or incomplete	If the records have been written up or are prima facie incomplete, the auditor should make a suitable comment in his audit report under Para 4(viii) of CARO, 2003. He should also qualify in his main report his affirmation u/s 277 (3) (b) as to whether proper books of accounts as reqd. by law have been maintained so far as it appear from an examination of these books. This is because cost records are books of accounts u/s 209 (1) (d).

Para 4 (ix) of CARO, 2003 Statutory Dues

Requirement of Para 4 (ix)	Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor. [Para 4(ix)(a)] In case dues of Income Tax/ Sales Tax/ Service Tax/ Customs Duty/ Wealth Tax/ Excise Duty/ Cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. [Para 4(ix)(b)] *{A mere representation to the Department shall not constitute the dispute.}*

"Explanation of words used in Clause no. (ix)"	
"Statutory	***Conditions to be fulfilled for a due to be considered as "Statutory Due"***

Due" under Para 4 (ix) (a)	***under Para 4 (ix)(a):-*** 1. An Obligation is cast on the company by a Central, State or Local Law to pay the dues regularly (e.g. monthly / quarterly / half yearly) 2. The law requires the due to be paid to a authority (i.e. statutory authority). 3. Examples of dues in (a) & (b) above are sales tax, service tax, provident fund where payment is made monthly / quarterly) 4. The obligation to pay does not arise under the law on the happening of a specified event (e.g. custom duty payable on imports, demand arising out of assessment orders). In such cases, if dues are paid as and when they arise, the auditor can treat the payment as regular. But if instalments have been granted by the authority, to pay the amount demanded, than auditor will have to report on whether these instalments are deposited regularly. ***Examples:*** ***The municipal taxes, TDS, License fees, Provident fund, employees state insurance, sales tax / VAT, service tax are statutory dues.***
Meaning of "disputed"	1. Where there is a positive evidence or action on the part of the company to show that it has not accepted the demand for payment of tax or duty from the authority, it is to be treated as disputed. 2. Examples of positive evidence or action: - Where it has gone into appeal. For this purpose, where an application for rectification of mistake (e.g., under section 154 of the Income Tax Act, 1961) has been made by the company, the amount should be regarded as disputed. 3. Where the demand notice/intimation for the payment of a statutory due is for a certain amount and the dispute relates only to a part and not the whole of such amount, only such amount should be treated as disputed and the balance amount should be regarded as undisputed. 4. It is not necessary for the auditor to examine the sustainability or otherwise of the claim of the company regarding disputed amounts. It is sufficient for his purpose if the evidence available shows that the amount is disputed by the company. 5. Mere representation to the concerned Department does not constitute the dispute.
From the date they become payable"	***The Expression "the date they become payable" can be interpreted in two sense:-*** ✓ On the one hand, it can be argued that the statutory dues referred to in this clause become payable on the last date by which payment can be made without attracting penalty and/or interest under the relevant law. ✓ On the other hand, it can also be argued that the amounts referred to in the clause become so payable as at the date of the expiry of the stay granted by the authorities. ✓ Where instalments have been granted for the payment of statutory dues referred to in the clause, the date on which the default occurs and the amount becomes payable to the authorities. ✓ As the purpose of this clause is to indicate the amounts which have become actually payable and are outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable, the latter view seems to conform more closely to the requirements of the Order.
Treatment of penalty and / or interest	Penalty and/or interest levied under the respective laws would be covered within the term "amounts payable".
Regularity of deposit of undisputed statutory dues	✓ To be reported by the auditor whether or not there are any arrears as at the balance sheet date. ✓ If company was irregular but has cleared the dues before year end still the auditor should report the irregularity. If the company is not regular in depositing the undisputed dues, the arrears, if any, need not be reported unless these arrears have been outstanding for more than 6 months from the date they become payable as at the balance sheet date.

Dues payable under foreign statues	For the purpose of Para 4 (xi) (a) of CARO, 2003 (i.e. reporting on regularity of payment o undisputed statutory dues and reporting arrears of such dues outstanding for more than six months), dues payable under foreign statutes applicable to the company should also be considered.
Non – Payment of advance tax	Non – payment of advance tax is a default in the payment of statutory dues. ***Note:-*** However, non – payment where company did not have any taxable income on the due dates on which it is to be paid (and company has taxable income after the last date for payment of advance tax and consequently company incurs interest under the Income – Tax Act, 1961) – this does not amount to default / irregularity in depositing statutory dues.
Tax demand set aside	Not statutory dues for the purposes of Para 4 (ix) of CARO, 2003
Reporting of arrears	The report should be restricted to the actual arrears and should not include the amounts which have not fallen due for payment to appropriate authority and have been recognised as outstanding dues at the balance sheet date.
Demands stayed	These are 'disputed dues'
Certain issues	1. Appeal against the demand has become time – barred – The demand amount should be treated as 'undisputed statutory due' for the purpose of Para 4 (ix) (a) of CARO, 2003. 2. Reporting regarding disputed statutory dues not deposited is necessary under Para 4 (ix) (b) of CARO, 2003 irrespective of whether these have been provided for in the accounts or not will be judged in context of AS – 4 and AS – 29.

Para 4 (x) of CARO, 2003
Net Worth Erosion or Accumulated Losses

Requirement of Para 4 (x)	✓ Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and ✓ Whether it has incurred cash losses in such financial year and in the immediately preceding financial year. [Para 4(x)]

"Explanation of words used in Clause no. (x)"	
"Net Worth"	1. Section 2(29A) of the Act defines the term "net worth" 2. ***As per section 2(29A) "Net Worth" means:-*** " Net Worth" is sum total of the paid-up capital and free reserves after deducting the provisions or expenses as may be prescribed. 3. ***Free Reserves:-*** "Free Reserves" means all reserves created out of profits and share premium account, capital reserves, CRR, Debenture redemption reserve. But does not include ✓ Reserves created out of revaluation of assets. ✓ Write back of depreciation provisions. ✓ Created out of amalgamation. 4. As per section 2(29A), only those provisions or expenses which have been notified by the Central Govt. will be deducted. Until Central Govt. notifies the provisions or expenses to be deducted in calculating Net Worth, net worth to be determined as paid – up capital + free reserves. 5. The figure of net worth computed from the balance sheet of the company should also be adjusted for the effect of qualifications in the audit report to the extent the qualifications are quantified.

"Loss" / " Accumulated Loss"	The term "loss" should be construed to mean the net profit/loss shown by the profit and loss account of the company as adjusted after taking into account all quantifiable qualifications in the audit report.
"Cash Loss"	***<u>Cash Loss is:</u>*** ✓ The profit / loss as shown by profit and loss account ✓ As adjusted for the effect of non – cash transactions such as Depreciation, amortization, deferred tax expense etc. The figure of cash loss arrived at as above should be adjusted for the effect of all quantifiable qualifications in the audit report.
Reporting of erosion of net worth and cash loss	***<u>The following points must be kept in mind while reporting under this clause:-</u>*** ✓ The auditor should mention in his report that he has arrived at his opinion on the matters specified in the Para 4(x) after considering the effect of all quantifiable qualifications on the figures of accumulated losses, net worth and cash losses. ✓ If any of the qualifications in the audit report are not quantifiable, he should state that the effect of such qualification has not been considered for the purpose of reporting under this clause. A situation may be there where the company has suffered cash losses in only one of the years referred to in the clause. In such a situation the auditor is well advised to comment on the two years separately. Thus, for example it would be proper to report that the company has incurred cash losses only during the preceding year but has not incurred any cash loss during the current financial year.

<u>*Para 4 (xi) of CARO, 2003*</u>
<u>*Default in repayment of Banks / FI Dues*</u>

Requirements of Para 4(xi)	Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported. [Para 4 (xi)]

"Explanation of words used in Clause no. (xi)"	
"Dues"	'Dues would cover both Principal and Interest on any kind of dues.
Default means	Non – Payment of dues on the last date / due dates specified in the loan agreements / debenture trust deed / debenture deed. For example, in the case of term loans, fixed dates are prescribed for repayment in the agreement or terms and conditions of the loans.
Certain Issues	**1. *Restructuring / reschedulement of dues*** ✓ Submission of application by the company for restructuring of dues not means that no default has place or that the default is wiped out. This is particularly true if the application pertains, to amounts already fallen due. ✓ If restructuring proposal has been accepted, the auditor should state in his report this fact. **2. *In case of disputes between company and the lender:-*** ✓ Auditor cannot comment whether there is any default. ✓ In such a cases, he should state that he is unable to state whether there is any default on account of disputes.
Reporting of default	✓ The period and amount of all default existing at the balance sheet date should be reported irrespective of when (whether in the current financial year or in previous financial year) the defaults occurred.

	✓ If default has been made good on or before the year end, the auditor should state the amount and period of default and also the fact that they have been made good. ✓ Amount defaulted (i.e. due but not paid) only needs to be reported and not the total outstanding to the bank / financial institution / debenture holder.

Para 4 (xii) of CARO, 2003
Loan given against Pledge of shares etc.

Requirement of Para 4 (xii)	Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out. [Para 4 (xii)]
"Explanation of words used in Clause no. (xii)"	
Application of clause	Clause (xii) applies only to loans and advances which are secured by pledge of shares, debentures or other securities. It does not apply to other forms of security e.g. hypothecation, guarantee etc.
Shares, debentures and other securities	✓ The words 'other securities' should not be interpreted as any assets other than shares / debentures given as security. ✓ The term, 'other securities' should, ejusdem generis, be construed to mean bonds or promissory notes issued by a government or semi-government authority. ✓ In a broader sense, it can include any other asset which is given as security for repayment of a loan or fulfilment of an obligation. ✓ However, the term 'other securities' is used along with shares and debentures and, therefore, for the purpose of this clause, consideration will have to be confined to securities which are similar to shares or debentures.
Pledge	***Pledge implies that :-*** ✓ There must be physical possession of the security ✓ Must be transferred to the company along with a power to sale of the security in the case of default. ✓ This transfer can be actual or constructive. ✓ For example, the share or debenture may be physically in the custody of the company or it may be with a person like a bank which holds it on behalf of the company.
Adequate documents and records	***The adequacy of documents and records has to be judged in the facts and circumstances of the case (i.e. the nature of the security and the borrower). But, according to ICAI's Statement on CARO, 2003 the records should generally include:-*** ✓ The full name (i.e. name, middle name and surname) and address (with Pin Code) of the borrower (Address proof may be in form of photocopy of passport / DL / voter ID / ration card). ✓ The loan agreement containing the amount of loan advance, period of repayment, rate of interest, security and other terms and conditions. ✓ Record of disbursements and recoveries. ✓ Full particulars of the shares, debentures / other securities pledged (e.g. name of the company, number of shares. share certificate number. etc) ✓ Blank transfer form duly signed by the borrower and share / debenture certificate / other documents needed to transfer the ownership of security and sell it. ✓ Periodical balance confirmations from the borrowers. ✓ Proof of borrowers borrowing power e.g. in case company is a borrower, the MOA,

	Board resolution etc. should be contained and kept on record.

Para 4 (xiii) of CARO, 2003
Chit Funds / Nidhi / Mutual Benefit Societies

Requirement of Para 4 (xiii)	Whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi / mutual benefit fund / societies: a) Whether the net – owed to deposit liability ratio is more than 1:20 as on the date of balance sheet; b) Whether the company has complied with the prudential norms on income recognition and provisioning against sub – standard / doubtful / loss assets; c) Whether the company has adequate procedure for appraisal of credit proposals / requests, assessments of credit needs and repayment capacity of the borrowers; *d)* Whether the repayment schedule of various loans granted by the Nidhi is based on the repayment capacity of the borrower. [Para 4 (xiii)]
"Explanation of words used in Clause no. (xiii)"	
Requirements of special statute	***Whether the provisions of any special statute applicable to chit fund have been duly complied with? –*** According to ICAI's Statement on CARO, 2003, this requirement should not be interpreted in literal sense because the intention of the requirement is that the auditor has to satisfy himself and report that the company has complied with all the provision of the special statutes insofar as they are applicable to the accounts of the chit fund company. The audit report should clearly state the above interpretation. ***An illustrative comment regarding compliance with special statute applicable to CF's:*** "According to the information and explanation given to us, the company has complied with the provision of ……….. Insofar as those provisions are applicable to the accounts under report."
Net owned funds [Para 4 (xiii) a]	According to the directions issued by the Central Government vide notification number GSR 555(E) dated 26th July, 2001 [as modified by notification number GSR 308(E) dated 30th April, 2002], the term "net owned funds" means the aggregate of paid-up equity capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet of the company. A reserve is considered as a "free reserve" if it is available for distribution as dividend. Further, the amount representing the proceeds of issue of preference shares shall not be included for calculating net-owned funds. Nidhis and mutual benefit societies can give loans to its shareholders or members against the security of gold, silver, jewellery, immovable property, fixed deposit, kisan vikas patra (KVP), national savings certificates, insurance policies and other Government securities. The Central Government, *vide* notification number GSR 309 (E) dated 30th April 2002 issued prudential norms for revenue recognition and classification of assets in respect of mortgage or loans.
"Deposit Liabilities"	A *nidhi* or a mutual benefit society can accept fixed deposits, recurring deposits accounts and savings deposits from its members in accordance with the directions notified by the Central Government. The aggregate of such deposits is referred to as "deposit liability".
Audit Procedures	***The auditor should –*** ✓ Ask the management to provide the computation of the deposit liability and net-owned funds on the basis of the requirements contained herein above. This would

	enable him to verify that the ratio of deposit liability to net owned funds is in accordance with the requirements prescribed in this regard. ✓ Verify the ratio using the figures of net owned funds and deposit liability computed in accordance with what is stated above. The comments of the auditor should be based upon such a statement provided by the management and verification of the same by the auditor.
Credit Appraisal Procedures [Para 4 (xiii) c]	1. ***The sub-clause (c) requires the auditor to comment upon -*** whether the company has adequate procedures for appraisal of credit proposals/requests, assessments of credit needs and repayment capacity of the borrowers. 2. ***The auditor should*** ✓ Study the procedures regarding appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers. It may so happen that a company might have a separate set of procedures for appraisal of credit proposals/requests of employees. ✓ Study of the individual borrower files would indicate whether proper systems and procedures have been followed. 3. The auditor can gather the requisite evidence by examining relevant documents (such as loan application forms, supporting documentation, sanctions, security documents, etc.) and by obtaining information and explanations from the management in appropriate cases.
Repayment Schedule [Para 4 (xii) d]	1. ***The sub – clause requires that the auditor to comment on -*** Whether the repayment schedule of various loans granted by the *nidhi* is based on the repayment capacity of the borrower. 2. ***The scope of the auditors' enquiry for this clause -*** Is limited to examination of the documentation available with the company in regard to grant of loans. Based on his examination of the documentation in regard to grant of loans, the auditor would form an opinion whether the repayment schedule of various loans granted by the *nidhi* is based on the repayment capacity of the borrower. 3. ***Where the number of loans granted by the company is very large -*** It is obviously not feasible for the auditor to satisfy himself that every single loan's repayment schedule granted by the *nidhi* is based on the repayment capacity of the borrower. The auditor's comments on this clause would have to be based on the auditor's examination of the documentation of all large loans, say, exceeding a particular limit determined by the auditor having regard to the concept of materiality and a test check of the documentation of other loans with a view to determine that the repayment schedule of various loans granted by the *nidhi* is based on the repayment capacity of the borrower.

Para 4 (xiv) of CARO, 2003
Records for dealing in securities, shares, etc
(Investment Company)

Requirement of Para 4(xiv)	If the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under section 49 of the Act. [Para 4(xiv)]

"Explanation of words used in Clause no. (xiv)"	
Audit Procedure	***Verify whether timely entries are made in the records by :-*** ✓ Surprise check of records. ✓ Examination of system of Internal Control as regards making entries in records. ✓ Examination of Internal Audit Report (IAR). ***Is the Principal business of the company dealing or trading in shares etc.? If not, than ascertain:*** 1. Whether all shares etc. are held by it in its own name; and 2. Assess whether the failure to get investments transferred to company's own name is understandable.

Factors to be taken into account by the auditor whether company is dealing or trading in shares etc.

S. No.	***Factors***	***Indication that company is dealing or trading in shares etc.***	***Indication that company may not be dealing or trading in shares etc.***
1.	Period of time for which individual shares, debentures etc. are held.	Short / extremely short / (say days rather than month) before being sold.	Long / extremely long.
2.	Method of valuation for balance sheet.	Valuation of stock – in – trade (i.e. cost or NRV, whichever is lower).	Valuation at cost.
3.	Treatment in Income – tax assessments.	Profits on sale of investment are treated as business income.	Profits on sale of investments are treated as capital gains.
4.	Reasons for purchase / sale.	With a motive to resell at a profit shortly thereafter.	With a motive to hold the shares etc.

Para 4 (xv) of CARO, 2003 Guarantee Given.

Requirement of Para 4(xv)	Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company. [Para 4 (xv)]

"Explanation of words used in Clause no. (xv)"	
Meaning of Guarantee	*According to* Section 126 of the Indian Contract Act, 1872 defines a contract of guarantee as a contract to perform the promise, or discharge the liability, of a third person in case of his default.
Letter of Comfort	Not quite a guarantee; usually a document issued by a parent company on behalf of a subsidiary operating in a different country. The parent company (Say 'A') agrees to make every effort to ensure that company B (the subsidiary) will comply with the terms of a given contract, but company A is not committed to perform B's obligations if B cannot do so or defaults.
This clause does not apply to	Letters of comfort given by company (as these are not guarantee).
ICAI's interpretation of Para 4(xv)	1. If the issue guarantee is not permitted by the MOA of the company (i.e. Ultra Vires the company), the auditor should state that it is prejudicial to the interest of the company. **2. In assessing whether the guarantee is prejudicial to the interest of the company, a number of factors will have to be duly considered by the auditor :**

	✓ Financial standing (i.e. financial soundness) of the party for whom the company has given the guarantee – If the company has given a guarantee on behalf of a party whose financial soundness is doubtful, and then the guarantee is prejudicial to the interest of the company. ✓ The nature of the security offered by the party (i.e. whether it fully covers the obligation under the loan, whether it is readily realisable). ✓ The party's ability to borrow (i.e. whether the memorandum of borrowing company permits the company to borrow). 3. The auditor should also verify whether the company has complied with the requirements of sections 295 and 372A of the Act. 4. If the company has obtained the previous approval of the Central Government under section 295, it should be construed that the guarantee is not prejudicial to the interest of the company.
Management Representations	***<u>The auditor should obtain a written representation from the management that:</u>*** ✓ There are no guarantees issued up to the year-end which are yet to be recorded; and ✓ All obligations in respect of guarantees have been duly recorded in the register of guarantees and disclosed.

Para 4 (xvi) of CARO, 2003 Application of Term Loans.

Requirement of Para 4 (xvi)	Whether the term loans were applied for the purpose for which the loans were obtained. [Para 4 (xvi)]

"Explanation of words used in Clause no. (xvi)"	
Meaning of Term Loans	Term loans normally have a fixed or pre-determined maturity period or a repayment schedule. In the banking industry, for example, loans with repayment period beyond 36 months are usually known as "term loans". Terms loans are generally provided by banks and financial institutions for acquisition of capital assets which then become the security for the loan, i.e., end use of funds is normally fixed.
Certain Issues	1. ***<u>Reporting required irrespective of who the lender is –</u>*** Para 4(xvi) does not specify that these term loan should be obtained from bank / financial institution. So a strict interpretation of the clause would mean that the term loan obtained from entities/persons other than banks/financial institutions would also have to be examined by the auditor for the purpose of reporting under the clause. 2. ***<u>If term loans fully repaid as at balance sheet date –</u>*** It appears that utilisation of TL (raised during the year) will have to be commented upon even if as at balance sheet date, they have been fully repaid. 3. ***<u>Term Loans disbursed during the fag – end of the accounting year and remaining unutilized -</u>*** In such a case, the auditor should mention in his audit report that the term loan obtained during the year has not been utilised. 4. ***<u>Term Loan obtained in previous accounting period –</u>*** This Para also covers TL obtained in previous accounting period and utilised during the current accounting period. 5. ***<u>Term loans from banks, raised against title deeds, long term FDRs, NSCs etc., where the bank is not concerned with the purpose for which it is being obtained -</u>*** The auditor should clearly mention the fact that in absence of any stipulation regarding the utilization of loans from the lender, he is unable to comment

	as to whether the term loans have been applied for the purposes for which they were obtained. It may, however, be noted that the auditor, in such cases, should verify that the company has not invested or utilized the money for purposes that are prohibited under the law. 6. ***Temporary investment of term loan funds pending end – use –*** The Company may obtain disbursal of term loan funds in one go. But it may not require the entire loan funds immediately because it is not going to pay 100 amounts in advance to the contractor or vendor of asset. So, the company may invest the surplus loan funds temporarily in FD with bank / ICDs etc. pending utilisation in the project or asset. This helps the company to earn some return and reduce the Cost of Capital. However, subsequently these funds are utilised for sanctioned purpose. In such cases, the auditor should state that pending utilisation for sanctioned purpose, the term loan funds were temporarily used for other than sanctioned purpose but were ultimately utilised for sanctioned end – use.
Audit Procedures	***The auditor should :-*** ✓ Examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the bank. As mentioned above, normally, the end use of the funds raised by term loans is mentioned in the sanction letter or documents containing the terms and conditions of the loan. The auditor should ascertain the purpose for which term loans were sanctioned. ✓ Compare the purpose for which term loans were sanctioned with the actual utilisation of the loans. ✓ Obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised. ✓ If the auditor finds that the funds have not been utilized for the purpose for which they were obtained, the auditor's report should state the fact. ***Note: -*** It is not necessary to establish a one-to-one relationship with the amount of term loan and its utilisation. It is quite often found that the amount of term loan disbursed by the bank is deposited in the common account of the company from which subsequently the utilisation is made. In such cases, it should not be construed that the amount has not been utilised for the purpose it was raised.

Para 4 (xvii) of CARO, 2003
Short term loan used for Loan – term purposes.

Requirement of Para 4(xvii)	Whether the funds raised on short-term basis have been used for long- term investment. If yes, the nature and amount is to be indicated. [Para 4 (xvii)]

"Explanation of words used in Clause no. (xvii)"	
Loan – term application of funds	***Long – term application of funds includes investment in :-*** ✓ Fixed Assets ✓ Long – term investment and other similar assets ✓ repayment of long – term loans and advances or ✓ redemption of long – term debt securities, etc.
Short – term sources of funds include	✓ Temporary credit facility like CC, OD ✓ Reduction in current assets ✓ Increase in current liabilities.

Applicability of this clause to branch audit	If it is branch Indian Company that the branch auditor may state that this clause is not relevant at the branch level. But if it is branch of Foreign Company than this clause would be applicable.
An example of negative reporting under the clause	"According to the information and explanations given to us and on an overall examination of the balance sheet of the company, we report that the company has used funds raised on short-term basis for long-term investment. The company has accepted public deposits amounting to rupees 5 crores which would fall due for repayment two years from the date of their acceptance. The company has invested the money for the increase of the production capacity which would be completed in the next four years."

Auditor's approach to Para 4(xvii)

The auditor should determine from the balance sheet of the company the long – term sources and long – term application of funds by a company and then compare the two. How the auditor is to judge utilisation of short – term funds for long – term from this comparison is tabulated below.

Situation	***Audit Reporting under Para 4(xvii)***
Quantum of long – term funds is not significantly different from the quantum of long – term applications.	**State that short – term funds have not been used for long – term investment (since long – term assets are financed from long – term sources)**
Quantum of long-term funds is significantly less than the long-term application of funds.	**State that short – term funds have been used for long – term investment. (since short – term funds have been used for long – term investment)**
Quantum of long-term funds is significantly more than the long-term application of funds	**State that short – term funds have not been used for long – term investment. (since long – term funds have been utilised for short – term assets)**
Company's system of funds deployment	If company is following the system of deploying funds based on their respective maturity pattern as a risk management technique, the auditor should compare the sources of funds with their deployment based on their respective maturity patterns. This is a very sophisticated way of analysing whether short – term funds have been invested in long – term assets. For example, if company's long – term debt that is to mature within the next 12 months and an equivalent amount in a long-term investment that would mature after 3 years, the maturity pattern analysis would indicate the potential inability to meet the liability on the debt on due date, but the traditional analysis would not do so.

Para 4 (xviii) of CARO, 2003 Preferential Allotments

Requirement of Para 4(xviii)	Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act, and if so whether the price at which shares have been issued is prejudicial to the interest of the company. [Para 4 (xviii)]

"Explanation of words used in Clause no. (xviii)"	
Applicability to branch audits	Para 4(xviii) of CARO, 2003 is not applicable to audit reports of branches of Indian companies.

Scope of Para 4(xviii)	Only preferential allotment of shares covered by this clause – PA of other securities issued by the company is not covered by this clause. PA of share would mean – An allotment of shares to parties and companies covered in the register maintained under section 301 of the Act in preference to others. The preference can be with regard to the price or other terms and conditions associated with the allotment.
'Shares'	The term "shares" includes both equity as well as Preference shares.
In case of Listed Companies	If the PA is as per SEBI (ICDR) Regulation, 2009, auditor can report that the price at which shares have been issued is not prejudicial to the interest of the company.
In a case of a private company / unlisted public company	Valuation of shares of a company involves use of judgment, knowledge of the business, analysis and interpretation and the use of different methods, which may result in assigning different values based on different methods. There are certain basic factors, which affect the value of a company's shares for which the price calculated is adjusted. The factors are earnings, dividends declared, asset value and goodwill of the company. Methods generally used for determining the fair value of the business by the company, which take into consideration one or more factors mentioned above are: 1. ***<u>Net Assets Basis –</u>*** considers the valuation of assets, subtracting therefrom liabilities, etc., to arrive at the value of the equity shares. 2. ***<u>Maintainable Profits Basis –</u>*** this is based on the future maintainable profits/earnings of the company. 3. ***<u>Yield Basis –</u>*** this method recognizes the yield/dividends as a base for arriving at the fair value of the shares. 4. ***<u>Discounted Cash Flow Method</u> –*** this method estimates the value of shares by estimating the future cash flows from operations and discounting the cash flows at a specified rate. ***<u>Note</u>: -*** It is not rare to find a combination of different methods used in the context of valuation of shares; for example, an averaging of maintainable profits basis and the net assets basis.
Valuation reports of expert	Companies sometimes do make allotment of shares based on the valuation reports issued by experts in this field. These experts are called 'management expert' under SA 500(Revised). While the auditor uses the report of an expert to determine whether the price for the preferential allotment of share is not prejudicial to the interest of the company, the auditor should also comply with the requirements of Standard on Auditing (SA) 620 (R), "Using the Work of an Expert".
Section 81	In case, the company has made preferential issue of shares by passing an ordinary resolution under clause (b) of sub-section (1A) of section 81 of the Act – Apart from examining the method used for valuation of shares of the company and ascertaining the reasonableness of the assumptions underlying the calculation, the auditor should also examine the Order of the Government as to its satisfaction that the proposal is most beneficial to the company. Where the Government is satisfied in this regard, the auditor need not make his assessment as to the reasonableness of the prices of the shares for the preferential allotment of shares. The auditor, however, is not precluded from doing so. If the auditor forms his opinion on the basis of the Order issued by the Government, he should state the fact of his reliance on the Government Order for the purpose of reporting.

<u>Para 4 (xix) of CARO, 2003</u>
<u>Securities Created (Debenture)</u>

Requirement of Para 4(xix)	**Whether security or charge has been created in respect of debentures issued? [Para 4(xix)]**

"Explanation of words used in Clause no. (xix)"

Audit Procedure	✓ Where the company has issued any debentures, the auditor should also examine the debenture trust deed executed under section 117A of the Act. ✓ The auditor should pay particular attention to verify whether proper security has been created in favour of the debenture trust. ✓ Examine the relevant documents creating the charge in favour of the trustees for the debenture holders duly registered in the concerned Registrar's office if the security is an immovable property. ✓ If the company has not created any security, the auditor should report the fact in his report.
Debenture issued towards year – end	If the debentures have been issued towards the end of the year and the securities are created subsequently then, to present a complete and balanced picture while reporting the fact that the security in respect of debentures is yet to be created, the auditor would be well advised to also mention the reason for the same, viz., that the debentures have been issued only recently (specify the month of issue) and that the company is taking steps to create the security. However, he should report as above only where, as a result of his enquiries, he is satisfied that the non- creation of security is not due to deliberate or inadvertent delay on the part of the company and that it is in fact in the process of creation of security.

Para 4 (xx) of CARO, 2003
End – use of Public Moneys

Requirement of Para 4(xx)	**Whether the management has disclosed on the end use of money raised by public issues and the same has been verified. [Para 4(xx)]**

"Explanation of words used in Clause no. (xx)"

ICAI's Interpretation	**1.** ***In case the company has made a public issue of any of its securities – The auditor is required to :*** ✓ Report upon the disclosure of end-use of the money by the management in the financial statements. ✓ State whether he has verified the disclosure made by the management in this regard. 2. ***Disclosure in notes to accounts and auditor to verify the same –*** It appears that the clause envisages that the companies should disclose the end use of money raised by the public issue in the financial statements by way of notes and the auditor should verify the same. 3. ***The figures of utilized moneys from public issues required to be disclosed in the notes to accounts –*** Is the cumulative figures of amounts utilized as at the year – end of the financial year under – audit. For the sake of greater clarity, the company may disclose break – up of year – end cumulative figures into opening figures and monies utilized during the year.

Audit Procedures	✓ An examination of the prospectus would provide the auditor an understanding of the proposed end-use of money raised from public. ✓ Should verify that the amount of end-use of money disclosed in the financial statements by the management is not significantly different from the proposed and actual end use. ✓ Obtain a representation from the management as to the completeness of the disclosure with regard to the end-use of money raised by public issues.
Reporting	✓ If the auditor is of the opinion that adequate disclosure with regard to end use of money raised by public issue has not been made in the financial statements, the auditor should state the fact in his audit report. ✓ If, for any reason, the auditor is not able to verify the end-use of money raised from public issues, he should state that he is not able to comment upon the disclosure of end-use of money by the company since he could not verify the same. He should also mention the reasons which resulted in the auditor's inability to verify the disclosure.
Monies raised ADR issue	Monies raised from Foreign Capital Markets through ADR issue – These are to be treated as moneys raised by public issues for the purposes of para 4(xx) of the CARO, 2003.

Para 4 (xxi) of CARO, 2003
Frauds noticed or Reported

Requirement of Para 4(xxi)	**Whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated. [Para 4(xxi)]**

"Explanation of words used in Clause no. (xxi)"	
The audit should	✓ The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. ✓ The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. ✓ The auditor should enquire of the management about any frauds on or by the company that it has noticed or that have been reported to it. ✓ The auditor should also discuss the matter with other employees of the company. ✓ The auditor should also examine the minute book of the board meeting of the company in this regard. ✓ Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence.

Para 5 of CARO, 2003
Reasons to be stated for unfavourable or qualified report

Requirement of Para 5	Where, in the auditor's report, the answer to any of the questions referred to in paragraph 4 is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

5. Audit Report – As per Standard on Auditing

To be discussed with Standard on Auditing

Practical Problems of Audit Report

REPORT UNDER SECTION 227(1A)

Sec. 227(1A) requires the auditor to make specific **enquiries** during the conduct of his audit. He is, however, not required to report on these matters unless he has any special comments to make. The auditor should only enquire on the specified matters & is not to investigate into them. The matters to be enquired into are:

1. Whether **loans and advances** made by the company on the basis of **security** have been properly secured & whether the t**erms** on which they have been made are **not prejudicial** to the interests.**[Sec.227(1A)(a)]**

PRACTICAL:

The Company has given a loan of ₹ 300,000 to X, a Supplier of the Company on the security of a life insurance policy of the face value of ₹ 600,000 & whose surrender value as on 31st Dec. was ₹ 50,000. The Company is in possession of the policy. However, an assignment in favour of Irregular Ltd has not been registered with LIC.

<u>Clause 227(1A)</u>**: Loans on inadequate security**

a. The Auditor should ascertain whether the Company holds a legally enforceable security & the value of the security fully covers the amount lent.
b. In this case, the Loan of ₹ 300,000 has been made on the basis of security having a surrender value of ₹ 50,000 only. Hence the Loan is not adequately secured. Also the security cannot be legally enforced since the Company has not registered the assignment in its favour.
c. The Auditor should report this matter to the members u/s 227(1A)(a)

2. Whether **transactions** of the company, which are represented merely by **book entries**, are not prejudicial to the interests of the company.**[Sec. 227(1A)(b)]**

PRACTIAL:

The Company recorded on 31st December a sale of goods to the tune of ₹ 100,000 to A & Co. Ltd., a sister concern & recognized a profit of ₹ 20,000 for the year ended 31st Dec. On 1st January, a purchase of the goods of the same description amounting to ₹ 100,000 from A & Co. Ltd was found to be recorded.

<u>Clause 227(1A):</u> **Book Entry Transactions**

a. In this case, the sale & purchase transactions represented by book entries only (without actual movement of goods) are intended to boost the profits of the Company. This causes fictitious profits & is not a genuine transaction.
b. The Auditor should report this matter to the members u/s 227(1A) (b) & also qualify his report since true & fair view of the accounts is affected.

3. Whether the company is **not** an **investment** company within the meaning of Sec. 372 or a banking company, whether so much of the assets of the company as consists of shares, debentures & other securities have been sold at a price less than that at which they were purchased by the company.**[Sec.227(1A)(c)]**

PRACTICAL:

The Company has sold during the year 200 Shares of Sinking Horizon Ltd for ₹ 20,000. The cost of shares at the time of acquisition was ₹ 40,000. It is also noted that during the year, sinking Horizon Ltd had lost 3 out of 4 ships owned by it in a storm near Alaska. There are definite indications that the Company might go into liquidation.

<u>Clause 227(1A):</u> **Sale of Investments below cost**

a. There is no prohibition for sale of investments below cost. The Auditor should only ascertain that the sale is bonafide & the price realized is reasonable having regard to the circumstances of the case.
b. In the given circumstances, the sale of investments seems to be bonafide as Sinking Horizon Ltd is not in a sound financial position.

c. Hence, the Auditor shall report this matter to the members u/s 227(1A) (c), but it does not attract a qualification if the sale/cost/loss on sale have been accounted & disclosed properly.

4. Whether **loans & advances** made by the company have been shown as deposits.**[Sec.227(1A)(d)]**

PRACTICAL:

The Company has given ₹ 50,000 to A & Co, a Partnership Firm very remotely connected with one of the senior employees. A & Co does not customarily accept deposits. Irregular Ltd does not owe any obligation in respect of A & Co. The above amount of ₹ 50,000 have been classified as "Deposits" in the Company's accounts.

Clause 227(1A): Classification of Deposits

a. In this case, A & Co does not accept Deposits, & also the Company has not obligation against A & Co. the amount given to A & Co should be shown only as "Loans & Advances".

b. The Auditor should instruct the Company to show the amount as "Loans & Advances". If the Company refuses a re-classification & continues to show them as " Deposits", the Auditor should report the same u/s 227(1A)(d) & also qualify his report due to distortion of " true & fair view"

5. Whether **personal expenses** have been charged to revenue account.**[Sec.227(1A)(e)]**

PRACTICAL:

One of the Directors of the Company celebrated the marriage of his daughter during the year. Two cars of the Company had been lent to the Director & the petrol bills amounting to ₹ 12,500 have been paid by the Company.

Clause 227(1A): Personal Expenses charged to Revenue

a. In this case, the Personal Expenses of the Director have been clearly charged to the revenue account of the Company.
b. The Auditor should report this matter to the shareholders u/s 227(1A)(e). Also if such amount is material, the Audit Report should be qualified since true & fair view of profits is affected.

Director of T Ltd draws an advance of US$ 200 per day in connection with the foreign trip undertaken on behalf of the company. On his return he files a declaration stating that entire advance was expended without any supporting or evidence. T Ltd books the entire expenses on the basis of such declaration. As the auditor of T Ltd how do you deal with this?

SA 500 (R) "Audit Evidence" states that an auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base his opinion.

Sec. 227(1A) (e) of the Companies Act 1956 requires an auditor to report when personal expenses have been charged to revenue account.

In the above case, ascertain whether payment made by the company for the foreign trip form an "allowance" or "reimbursement". An allowance is a fixed sum of money allowed on the basis of specified criteria. No evidence supporting the expenditure is required for payment of allowance to the director. On the other hand, if the payment is reimbursement, it should be against actual expenditure.

The director concerned should provide proof of expenditure. Since the director has given only a declaration, he auditor should ascertain other relevant facts as to whether the advance paid is pursuant to the policy of the company which is based on approximate estimation of the expenditure normally incurred by a person of the status of a director & the same is applicable to persons of a similar status within the company. If the auditor considers the advance taken is reasonable, and then the declaration can be considered adequate, otherwise he may have to call for additional documentary evidences.

6. Where it is stated in the books & papers of the company that any **shares** have been allotted for **cash**, whether cash has actually been so received in respect of such allotment, and if no cash has actually been so received, whether the position so stated in account books & balance sheet is correct, regular & not misleading. **[Sec. 227(1A)(f)]**

PRACTICAL:

The Company owed ₹ 50,000 to Shri R.S. It issued Equity Shares amounting to ₹ 50,000 in liquidation of the above debt. What are the reporting considerations involved in the above transactions?

Clause 227(1A): Allotment of Shares:

a. As held in ***Spargo's Case*** & confirmed by **CLB Circular,** the allotment of shares by a Company to a person in lieu of genuine debt due towards him is in perfect compliance of Sec. 75(1). The issue of Equity Shares in liquidation of its debt to Shri R, .S. is legal.

Hence, the Auditor has no duty to report in this instance

REPORT UNDER SECTION 227(2)

The Auditor has to state whether, in his opinion the said accounts give the information required by the act in the specified manner & give a ***true & fair view:***

a. In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and
b. In the case of the profit & loss account, of the profit of loss for its financial year.

PRACTICALS:

H.W.P.Private Ltd is having only two members H & W. During the audit of accounts for the year ended 31st march 2010, you as auditor find that:

i. H. who is in charge of purchases has introduced fictitious purchase bills of ₹ 50 Lakhs.

ii. W. who is in charge of sales has sold goods worth ₹ 1 Crore without bringing the same in the Books of Account.

You raise the matter with H & W in their capacity as directors. They contest that as this is a position known to them & within their own fold, you should not report the same under the Companies Act 1956. Discuss whether the above arguments are acceptable under the Companies Act, 1956 for non-reporting. If not, state the reasons & the manner of reporting

The arguments put forth by the Directors for non-reporting of Fictitious purchases of Rs 50 lakhs & omission of recording of sales of ₹1 Crore under the Companies Act 1956 are not acceptable in view of the following reasons:

i.) The scope of audit of a company is determined by provisions of the Companies Act 1956. Even the terms of the engagement cannot restrict the scope of audit in relation t matters which are prescribed by legislation. Corresponding to scope of audit, even the rights of an auditor available under statute cannot be restricted. In the case of ***Newton v. Birmingham Small Arms Co.(1895),*** it was held that any regulation which precludes the auditors from availing themselves of all the information t which they are entitled under the Companies Act are inconsistent with the Act.

ii.) Sec. 227(2) proves that the duty of an auditor is to make a report to the members of the company. In his report, the auditor has to state whether *"in his opinion & to the best of his information & according to the explanations given to him."* The accounts *"give a true & fair view in the case of the B.S., of the state of the company's affairs as at the end of its F.Y. & in the case of the P & L a/c of the P & L a/c for its financial year."*

Thus, the primary duty of the auditor is to determine whether the balance sheet shows a true & fair view of the state of the company's affairs as at the end of the F.Y & whether the P & L a/c shows a true & fair view of the working results of the company for the year.

iii.) The Companies Act 1956 does not make any distinction between a private limited company & a public ltd company. Therefore, the fact that there are only two members & they are fully aware of such transactions would not have any impact as far as scope of audit is concerned. The decision of ***Pendleburys Ltd vs. Ellis Green & Co.(1936)***

Therefore, in view of the above mentioned reasons, inflation of purchases (which in this case is ₹ 50 Lakhs) & omission of sales (which in this case is ₹ 1 Crore is bound to affect the true & fair view of the F.S. of the company. It would, therefore, be obligatory on the part of auditor to report these aspects in the audit report.

REPORT UNDER SECTION 227(3)

REPORT UNDER SECTION 227(3)(a): The Auditor's Report shall state whether he has obtained all the information & explanations, which to the best of his knowledge & belief were necessary for the audit.

PRACTICAL:

During the course of statutory audit of an investment company dealing in shares and securities, in spite of repeated reminders by the statutory auditor, the company officials did not provide the investments held by the company at the Balance Sheet date for verification and also did not provide the details for valuation of unlisted shares as on the Balance Sheet date. The statutory auditor, in his final audit report to the shareholders, reported as follows:

"Subject to the verification of the existence and value of the investments, the Balance Sheet shows a true and fair view."

Is the report made by the statutory auditor correct?

As per Sec. 227(3) (a) of the Companies Act 1956,

Failure to Obtain Information and Explanation, the statutory auditor is required to express his opinion on the truth and fairness of financial statement audited by him only after examining the authenticity with reference to the information and explanations given to him. He must determine the extent of information which should be obtained by him before he expresses his opinion on the financial statement submitted to him for report. He should not express an opinion before obtaining the required data and information.

In the given case, since the statutory auditor did not see the existence and also valuation of the investments held by the investment company the auditor, should not say "Subject to the verification of the existence and value of the investments, the balance sheet shows a true and fair view." In fact, as per facts given in the question, the auditor has not been able to obtain information and might not be able to satisfy himself by adopting other audit procedure and accordingly may have to appropriately modify the report. The auditor may state that because of these circumstances, he has been unable to form an opinion. But, reporting by the auditor that, "subject to verification of the existence and value of the investments, the balance sheet shows a true and fair view", the auditor is not providing information but only means to information.

The situation in this case is ***analogous to London and General Bank's case.*** By reporting in the above manner auditor is not conveying any information. Rather, the auditor is arousing the suspicion of users of financial statements. Section 227(3) requires the auditor to specifically, state whether or not he has obtained all such information and explanation.

Conclusion- If the auditor has not been able to obtain relevant information or explanations, he may have to qualify his opinion on the truth and fairness of the financial statements or express his inability to give an opinion in the matter. Thus the auditor has failed to perform his responsibilities

Note – One auditor must also take care of COE – 2009, Sch. – II, Part – I, Clause – no. 8 and 9

REPORT UNDER SEC. 227(3) (b): The Auditors' Report (A.R) shall state whether in his opinion, proper books of account as required by law have been kept by the Company, & proper returns adequate for the purpose of his audit have been received from Branches not visited by him.

REPORT UNDER SEC. 227(3) (bb): The A.R. shall state whether the Report on the accounts of any Branch Office audited u/s 228 has been forwarded to him as required by Sec. 228(3)(c), & how he has dealt with the same in preparing his report.

REPORT U/S 227(3) (c) : The A.R. shall state whether the Company's Balance Sheet & P & L A/c dealt with by the Repro tae in agreement with the Books of Account & Returns.

REPORT U/S 227(3) (d): The AR shall state whether in his opinion, the B.S. & P & L A/c comply with the Accounting Standards referred to u/s Sec. 211(3C). **(See Practical Problem in Question Related Accounting Standard)**

REPORT U/S 227(3) (e): The AR shall state in **thick type** or in ***italics***, the observations or comments of the Auditors, which have any **adverse** effect on the Company's functioning. **(See Practical problem: 2)**

PRACTICALS:

1. **The Statutory Auditors of Get Well ltd included certain comments in his report u/s 227 of the Companies Act 1956. Since the Company requested the auditors to drop the above comments, as otherwise it will affect their future business, as a compromise the auditor included the comment in the report in ordinary type. Comment.**

As per Sec. 227(3) (e) of the Companies Act 1956, one of the issues relating to audit report is that the report shall indicate in Bold or in Italics the observations as comments of the auditor which have any adverse effect on the functioning of the company. According to the Guidance Note issued clause (e) of the sub-section creates a requirement for the auditor to consider any matter leading to the modification of the auditor's report on financial statements is likely to have an adverse effect on the functioning of the company & if so the auditor is required to highlight such matter in Bold or in Italics.

In the instance case, the auditor's action in having printed certain comments in ordinary type was contrary to the provision of the Act & Guidance Note. He will be deemed to have discharged his duties negligently.

REPORT U/S 227(3)(f): The AR shall state whether any **Direction** is **disqualified** from being appointed as Director u/s 274(1)(g).

2. **Mr. Z, a Director of M/s LM Private Ltd. Is also a Director of another Company M/s O P Private Ltd which has not filed the Annual Accounts & Annual Returns for last 3 years, 2007-2008 to 2009-2010. Mr. Z is of the opinion that he is not disqualified u/s 274(1) (g) of the Companies Act 1956 & Auditor should not mention the disqualification remark in the Audit Report.**

Principle:

a. **Disqualification:** Disqualification u/s 274(1)(g) applies only to appointment or re-appointment as Director in Public Companies & not private Companies. Therefore, Mr. Z is not disqualified u/s 274(1)(g)
b. **Reporting Requirement:** Sec. 227(3)(f) applies to audit of both Public & Private Companies. Even the Auditor of Private Company has to report whether any Director of that Private Company is disqualified from being appointed as Director of any other Public Company.
c. **Conclusion:** Therefore, in the given case, the Auditor need not report on the disqualification of the Director

REPORT U/S 227(3) (g): The AR shall state whether the cess payable u/s 441A has been paid & if not, the details of amount of amount of cess not so paid.

REPORT UNDER SECTION 227(4A)

REPORT U/S 227(4A): The AR shall include a statement on the matters prescribed under the **COMPANIES AUDTIORS' REPORT ORDER (CARO) 2003.**

COMPANIES EXEMPTED FROM APPLICATION OF CARO

Applicability: CARO 2003 applies to all Companies including a Foreign Company as defined u/s 591.

Exceptions: **CARO does not apply** to the following. Classes of Companies:

a. Banking Company as defined u/s 5(c) of the Banking Regulation Act 1949.
b. Insurance Company as defined u/s 2(21) of the Companies Act 1956.
c. Company licensed to operate u/s 25 of the Companies act 1956 and
d. Private Ltd Co's subject to the following conditions:
   - Aggregate of Paid up Capital & Reserves should not exceed ₹ 50 Lakhs.
   - Loan outstanding from any Bank or Financial Institutions should not exceed ₹25 Lakhs.
   - Turnover should not exceed ₹ 5 Crores.

PRACTICALS:

1. A Pvt. Ltd is incorporated on 1st July 2009. During the year ended 31st March 2010, it had issued shares (fully paid up) of ₹ 40 Lakhs had borrowed ₹ 7.5 Lakhs each from 2 financial institutions & its turnover (Net of Excise of ₹ 50 Lakhs which h is credited to a separate account) is ₹ 475 Lakhs. Will CARO be applicable to A Pvt. Ltd.?

Refer to the conditions for exemption of Private Companies.

1. Aggregate of Paid Up Capital & Reserves is ₹ 40 Lakhs (lower than the specified limit of ₹ 50 Lakhs).
2. Total Loan Outstanding = ₹ 7.5 Lakhs x 2= ₹ 15 Lakhs(lower than the specified limit of ₹ 25 Lakhs)
3. If Excise Duty is taken /credited to a separate account, it shall not form part of the Turnover. Hence, turnover for this Company = ₹ 4.75 Crores(lower than the specified limit of ₹ 5 Crores)

Hence CARO **does not** apply to A Pvt. Ltd., since all the conditions relating to exemption are satisfied.

2. T Pvt. Ltd's paid up Capital & Reserves are less than ₹ 50 Lakhs & it has no outstanding loan exceeding ₹ 25 Lakhs from any Bank or Financial Institution. Its sales are ₹ 6 Cores before deducting Trade discount of ₹ 10 Lakhs & Sales Returns ₹ 95 Lakhs. The services rendered by the Company amounted to ₹ 10 Lakhs.

Refer to the conditions for exemption of Private Companies

1. Aggregate of Paid up Capital is less than ₹ 50 Lakhs.
2. Loan from Banks & Financial Institutions is less than ₹ 25 Lakhs.
3. Turnover = (₹ 6 Cores – ₹ 10 Lakhs – ₹ 95 Lakhs) + ₹ 10 Lakhs = ₹ 5.05 Crores (more than the specified limit of ₹ 5 Crores)

Hence, CARO applies to T Pvt. Ltd, since the turnover exceeds ₹ 5 Crores.

3. A Private Ltd reports the following. Position as on 31st March 2010:

Paid Up Capital	**₹ 30 Lakhs**
Revaluation Reserve	**₹ 10 Lakhs**
Capita Reserve	**₹ 1[illegible] Lakhs**
P & L A/c (Dr. Balance)	**₹ 2 Lakhs**

The management of the Company contends that CARO 2003 is not applicable to it. Comment.

As per the Statement on CARO 2003, issued by ICAI, for determining the applicability of the CARO 2003 to a private limited company, both capital as well as the revenue reserves shall be taken into consideration while computing the limit of ₹ 50 Lakhs prescribed for paid up capital & reserves. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose for determining the applicability of the Order. The credit balance in the P & L a/c is available for general purposes like declaration of dividend. The debit balance in the P & L a/c, if any, should be reduced from the figure of revenue reserves only. If the company does not have revenue reserves, debit balance of P & L a/c cannot be reduced from the figures of paid up capital, capital reserve & revaluation reserve.

Accordingly, the P & L a/c (Dr, Balance) of ₹ 2 Lakhs cannot be deducted & hence CARO 2003 is applicable to the Company.

LIST OF MATTERS TO BE REPORTED UNDER CARO 2003

1. **Fixed Assets 4 (i):**
   a. **Adequacy of Records:** Whether or not proper records have been maintained to show full particulars including quantitative details & details about situation of Fixed Assets.
   b. **Verification:**
      - Whether Mgmt of Co. has physically verified the Fixed Assets, at reasonable intervals &
      - Whether material discrepancies observed, if any, on such verification have been suitably dealt with in the books of account.
   c. **Going Concern:** whether the going concern assumption is violate din case of sale of a substantial part of the Fixed Assets.

PRACTICAL:

As a Statutory auditor comment:

Fixed Assets comprising 1/3rd of the Total Assets have been disposed of during the year.

Refer above clause.

The Auditor has to evaluate the appropriateness of Going Concern Assumption in view of the above disposal of Fixed Assets & Report accordingly.

2. **Inventories 4(ii):**
   a. **Verification:** Whether Mgmt has physically verified all the inventories at suitable intervals.
   b. **Adequacy of procedures:** Whether the procedures for physical verification of inventory are reasonable & adequate, having regard to the size of the Company & the nature of its business.
   c. **Adequacy of Records:**
      - Whether the Company is maintaining proper records of inventory and
      - Whether any material discrepancies were noticed on physical verification & if so, whether the same have been properly dealt with in the Books of Account.

PRACTICAL:

As a Statutory auditor of B Ltd, to whom CARO is applicable, how would you report in the following Situation:

Physical Verification of only 50% (in value) of items of stock has been conducted by the Company. The balance 50% will be conducted in next year, due to lack of time & resources.

Refer above clause.

Since Physical Verification has not been carried out adequately, the Auditor should:

1. Point out the specific areas where he believes the procedure of inventory verification is not reasonably adequate.
2. Analyse the impact on Financial Statements & report accordingly.

SK Ltd has fully computerized its accounting operations. The stock records are maintained up to date with timely entries passed for all receipts & issues. The Company has hired a professional security agency, which monitors & implements a close vigilance over the operations of the Company. As such, the Company had dispensed with the practice of taking stock of their inventories as at the year end, as in their opinion, the exercise is redundant, time consuming & intrusion in the normal functioning of the operations.

Refer to above Clause.

The Auditor should report that the Company does not have any system of physical verification of Stock. Further, Stock being a material item in the P & L & B.S., the Auditor should qualify his report on the truth & fairness of F.S.

Comment on the following extracts from the Statutory Auditor's reports on the accounts of Limited Companies indicating with reasons, whether or not the form of reporting complies with the statutory & professional requirements:

"On the basis of examination, the valuation of inventories is fair & proper & in accordance with normally accepted accounting principles & is on the same basis as in the previous year except for some changes in the method of valuation of the inventories of Finished Goods."

Refer above clause.

1. **Analysis:**
   a. **Revised Schedule VI, Clause 3(xv)** requires disclosure of the amount, if material, by which any items shown in the P & L a/c is affected by any change in the basis of accounting.
   b. **AS-2** requires that any change in the accounting policy relating to inventories which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. When there is a change in the accounting policy the amount by which any item in the F.S. is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

2. Conclusion

a. Change in basis of Inventory Valuation amount to change in the basis of accounting. If the effect on profit is material, adequate disclosure should be made in the accounts or notes.
b. The Auditor should ensure such change in method of valuation should be disclosed in the F.S. or in the Notes. Else, he would not have satisfied the statutory reporting requirements.

3. Loans To/From Directors & Interested Parties 4 (iii) (a)

a. **Particulars of Parties:** Has the Company granted any loans, secured or unsecured, to Companies, Firms and other parties covered in the Register maintained u/s 301 of the Act. If so, the number of parties & amount involved in the transactions.
b. **Terms & Conditions:** Whether rate of interest & other terms & conditions of loans given by the Company, secured or unsecured are prima facie prejudicial to the interests of the Company.
c. **Repayment:** Whether receipt of the Principal & the interest amount are regular.
d. **Steps for recovery:** If overdue amount is more than ₹ 100,000 whether reasonable steps have been taken by the Company for recovery of Principal & Interest.

PRACTICAL:

ABC Pvt. Ltd has granted loan of ₹ 20 Crores to XYZ Ltd, a sister concern & it remains outstanding at the year end. How would you report the fact? (PM)

Reporting of loan under CARO 2003 as per Para 4 (iii) : the auditor has to report whether the company has granted any loans, secured or unsecured, to Companies, Firms and other parties covered in the Register maintained u/s 301 of the Act. If so, the number of parties & amount involved in the transactions.: and further as per Para 4(v)(a)" *Whether the particulars of contracts or arrangements referred to in Sec. 301 of the Companies Act 1956, have been entered in the register required to be maintained under the section."*
Hence, in the instant case ABC Pvt. Ltd has granted loan of ₹ 20 crores to XYZ Ltd, a sister concern needs to be reported as per Para 4(iii) & 4(v) (a) of CARO 2003.

Loan Taken (iii) (b)

a. **Particulars of Parties:** Has the Company taken any loans, secured or unsecured, from Companies, Firms or other parties covered in the Register maintained u/s 301 of the Act. If so, the number of parties & amount involved in the transactions.
b. **Terms & Conditions:** Whether rate of interest & other terms & conditions of loans taken by the Company, secured or unsecured are prima facie prejudicial to the interests of the Company.
c. **Repayment:** Whether payment of the Principal & the interest amount are also regular.

4. Internal Control 4 (iv)

a. **Adequacy:** Is there an adequate Internal Control procedure commensurate with the size f the Company & the nature of its business, for the purchase of inventory & Fixed Assets & for the sale of its goods & services.
b. **Correction of Weakness:** Whether there is a continuing failure to correct major weaknesses in Internal Control.

PRACTICALS:

During the course of production, a Company accumulates huge quantity of Scraps & certain By- products. The Scraps are sold by auction & for the sale of By-Products, reasonable records are maintained but no records are maintained for recording the generation of Scraps & By-products & accordingly not being satisfied with the state of affairs, you want to qualify your report. But Mgmt views that under CARO, the Auditor is not required to report about maintenance of records in connection with generation of Scraps & By-Products. Comment on the view of the management.

1. **CARO Requirements:** The following. Reporting requirements of CARO are relevant in this regard:
   a. **Internal Control 4(iv):** Refer to above clause.
   b. **Cost Accounting Records:** Refer to **Cl. 4(viii)**
   c. **Fraud:** Refer to
2. **Observations:**
   a. Since the quantum of Scrap & By-Products is considerable, it appears that maintenance of records for

generation as well as records for sale of Scrap/By-Products is necessary, but the Company has not maintained such records.

b. The Auditor has to consider the non-maintenance of records for Scrap & By-Products in the light of:
   - Effectiveness of internal control system
   - Compliance with Cost Accounting(Records)Rules where applicable and
   - Possibility of frauds in relation such Scrap & By-Products.

c. Hence, the Auditor will have to issue an adverse comment on non-maintenance of reasonable records for sale of Scrap-By-Products & decide on the aspect of records on generation, on the basis of facts& circumstances of the case.

Purchases of Raw Materials by a business were supported by invoices, challans & receipts of suppliers. Invoices were authorized by the Purchase Manager & payments were made to suppliers by account payee" cheques". After the accounts were audited, it was discovered that the raw materials were purchased at inflated prices resulting in a loss of ₹ 3 Lakhs to the business. Will the Auditor be held liable in this connection?

1. **CARO Requirements:** In the above case, the purchase of materials have been documented by invoices, challans acknowledging actual supply, payment by account payee cheques & valid receipts from suppliers. It is also observed that the Auditor has verified the purchase transactions, the Auditor's reporting duties in this regard under CARO involve the following:
   - **a. Internal Control:** Refer **Cl. 4 (iv)**
   - **b. Transactions covered by Sec. 302: Refer Sec. 4 (v)**
   - **c. Fraud:** Refer **Cl.4 (xxi)**
2. **Auditor's Duties:**
   - **a.** The Auditor had examined the Company's Internal Control System in relation to purchases.
   - **b.** In case of transactions with parties listed u/s 301 of the Act, the Auditor is required to verify the reasonableness of prices having regard to the prevailing market prices.
   - **c.** The Auditor is also required to examine whether there has been any fraud detected/noticed/reported in relation to purchases.
3. **Conclusion:** If the Auditor has properly examined all these & also had satisfied himself about compliance of these in placing orders for purchase of Raw Materials, he will **not** be liable for the excess price paid. However, if he has not exercised due care & diligence in the performance of his duties, he may be guilty of negligence.

5. **<u>Transactions covered by Sec. 301 4(v)</u>**
   - **a. Records:** Whether the particulars of contracts or arrangements referred to u/s 301 have been entered in the Register to be maintained under that section.
   - **b. Reasonability:** Whether transactions made in pursuance of these contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. (This information is required only in case of transactions exceeding the value of ₹ 5 Lakhs in respect of any party & in any one financial year.

6. **<u>Deposits from Public 4 (vi):</u>** If the Company has accepted Deposits form public, whether the following Are complied with:
   - **a.** Directives issued by RBI.
   - **b.** Provisions of Sec. 58A & 58AA or any other relevant provision of Companies Act.
   - **c.** Rules framed u/s 58A& 58AA or any other relevant provision of the Companies Act 1956.
   - **d.** Orders, if any, passed by the Company Law Board/NCLAT/RBI /Any Court/Tribunal.
   - **e.** The nature of contraventions, if any, should be stated in the Report.

PRACTICALS:

A Public Company defaulted in the repayment of deposits together with interest on the due date or more than a year & the Chief Accountant contends that the Auditor need not report on the default committed by the Company. Give your views on the above.

Refer above Clause.

In view of the above, the auditor should report on default committed by the Company.

Discuss the reporting requirements under the Companies (Auditor's report) Order 2003, where a company has defaulted in compliance of sec. 58AA of the Companies Act 1956 with regard to public deposits.

Ref. above clause.

Sec. 58AA deals with small depositors. As per this, a small depositor means a depositor who has deposited during a financial year a sum not exceeding ₹ 20,000/- This section requires compliance of certain matters by the company.

Non compliance of Sec. 58AA occurs where company fails to intimate company law board, any default in repayment of deposit by s mall depositors or part thereof or any interest thereupon. The auditor has therefore, to first determine whether there is any default in repayment of such deposits, when number of depositors are large, it may not be possible for an auditor to verify each repayment. In such situation, he should examine internal control system. He should obtain schedule of repayment to small depositors & should make reasonable test checks of repayments made by the company. If during test check, default in repayment is noticed, he should see whether the same has been intimated to Company Law Board.

7. **Internal Audit 4(vii):** Having regard to their size & nature of business, the Auditor should Report whether or not the following. Companies have an Internal Audit System:
   - **a.** Listed Companies.
   - **b.** Companies having Paid-up Capital & Reserves exceeding ₹ 50 Lakhs as at the commencement of the F.Y. concerned.
   - **c.** Companies having an Average Annual Turnover exceeding ₹ 5 Crores for a period of 3 consecutive F.Ys immediately preceding the F.Y concerned.

PRACTICALS:

JKT Ltd having ₹ 40 Lakhs Paid Up Capital, ₹ 9.50 Lakhs Reserves & Turnover of last three consecutive financial years immediately preceding the financial year under audit, being ₹ 4.90 Crores, ₹ 4.50 Crores & ₹ 6 Crores. But does not have any internal audit system. In view of the management, Internal Audit system is not mandatory. As an Auditor comment on the above.

You are the Statutory Auditor of a Limited Company engaged in the manufacture of chemicals. The Company has a turnover exceeding ₹ 5 Crores for a period of three consecutive financial years immediately preceding the F.Y concerned, but does not have an internal audit system. Give your views.

Refer above Clause.

Analysis: The Aggregate of Paid Up Capital & Reserves of the Company is ₹ 49.50 Lakhs (within the limit of ₹ 50 Lakhs). However, the Average Annual Turnover is ₹ 5.13 Crores and hence the above reporting clause is attracted.

Auditors' Duties: The Statutory Auditor should enquire whether the Company has an Internal Audit System commensurate with its size & nature of its business. The con-existence of the Internal Audit System will mean that more substantive audit procedures are required since the efficacy of internal control system would itself be questionable.

Conclusion: CARO does not mandate the above classes of Companies to compulsorily have an Internal Audit System. Hence, the Management's view that the Internal Audit is not mandatory is correct. However, the Auditor is required to report the fact that the Company does not have any internal audit system, under CARO Reporting requirements.

2.Comment on the following extract from the Statutory Auditor's reports on the accounts of Limited Companies indicating with reasons, whether or not the form of reporting complies with the statutory & professional requirements:

"Because the Company has an adequate system of Internal Control, it has not considered it necessary to

establish an internal audit system, even though its Paid up Capital exceeds ₹ 50 Lakhs."

Refer above Clause.

Analysis: CARO does not require such Companies to have an Internal Audit System. However, the Auditor's Reporting is not contingent upon existence or adequacy of the internal control system. This is a statement of act, i.e. whether the Company has an Internal Audit System. The Auditor need not/ should not justify the non-existence of the Internal audit system.

Conclusion:

A. The auditor has brought out the fact that no system of Internal Audit exists in the Company. Hence, the basic reporting requirement may be considered to have been satisfied both from statutory angle & professional duty angle.

B. However, he could have avoided the justification for non-existence by giving reasons such as adequacy of internal control.

PQR Ltd. a Listed Company & having an average annual turnover of more than ₹ 5 Crores has not Internal Audit System. Give your views.

Refer above Clause.

The Clause has a mandatory application in respect of listed companies irrespective of the size of paid-up capital & reserves or turnover. For other companies, it is applicable if either of the following Conditions are satisfied:

a. The Company has a paid-up capital & reserves exceeding ₹ 50 Lakhs at the commencement of the F.Y. or
b. The Co. has an average annual turnover of ₹ 5 Crores or more for a period of 3 consecutive financial years immediately preceding the F.Y. concerned.
c. **Conclusion:** In the above case, PQR Ltd is a listed company & having an average annual turnover of more than ₹ 5 Crores. Hence the auditor will have to mention in his report the fact of not having such internal audit system by the Company.

8. **Cost Accounting Records 4 (viii):** If the CG had prescribed maintenance of Cost Records u/s 209(1)(d), whether or not such accounts & records have been prepared & maintained properly.

9. **Statutory Dues 4 (ix):**
   a. Is the Company regular in depositing Undisputed Statutory Dues e.g. Provident Fund, Investor Education & Protection Fund, Employees' State Insurance, Income Tax, Wealth Tax, Service Tax, Sales Tax, Customs Duty, Excise Duty, Cess & any other statutory dues with the appropriate authorities?
   b. If not paid regularly, the extent of the arrears of outstanding statutory dues as at the last day of the F.Y concerned for a period of more than 6 months from the date they became payable, shall be indicated in the Report.
   c. If such non-payment of dues is on account of any dispute, then the amount involved & the forum where the dispute is pending should also be mentioned.

PRACTICALS:

ABC Ltd has not deposited P.F. Contributions of ₹ 20 Lakhs to the authorities, but accounted in the books. Comment on the above.

1. **Accrual:** P.F. contributions should be accounted in the books on accrual basis, whether paid or not. As per Sec. 209(3) a Company has to maintain proper books of account on accrual basis of accounting.
2. **Companies Act:** Under Sec. 227(3)(d) the Auditor shall state whether the Balance Sheet & the P & L A/c comply with the Accounting Standards u/s 211(3C).
3. **CARO Requirements: Note:** Refer to ***Clause 4 (ix).***
4. **Conclusion:** In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary in view of CARO requirements. The Auditor should disclose the fact of non – payment of ₹ 20 Lakhs in his Report.

A Company having several depts. with separate payrolls & where payments of wages are spread over several days makes lump-sum deposits of estimated amounts of P.F & Employees State Insurance dues & adjusts the excess or deficit against the following month's deposit. Comment on the above.

Caro Requirements: Refer above clause.

1. In case of a large Company where there are a number of depts.. With separate payrolls & where payments are spread over a number of days, the collection of data reg. the PF/ESI collection & the Company's contribution thereto may take some time.
2. To avoid delayed payments, the Company makes lump sum deposits of estimated amounts & adjusts the excess or deficit against the following Month's deposit.
3. If this method is consistently followed & the difference between the total dues & the lump sum deposit is not material, it can be deemed as regularly deposited & hence, no adverse comment is necessary.

During the course of audit of ABC Ltd, it is noticed that out of ₹ 12 Lakhs of PF Contribution accounted in the books, only ₹ 2 Lakhs has been remitted to the authorities during the year. On enquiry, the Chief Accountant informed that due to financial problems they have not remitted but will remit the same as &when the position improves. As a Statutory Auditor, how would you deal with the above situation?

Refer above clause.

Company's Default & auditor's Duty: In the given case, the Company has not complied with the reqts. Also deposit of PF contributions, to the tune of ₹ 10 Lakhs. Financial problems do not constitute sufficient reason for non-compliance. Hence, the Auditor shall report the non-compliance under Clause 4(ix) if CARO in his report.

Big & Small Ltd received a show cause notice from central excise dept. intending to levy a demand of ₹ 25 Lakhs in December 2010. The company replied to the above notice in January 2011 contending that it is not liable for the levy. No further action was initiated by the central excise dept upto the finalization of the audit for the year ended on 31st March 2011. As the auditor of the company, what is your role in this?

As per Para 4(ix)(b) of CARO 2003, : (State Clause)

Conclusion: In the present case issuance of show cause notice by Excise Dept. does not tantamount to demand payable by the Company. In as much as the Company has replied to the notice & no further correspondence was received from the Dept., it has to be construed that there is no demand. The auditor need **not r**eport on this.

XYZ Pvt. Ltd. has submitted the F.S. for the year ended 31.3.11 for audit. The audit assistant observes & bring to your notice that the company's records show following Dues:

a. **Income Tax relating to A.Y.2007-08 ₹ 125 Lakhs. Appeal is pending before Hon'ble ITAT since 30.9,09.**
b. **Customs duty Rs ₹ Lakhs- Demand Notice recd on 15.9.10 but no action has been taken to pay or appeal. As an auditor, how would you bring this fact to members?**

a. State clause 4 (ix) (b) of CARO: *"In case dues of IT/ST…….*

The auditor should also obtain a management representation about the disputed dues, the amounts involved & the forum where the dispute is pending. The auditor should carry out necessary audit procedures to verify the information provided by management.

The Information may be reported in the Statement of Disputed Dues as nature of the dues, amounts, period which the amount relates & forum where dispute is pending.

In the present case, there is Income Tax demand of ₹ 125 Lakhs & the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax Authority is without any basis. Therefore, as per AS-29 partly to the ex tent the company considered that the demand is based on some logical basis, that amount may be provided for & the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of members by reporting under Para 4(ix) (b) of CARO 2003 as per the requirement mentioned therein.

b. As per Para 4(ix)(a) the auditor has to report upon the regularity of the company in depositing undisputed statutory dues including PF…….. If Company not regular Auditor has to state the extent of arrears of statutory dues which have remained unpaid…….

With reference to the regularity, in case of custom duty on import of goods or demands arising on account of assessment orders etc,, which a company is required to pay as & when an event giving rise to the liability of the company occurs. Such dues should be construed to have been paid regularly if the company deposits them as & when they become due. However, the auditor should be required to comment upon the regularity of the company in depositing the installments, if any, granted by an authority in respect of a demand against the company.

In the above case, the demand note has been recd for Custom Duty of ₹ 85 lakhs on 15.9.2010 & is outstanding for more than 6 months, for which no action has been taken by the mgmt, leads to the irregularity which should be brought to notice of members by reporting under Para 4(ix)(a) of CARO 2003.

10. **Loss Making Companies 4 (x):** In case of a Company which has been registered for a period not less than five years, the following Should be reported:

- **a.** Whether the Accumulated Losses at the end of the relevant F.Y exceeded 50% of the Company's Net Worth
- **b.** Whether the Company has incurred Cash Losses in the immediately preceding F.Y.

PRACTICAL:

As the Statutory Auditor of B Ltd, to whom CARO is applicable how would you report the following situation?

Acc. Losses of the Company are 50.9% of its Net Worth & it is incurring continuous losses since last 2 years.

Refer to Clause above.

Assuming that the Company is in existence for more than 5 years, the Auditor should report:

a. Whether the accumulated losses at the end of the year are more than 50% of its net worth and

b. Whether it has incurred cash losses during the current year & the immediately preceding F.Y.

In the above case, since the company is covered by the above requirements, there are symptoms of potential sickness & thus, auditor should report the same.

11. **Repayment of Dues (4 (xi):**

a. Has the Company paid the Principal and Interest due to Financial Institutions Banks or Debenture holders without default?

b. In case of default, the period & the amount of default shall be reported.

PRACTICAL:

OK Ltd has taken a term loan from a nationalized bank in 2006 for ₹ 200 Lakhs repayable in five equal installments of ₹ 40 Lakhs from 31st March 2007 onwards. It had repaid the loans due in 2007 & 2008, but defaulted in 2009, 2010 & 2011. As the Auditor of OK Ltd, what is your responsibility assuming that company has sought reschedulement of loan?

As per Para 4 (xi) of CARO:

Conclusion: In this case, OK Ltd has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position. Hence the auditor has to report in his audit report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 Lakhs.

12. **Loans against Securities 4(xii)**

- **a.** If the Company has advanced or granted loans/advances against security by way of pledge of Shares, Debentures & other securities, proper & adequate documents & records are to be maintained.
- **b.** Where there are deficiencies in the maintenance of records, the same should be reported by the auditor.

13. **Chit/Nidhi/Mutual Benefit fund/Societies 4 (xiii):** Whether or not provisions of any Special Statute applicable to Chit Fund have been duly complied with in respect of Nidhi/Mutual Benefit Fund/Societies-

a. Whether Net-Owned funds to Deposit Liability ratio is more than 1:20 as on the B.S. date.

b. Whether the Company has complied with the prudential norms on Income Recognition & provisioning against Sub-Standard /Doubtful /Loss Assets.

c. Whether the Company has adequate procedures for appraisal of credit proposals/ requests, assessment of credit needs & repayment capacity of the borrowers.

d. Whether the repayment schedule of various loans granted by the Nidhi is based on the repayment capacity of the borrower.

PRACTICAL:
The business of CRY Ltd, a Chit Fund Company, also consisted of granting of Loans & Advances on the basis of security of Shares & Debentures. As an Auditor, how do you satisfy yourself about the adequacy of documents & records?

1. **Clause 4(xii) of CARO** requires the Auditor to state whether or not provisions of any Special Statute applicable to Chit Fund have been complied with.
2. **Verification:** As part of his regular audit, the Auditor is required to examine & report whether adequate documents & records are maintained in case of Chit Fund Company which has granted loans & advances on the basis of security by way of pledge of shares & debentures. The adequacy of records depends upon the nature of the security & the party to whom the loan or advance has been granted.
3. **Physical Inspection:** The Auditor should conduct physical verification to ensure that the securities are in the custody of the Company & that the market value of the securities is adequate to cover the outstanding amount of loan & interest due.

14. **Companies Dealing in Securities 4 (xiv):** Where the Company is dealing or trading in Shares, Securities, Debentures & other investments, whether:
    a. Proper Records have been maintained of the transactions & contracts
    b. Timely entries have been made therein.
    c. Shares, Securities, Debentures & Other Investments have been held by the Company in its own name except to the extent of the exemption, if any, granted u/s 49 of the Act.

PRACTICAL:
As a Statutory auditor how would you report on the following under CARO – 2003?
O Pvt. Ltd is a dealer in Shares & Securities.

Refer above clause.

Based on his examination of records, if the Auditor is satisfied in respect of the matters specified in the above clause, he may report as under:

" In our opinion and according to the information & explanations given to us, the Company has been maintaining proper records in respect of transactions & contracts in securities during the year under audit, & timely entries have been made therein Further, all Shares & Securities are held by the Company In its own name."

15. **Guarantees Given(4 (xv):** Where the Company has given any guarantee for loans taken by others from Bank or Financial Institutions, whether or not the terms & conditions thereof are prejudicial to the interest of the Company.

PRACTICAL:
As the Statutory Auditor of B Ltd, to whom CARO is applicable, how would you report the following?
The Company has stood guarantee to its sister concern, whose financial condition was not healthy, for a sum of ₹ 20 Lakhs borrowed from a Bank.

1. Examine the MOA to determine whether the Co. has the power to give guarantee.
2. Verify the Minutes Book & Register of Guarantee, to confirm whether the guarantee has been sanctioned by the competent authority.
3. See whether the requirements of Sec. 295 & 372A are complied with.
4. Confirm whether the Guarantee given, has been disclosed as a **Contingent Liability.**
5. Consider the financial standing of the party, nature of security offered etc, in determining whether the guarantee is prejudicial to the Company's interests.
6. Since the financial condition the Sister Concern is not good, express the opinion that: *"The terms & conditions of the guarantee of ₹20 Lakhs, given for loans taken by M/s…… (sister concern) from M/s………Bank, are prejudicial to the interest of the Company."*

16. **End Use of Borrowings 4 xvi):** Whether or not Term Loans are applied for the purpose for which such loans were obtained.

PRACTICAL:

As a Statutory auditor comment:
A Term Loan was obtained from Bank for ₹ 75 Lakhs for acquiring R & D Equipment, out of which ₹ 12 Lakhs was used to buy a car for use of the concerned Director, who was overlooking the R & D activities.

The Loan is for R & D Equipment and not Car. Hence, the Auditor shall report that the Term Loans were not applied for the purpose for which they were obtained.

17. **Application of Funds 4 (xvii):**
    - **a.** Whether the Short Term Funds have been applied for Long Term Investment.
    - **b.** If such application is made, the nature & the amount involved should be indicated in the Audit Report.

18. **Preferential Allotment 4(xviii):**
    - **a.** Whether the Company has made any preferential allotment of shares to parties & companies covered in the Register maintained u/s 301 of the Act.
    - **b.** If preferential allotment has been made, whether the issue price of such shares is prejudicial to the interest of the Company.

19. **Securities for Debentures issued 4 (ix):** Whether or not adequate security or charge has been created in respect of debentures issued.

20. **End use of issue proceeds 4 (xx):**
    - **a.** Whether the end use of money raised by the Public Issue has been adequately disclosed by the Management of the Company.
    - **b.** Whether such end use & disclosure has been verified.

PRACTICALS:
What are the reporting requirements in CARO in respect of money raised by Public Issues?

Refer above clause.

1 **CARO Requirements:** The auditor is expected to verify & report whether the end use of moneys rose by way of pubic issues have been properly reported/disclosed.

2. **Revised Schedule VI Requirements:** Only unutilized amount of any public issue made by the Company should be disclosed in the F.S. CARO reporting requirement. Envisages that the Company should disclose the end use of money raised by the Public Issue, in the F.S. , by ways of Notes, & the Auditor should verify the same.

3. **Auditors' Duties:**
   - Should obtain representation from Mgmt, as to the completeness of the disclosure with regard to the end-use f the moneys raised by Public Issues.
   - If auditor opines that adequate disclosure has not been made in this regard, he should state the fact in the Audit Report, as reqd. by CARO.
   - If for any reason, he is not able to verify the end use of moneys raised, he should state that he is not able to comment upon the disclosure of end use of moneys raised by the Company & mention the reasons for inability to verify the same.

X Ltd, to whom CARO is applicable, has issued 9% Debentures of ₹ 5 Cores, redeemable after 5 years & used the proceeds of issue or payment of Sundry Creditors & other Current Liabilities of ₹ 2.80 Crores. As an Auditor, comment on the above.

Refer above Clause & Clause 4(xvi)

1. **Terms of Issue:** The Auditor must see whether the Terms of issue of Debentures contain any specific purpose/ project for which the funds raised will be utilsied.
2. **Analysis:** If the terms of issue specify the end use/ purpose of utilization of proceeds of Debentures Issue, the payment of Sundry Creditors & Current Liabilities will not be proper.
3. **Conclusion:** In such a case the Auditor has to report that:
   a. Term Loans have been utilised for purposes other than for which such loans were obtained.
   b. End Use of money raised by way of Debentures Issue has not been properly disclosed by the Company.

21. **FRAUD 4 (xxi):**

a. Whether any fraud on or by the Company has been noticed or reported during the year.
b. Where any fraud is noticed & reported, the nature

PRACTICAL:
As a Statutory Auditor how would you report on the following Under CARO
ABC Pvt. Ltd is a manufacturer of jewellery. A Senior Employee of the Company informed you that the Company does not disclose the purity of gold used on the jewellery.

Refer Clause above.

If purity of gold is not properly disclosed on the jewellery, it amounts to defrauding of customers by the Company's Management, in order to obtain an illegal advantage. However, this does not create any material Mis-statement in the F.S., &hence the Auditor is not concerned with the same.

Purity of Gold may have an impact on valuation of inventory, but the auditor is not required to comment & report on the valuation of inventory under CARO.

As long as the books of account are not falsified arising out of the difference in the purity of gold, the actual cost of gold & sale price thereof, there is no implication for Mis-statement in the F.S. In such cases the Auditor need not report on non-disclosure of purity of gold on the jewellery.

PRACTICALS:
An old car of a Company having a nominal book value has found a buyer, who is willing to pay ₹ 1 Lakh for it. The Company proposes not to sell the car, but neglect its valuation in its accounts at ₹ 1 Lakh should he Auditor permit the Company do so?

1. Fixed Assets should be stated at Historical Cost net of depreciation thereon. They should not be valued on the basis of **Net Realisable Value.**
2. This view is in accordance with:
   a) Generally accepted accounting principles
   b) As-10 and
   c) The disclosure requirements of Revised Schedule VI to the Companies Act, 1956.
3. Since the intention of the Company is not to sell the car, the asset should be stated at its Book Value only, however nominal it may be. The accounting treatment given by the Company is **correct.**

X Ltd did not follow the applicable Accounting Standard for disclosing Earnings Per Share (EPS) in the Financial Statements. The fact of such non-disclosure was, however, mentioned in the notes forming part of accounts. As the Statutory auditor of X Ltd, how would you report the above case?

Disclosure of EPS is required for all companies as per AS 20"Earnigns per Share". AS-20 is also one of the AS notified by the Companies (Accounting Standards) Rules 2006. If he disclosures required by AS-20 are not made, it is the duty of the auditor to qualify in his report "*Whether Accounting Standards under the clause as noticed u/s 211(3C) have been followed?*" Mere disclosure by company in notes does not absolve him of his duty.

The same is however not a qualification to affect the "True & Fair" position of financial results of the company.

BRANCH AUDIT

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

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

1.	General Meeting	The decision to appoint any person other than the Company Auditor as Branch Auditor should be taken at a General Meeting.
2.	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.

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

Rights of Company Auditor [Sec.228 (2)]

Company Auditor shall have the following rights when the Branch Accounts are audited by another person:

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

3. 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.

Exemption from Branch Audit under Companies Act

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 (MPT)*** 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)	₹ 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.

Meaning of certain terms			
S. N.	***Terms***		***Meaning***
1.	***Quantum of Activity***		***Quantum of Activity is defined as the highest of the following:***
		i)	The aggregate value of goods produced, manufactured or processed.
		ii)	The aggregate value of goods sold and services rendered.
		iii)	The amount of expenditure, whether of revenue or capital nature, incurred by the branch office.
2.	***Average quantum of activity***		'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's 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***	'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

Grounds for exemption – The exemption may be given on any of the following grounds		
S.N.	**Grounds**	**Conditions**
1.	***Proper scrutiny and check available***	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.***
2.	***Audit of accounts is done by a qualified person (who is employee)***	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***:
	Conditions	
.a)	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.	
b)	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.	
c)	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.	
d)	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.	
e)	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.	

3.	***Cost of Branch Audit***	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.
4.	***Other Reasons***	That for any other reason, the Central Government is satisfied that exemption may be granted

Condition to be fulfil for exemption for in other cases	
1.	The exemption may be given for a specified period and subject to certain conditions.

2.	If terms and conditions of the exemption are not complied with, the exemption may be withdrawn by the Central Government.
3.	The exemption order shall be given to the auditor of the company and shall also be read at the next general meeting.

Special Audit u/s 233A

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.

S. N.	Aspects	Particulars
1.	**Circumstances in which special audit may be ordered**	May be ordered by Central Government if it forms an opinion as to the existence of any of the following circumstances
		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.	***Power 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 arrears of land revenue.

Accounts of Company

Section 209: BOOKS OF ACCOUNTS TO BE KEPT BY THE COMPANY

1. Books of accounts to be kept

- Details regarding Receipts / Payments of cash
- Sales / purchases of goods by the company
- Assets / liabilities of the company
- Cost records – if required by the Central Government.

2. Venue

Should be kept at the ***Registered Office.*** If BOD decides to keep books at any other place in India it can do so, but a notice to Registrar in writing should be given within 7 days of its decision to do so ***(Form No. 23AA)***

3. Branch books

- Can be kept at their respective offices.
- But proper summarised returns of branch transactions should be sent to registered office at reasonable intervals. But such interval shouldn't exceed more than 3 months.

4. No proper books deemed to have been kept if

- Double entry system and Accrual basis of accounting is not followed and
- True & fair view not reflected.

5. Directors can inspect "Books of account and other books and papers" during business hours.

6. Preservation of Books of account

Company	
In existence for 8 years or more	***Not in existence for 8 years***
Books and related & vouchers relating to 8 preceding years.	Books & related vouchers of all years.

7. Person responsible for Sec 209 compliance: -

- Manager
- Managing Director
- All other officers / employees / agents of the company. *(Does not include Auditors, Bankers and Legal advisers)*
- If the company has no manager / MD, then every Director of the company.

Section 209A: INSPECTION OF BOOKS OF ACCOUNTS OF COMPANY

(I) Who are all entitled to inspect:

- ✓ ROC
- ✓ Officer authorized by central government

- ✓ Officer authorised by SEBI [inspection only with respect to matters provided u/s 55A]

Note: These persons can inspect without previous notice.

(II) Assistance to persons inspecting

(a) Form of assistance

- Providing them with all books of accounts & other papers.
- Furnishing any statement, information or explanation with respect of affairs of the company.
- Any other assistance.

(b) Who shall give assistance?

- Every director
- Other officers / employees of the company

(III) Powers of person inspecting: -

- ✓ Take copies of such books etc.
- ✓ Place identification marks thereon (as a token of inspection)
- ✓ All powers that a civil court have.
- ✓ All powers, which ROC has under this act to make inquiries.

(IV) The Inspector should make a report to Central Government and in case of person appointed by SEBI, he should report to SEBI.

(V) Violation of Sec. 209A by a director leads to vacation of office and is disqualified for appointment as a director for 5 years in any other company.

Section 210: ANNUAL ACCOUNTS & BALANCE SHEET

- ☞ Balance sheet & Profit and loss account should be laid before every AGM.
- ☞ In case of non-profit organization, "Income and Expenditure account" should be laid in the place of profit and loss account.
- ☞ Period of financial statement:

  In case of 1st AGM: From Date of Incorporation up to a date, this doesn't precede the AGM by more than nine months.

  Subsequent AGM's: Financial year

Note: **The end of financial year shall not precede the date of AGM by more than more six months. [Extension from ROC by three months possible]**

I) ***Financial year***

- ☞ Can be less than 12m
- ☞ Can be more than 12m
- ☞ But shall not exceed 15m ***[ROC can give extension up to 18m]***

Section 211: FORM & CONTENTS OF BALANCE SHEET AND PROFIT & LOSS A/c

I) ***Revised Schedule VI part I & II compliance necessary with respect to B/S & P&L***

Exemption to:

- ✓ Banking Company
- ✓ Insurance company
- ✓ Electricity Company
- ✓ Any other company having specific form of B/S & P&L a/c, specified by act governing it.

II) *Central Government has got Power to exempt compliance of any of the requirement of revised schedule VI by notification in official gazette.*

Note:

- ✓ CG can exercise such power only in public interest.
- ✓ Exemption may be conditional / unconditional.

III) *Compliance of Accounting Standards [Relevant provisions Sec.211 (3A) (3B) (3C)]*

Accounting Standard means Accounting Standard prescribed by National Advisory Committee on Accounting Standards. Till such committee prescribes AS, AS issued by ICAI is applicable.

If AS is not complied the following disclosure in financial statement is necessary:

- ✓ The fact of deviation from AS.
- ✓ Reasons for such deviation.
- ✓ Financial effect of such deviation

IV) *Modification of Requirements of The Companies Act With respect to Financial Statement Possible*

- ✓ On an application by BOD to CG.
- ✓ Suo moto modification by CG with BOD consent.

V) ***Non-disclosure of certain matters required by Schedule VI, if not required by the following acts, will not affect true and fair view shown by financial statements:***

Companies	**Act**
Insurance company	Insurance act 1938
Banking company	Banking companies act 1949
Electricity company	Electricity supply act 1948
Any other company	Special Acts governing that company

VI) ***Financial statement include Notes to accounts.***

VII) *Penalty for default in form and contents of Annual Accounts.*

Imprisonment for a term which may extend to 6 months, or Fine which may extend to Rs. 10,000/- or both.

Section 216: ANNEXURES AND ATTACHMENTS

Profit and loss account is an annexure to Balance sheet and Auditor's report is an attachment.

Section 218: PENALTY FOR CIRCULATION OR PUBLICATION OF FINANCIAL STATEMENTS IN CERTAIN CASES

A company shall not circulate financial statements

- ☞ Which are not authenticated under Section 215•
- ☞ Which are not accompanied by its annexures and attachment

If it does so it is liable to penalty, which may extend to five thousand rupees.

Section 222: CONSTRUCTION OF REFERENCES TO DOCUMENTS ANNEXED TO ACCOUNTS

1) If any information is required by this act to be given in accounts & is allowed by it to be given in a statement annexed to the accounts, such into may be given in Board's report.

2) Such portion of Board's report should be treated as annexure to the account and shall be the subject matter of audit report.

Joint Audit

Responsibility of Joint Auditors – SA 299

1. Division of Work

- Where joint auditors are appointed, they should, by mutual discussion divide the audit work among themselves. The division of work would usually be in terms of audit of identifiable units or specified areas. In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time. Certain areas of work, owing to their importance or owing to the nature of the work involved, would often not be divided and would be covered by all the joint auditors.

2. Coordination among Joint Auditors

- Where a company auditor comes across matters, which are relevant to the areas of responsibility of their joint auditors, he should communicate it immediately to the other joint auditors to discharge himself of the responsibility.

3. Relationship among Joint Auditors

- In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –

  a) In respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

  b) In respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;

  c) In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

  d) For examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and

  e) For ensuring that the audit report complies with the requirements of the relevant statute.

- In case the information is brought to the other joint auditors by an auditor after submission of the audit report, the other joint auditors would not be responsible for such matter.
- Each joint auditor is responsible for drafting his own audit programme and determines nature, extent of checking etc.
- Each joint auditor should keep appropriate working papers, which enables him to come to a conclusion regarding the financial statements.
- In the case of audit of a large entity with several branches. In such a case, it is the separate responsibility of each joint auditor to review the reports of the branches allotted to him and to ensure that they are properly incorporated into the accounts of the entity.
- In respect of branches, which do not fall under any division or zones, which were separately assigned to different joint auditors, they may agree among themselves regarding the division of work relating to such branch returns.

- Each joint auditor is entitled to rely upon the work carried by other joint auditors. It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests to ascertain whether the work has actually been performed in accordance with generally accepted audit procedures.
- If one of joint auditors also carries out the audit of branches or other division of the entity, the joint auditors are entitled to rely upon the work carried out by him, unless the other joint auditor specifically brings out any material discrepancy.

4. Reporting Responsibilities

- Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report.
- A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

Dividend and Deprecation

Dividend to be paid only out of profits – Section 205(1)

☞ ***Dividend can be declared or paid by a company for any financial year only out of —***

(a) Its profit for that year, arrived at after providing for depreciation as per Section 205(2); or
(b) Its profits for any previous financial year or years, after providing for depreciation as aforementioned and remaining undistributed; or
(c) Out of both of above (i.e. balances of profits mentioned in (a) and (b) above); or
(d) Out of moneys provided by the Central or State Government for payment of dividend pursuant to the guarantee given by the government.

☞ ***Depreciation to be fully provided for***

If the company has not provided for depreciation for any previous financial years, it shall before declaring or paying dividend for any financial year provide for such depreciation out of the profits of that financial year or out of the profits of any other previous financial year or years.

☞ ***Unabsorbed Depreciation or Loss brought forward to be adjusted***

If the company has incurred any loss in any previous financial year or years, then,

- ✓ The amount of the loss or
- ✓ An amount which is equal to the amount provided for depreciation for that year(s)
- ✓ Whichever is less,

Shall be set off against

(1) The profits of the company for the year for which dividend is proposed to be declared or paid or
(2) Against the profits of the company for any previous financial year or years, arrived at in both cases after providing for depreciation.

☞ ***Dividend without providing for Depreciation***

The Central Government may, if it thinks necessary so to do in the public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year or years without providing for depreciation:

Transfer to Reserves – Section 205(2A)

☞ No dividend shall be declared or paid by a company for any financial year out of profits of that company for that year, after providing of depreciation in accordance with the provisions of Section 205(2), except after the company has transferred to the reserves of the company of such percentage of its profits for that year, as may be prescribed but not exceeding 10%.

% of profit to be transferred as per Companies (Transfer of Profits to Reserve) Rules, 1975

Rate of Dividend	*Minimum % of profits required to be transferred to reserves*
Upto 10%	NIL
> 10% upto 12.5%	2.5% of current profits
> 12.5% upto 15%	5% of current profits
> 15% upto 20%	7.5% of current profits

Exceeding 20%	10% of current profits

Notes:

1. Profits referred to above are profits after providing for current as well as arrears of depreciation.
2. The profits should be after tax.
3. The profits for the above purpose are arrived at after debiting for Statutory Development Reserve.
4. Rates of dividend referred to above relate to rates of equity dividend and portion of dividend in excess of fixed rate of dividend in respect of participating preference shares.
5. The reserves referred to are only free reserves and do not include transfer to capital or any specific reserve.
6. There shall be no bar on a company if it voluntarily transfers a higher percentage of profits to reserves, provided the rate does not exceed 10%.

Transfer to reserves in excess of 10%

☞ There is no bar on companies for transferring profits to reserves in excess of 10%. If the company wishes to transfer an amount more than 10% of its profits, it shall have to further comply with the following conditions laid down in the Companies (Transfer of Profits to Reserve) Rules, 1975.

Case	Condition
Company proposing higher % transfer to reserves and simultaneously contemplating ***declaring dividend***	1. Rate of dividend proposed is not less than ***average rate*** of dividend declared in the preceding 3 Years. **OR** 2. If there was a ***bonus issue*** of shares in the relevant year or nay of the 3 immediately preceding years, the amount of proposed dividend for the relevant year should be at least equal to the ***average amount (quantum)*** of dividend declared in the immediately preceding three years. **OR** 3. However, if the ***net profit after tax for the year is lower than 20%*** of the average profit after tax for the immediately 2 preceding years, the company need not maintain the above referred rate/amount of dividend and company is free to transfer any amount to reserves.
Company proposing higher % transfer to reserves but simultaneously ***not declaring any dividend***	Amount proposed to be transferred to reserves will have to be lower than the ***average amount*** of dividend over the immediately preceding 3 financial years.

Dividend out of Past Profits

☞ In the event of inadequacy or absence of profits in any year a company can declare dividend out of its past profits which had been transferred to reserves, by:-

(i) Either complying with the Companies (Declaration of Dividend Out of Reserves) Rules, 1975; or

(ii) Obtaining prior approval of Central Government (in case such rules are not complied with)

☞ According to "Companies inadequacy or absence of (Declaration of Dividend out of Reserves) Rules, 1975 in the event of profits in any year, dividend may be declared for that year out of the accumulated profits earned by it in previous years and transferred by it to the reserves, subject to the conditions that:-

1. Rate of Div. $\leq$ Average Div. rate in immediate preceding 5 yrs.

   Or (Whichever is less)

   10% of its paid up capital,

+

2. Total Amount withdrawn from accumulated profits earned in previous years and transferred to the reserves $\leq$ 10% of (Paid up Capital + free Reserve) and this amount first be utilised to set off losses incurred in this year before any dividend in respect of preference or equity shares is declared.

+

3. Balance of Reserve after such withdrawn $\geq$ 15% of paid up capital.

VERIFICATION OF DIVIDEND

1. He should examine the Memorandum and Articles of Association of the Company to determine the rights of different classes of shareholders to whom dividend has been paid.
2. He should ensure that dividends can only be distributed out of profits. The capital of the shareholders cannot be used for the purpose of payment of dividends.
3. He should ascertain whether profits earmarked for the purpose of dividend have been computed in accordance with the requirements of section 205 of the Companies Act.
4. He should ascertain whether the rate of dividend has been recommended properly in a meeting of the Board of Directors.
5. He should inspect the shareholders minute book to verify the amount of dividend declared and confirm that the amount does not exceed the amount recommended by the directors.
6. He should see that profits appropriated for payment of divided are after transfer to reserves an amount in accordance with the rules framed by the Central Government.
7. He should examine the list of shareholders as drawn from the Registrar of Shareholders and see that the total amount of dividend payable companies with the Dividend Account.
8. If a separate bank account is opened for payment of dividends, he should check the transfer of total amount of dividends payable from the Dividends Account.
9. He should verify the amount of unclaimed dividend with the Dividend Account, bank Pass Book and dividend warrants as have been returned undelivered.
10. He should see that where the dividend is declared, distributed or paid by a domestic company (not a foreign company), the tax on distributed profit at the rate of 10% is paid within 14 days from the date of declaration, distribution or payment of dividend whichever is earliest. [Section 115(0) of the Income Tax Act, 1961]

11. The auditor should see that the dividend which remains unpaid or unclaimed within 30 days of the declaration of the dividend, such unpaid or unclaimed dividend has been transferred to a special bank account entitled "Unpaid Dividend Account of _________ Company Limited / Company Pvt. Limited". The transfer must be made within 7 days from the date of expiry of 30 days. Such an account is to be opened only in a Scheduled Bank.
12. If any dividend remains unpaid or unclaimed for a period of seven years from the date of transfer, the amount standing to the credit of the special bank account has to be transferred by the company to the fund called Investor Education and Protection Fund.

Auditors duty regarding Depreciation

1. Companies Act provides only minimum rates. The company can charge depreciation at a higher % also. (or it means lesser life).
2. The company can adopt different methods for different type of assets provided the same is consistently followed.
3. Change in method of depreciation should be with retrospective effect and only if it is required by statute or accounting standard or if it results in better presentation.
4. The accounts must disclose the methods which have been used to calculate depreciation.
5. Low-value items may be fully depreciated provided this is disclosed appropriately in the accounts.
6. Depreciation should be calculated from the date when the asset is ready to use.
7. When the asset is installed during the year, check that it is only pro-rate depreciation that appears in the accounts.
8. In case of revaluation of assets, check the depreciation on revalued part (whether charged to Profit & Loss Account or revaluation reserve.

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Practical Problems

P 1. T Ltd. purchased goods on credit for ₹ 5 crores for export from ABC Ltd. Upon the export order being cancelled, T Ltd. decided to sell the same in the domestic market at a discounted price. Accordingly ABC Ltd was requested to offer a price discount of 25%. ABC Ltd. wants to adjust the sales figure to the extent of discount requested by T Ltd.

Ans: - ABC Ltd. had sold goods on credit worth ₹ 5 crores to T Ltd. and, therefore, the sale was complete in all respects. T Ltd's decision to sell the same in the domestic market at a discount does not affect the amount booked under sales by ABC Ltd. The price discount of 25% offered by ABC Ltd. at the request of T Ltd. was not in the nature of discount given during the ordinary course of trade because otherwise same would have been given at the time of sale itself. Now as far as ABC Ltd. is concerned, there appears to be an uncertainty relating to collectability, which has arisen subsequent to the time of sale. Therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Therefore such discount should be charged to the profit and loss account separately and not shown as deduction from the sales figure.

P 2. During the year under audit Z Ltd. credited to the Profit and Loss Account, the entire profit of ₹ 20 lakhs on the sale of land not required for its use. You are informed that the directors would like to propose dividend out of the above profit.

Ans: - Profit of ₹ 20 lakhs on the sale of land is a capital profit. It represents the excess of sale value over the original cost of the asset.

As per Guidance Note on 'Audit of Payment of Dividend', capital profits can be distributed as dividend only if all the following conditions are fulfilled:

(i) The Articles or the bye-laws or other rules and regulations applicable to the entity, permit such distribution; and

(ii) It has been realised in cash; and

(iii) The Board or similar authority is satisfied that net aggregate value of the assets remaining after distribution of that profit will not be less than the book values so that share capital and reserves remaining after the distribution will be fully represented by the remaining assets.

Accounting Standard 10 on "Accounting for Fixed Assets" also requires that any gain arising from disposal of a fixed asset should be recognised in the profit and loss account. Moreover, section 205 of the Companies Act, 1956 does not make any distinction between capital profit and other profit.

Thus all profits which can properly be taken to the profit and loss account are 'profits' for the purposes of section 205 and are, thus, distributable.

P 3. Y Ltd. provided ₹ 25 lakhs for inventory obsolescence in 2012-2013. In the subsequent years, it was determined that 50% of such stock was usable. The company wants to adjust the same through prior period adjustment account as the provision was made in the earlier year.

Ans:- As per AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The write-back of provision made in respect of inventories in the earlier year does not constitute prior period adjustment since it neither constitutes error nor omission but it merely involves making estimates based on prevailing circumstances when financial statements were being prepared. It is a mere estimate process involving judgement based on the latest information available. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.

In this case, Y Ltd. provided ₹ 25 lakhs for inventory obsolescence in 2012-13. In the subsequent year due to change in circumstances, it was determined that 50% of such stock was usable. Revision of such an estimate does not bring the resulting amount of ₹ 12.5 lakhs within the definition either of a prior period item or of an extraordinary item. The amount, however, involved is material and requires separate disclosure to understand the financial position and performance of an enterprise. Accordingly, adjustment in the value of the inventory through prior period item would not be proper.

P 4. You have been appointed a statutory auditor of a limited company engaged in the manufacture of chemicals. What would be your views on the following?

(a) The management tells you that the work in process is not valued since it is difficult to ascertain the same in view of the multiple processes involved and in any case the value of opening and closing work in process would be more or less the same.

(b) The company has a turnover exceeding ₹ 5 crores for a period of three consecutive financial years immediately preceding the financial year concerned, but does not have any internal audit system.

(c) The management tells you that there is no need for them to follow accounting standards specified by the Institute of Chartered Accountants of India as these are for the auditor to follow.

Ans:-

(a) Valuation of Work-in-Process: As per AS 2 (Revised) on "Valuation of Inventories", the inventories also include those assets which are in the process of production for sale in the ordinary course of business apart from finished goods and those materials or supplies to be consumed in the production process or in the rendering of services. It is, thus necessary for a company to ensure that each and every component of inventory is valued properly. The argument advanced by the company that it is difficult to ascertain the same in view of the multiple processes involved is not acceptable. Because, the Guidance Note on "Audit of Inventories" also recognises the likely difficulties in valuation of work-in-process and states that, "in general , the audit procedures regarding work-in- process are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-process for assessing the appropriateness of its valuation.

For this purpose, the auditor may examine the production/costing records (for example, cost sheets), hold discussions with the personnel concerned and obtain expert opinion, where necessary". The argument that the opening and closing work-in-process would be more or less the same is also not justified because the omission of those would lead to distortion in true and fair view. Further, costs incurred for raw materials and the overheads would normally be different and would give rise to different value of opening and closing stock.

The Guidance Note even requires the auditor to ascertain the system from which the value of work-in-process is obtained is reliable, and to examine subsequent records of production/sales.

Therefore, in view of the above, the auditor shall have to qualify the audit report in case work-in-process is not valued and shown in the financial statements.

(b) Existence of Internal Audit System: Para 4(vii) of the CARO, 2003 issued under section 227(4A) of the Companies Act, 1956, requires a statutory auditor to comment whether the auditee company has an internal audit system commensurate with its size and nature of its business. This is, however, applicable only if the company has a paid-up capital exceeding ₹ 50 lakhs as at the commencement of the financial year concerned or has an average annual turnover exceeding ₹ 5 crores for a period of three consecutive financial years immediately preceding the financial year concerned.

In the instant case, the second condition is met and thus the auditor is required to make an inquiry whether the company has an internal audit system commensurate with its size and nature of its business. Since the internal audit system is not in existence, the auditor will have to mention the fact of not having such a system in his CARO Report. The fact that the company does not have an internal audit system commensurate with its size and nature of its business would also have repercussions on the normal audit procedures since the efficacy of internal control system would itself be questionable. Under the circumstances, apart from disclosing the fact of non-existence of the internal audit system in the report, the auditor should also modify substantive audit procedures as well.

(c) **Observance of Accounting Standards:** In terms of Companies Accounting Standards Rules 2006 prescribed by the Central Government under section 211 3(c) of the Companies Act, 1956. It is mandatory for a Company to follow all the prescribed Accounting Standards while preparing and presenting its financial statements. If a Company does not follow Accounting Standards the auditor is required to give a qualification in his report in terms of section 227(3) of the Companies Act, 1956. In fact directors of the companies are also required to give a written statement as part of Director Responsibility Statement under section 217 of the Companies Act that all the Accounting Standard prescribed has been followed and there are no discrepancies. In view of the provision the contention of the company is not correct.

P 5. As a statutory auditor of a Public Limited Company, how would you deal with the following situations?

(a) The company has sold some old machinery for ₹ 1 Crore. The details of the cost of such machinery are not available since the entire records relating to fixed assets have been destroyed in an earthquake.

(b) The company had subscribed to shares of associate companies amounting to ₹ 5 crores. These associate companies have incurred substantial losses and have been referred to BIFR for being declared as sick companies. The company does not want to make any provision for the fall in the value of the investments.

Ans:-

(a) **Sale of Machinery:** AS 10 on "Accounting for Fixed Assets", gains or losses arising on disposal are generally recognised in the profit and loss statement. Therefore, when the company sells old machinery, profit/loss on sale thereof has to be determined. Such profit or loss can be determined provided the cost and written down value of the said machinery is available. In the instant case, since the entire records of fixed assets have been destroyed, the cost and the WDV of the machinery sold could not be arrived at. The company may therefore, have to determine the same on some estimated basis provided all reasonable efforts to determine the cost/WDVs of the machinery do not yield any better result. An all out attempt should be made by the management to reconstruct the old records. Such records may be constructed by obtaining old copies of annual reports distributed amongst shareholders, annual accounts filed with Registrar of Company; IT Returns filed by the auditor may also be having record of physical verification of earlier years etc. In fact, through this process, the company shall be able to determine the WDV of the asset because the machinery sold seems to be quite big and must have been recorded on standalone basis.

The auditor will have to see whether the estimate of cost and WDV arrived at in the above manner by the company is reasonable and whether the profit/loss is determined accordingly. A note to that effect would also have to be given by the management in the accounts. If the auditor is of the opinion that the said estimates are satisfactory based on available records and the note given by management explains the said fact, he may not qualify his report. If he is not so satisfied, he would have to give disclaimer in the audit report that in the absence of proper records, the said profit/loss has been arrived on an estimated basis and in that view he has been unable to form an opinion. As far as the report under the CARO, 2003 order is concerned; the auditor would have to point out that proper records of fixed assets showing full particulars as required by that clause are not available.

(b) **Valuation of Investments:** AS 13 on "Accounting for Investments" requires investments to be classified as long term and current investments distinctly in its financial statements. Since the investment in share of associate company is intended to be kept for a period more than one year, they would be classified as long term investment.

AS 13 states, "long-term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually". In the instant case, these associate companies have incurred substantial losses and have been referred to BIFR for being declared as sick companies. The net worth of these companies would have been wiped out resulting in a fall in the value of the investments.

Therefore, such fall cannot be merely temporary as the companies could take a long time to turn around (if at all) and again have a positive net worth. The auditor would therefore have to qualify his report by saying that no provision for diminution for fall in the value of investments as required by AS 13 has been made and to that extent the profits and reserves have been overstated.

P 6. As an auditor state your views on the following situations:

(a) Included under Current Assets of XYZ Ltd. is inventory aggregating to ₹ 20 crores. A part of the said inventory manufactured for export had to be sold earlier at a discounted price off-shore due to moisture content present at the time of delivery. A part of similar inventory is included in ₹ 20 crores.

(b) The company has suffered a net loss for the year. The directors however declared and paid an interim dividend @ 30% based on the half-yearly performance.

Ans:-

(a) **Valuation of Damaged Inventory:** A part of the inventory exported earlier had to be sold at a discounted price off shore due to moisture content present at the time of delivery. The auditor will therefore have to examine what part of the inventory is included in the inventory valued at ₹ 20 crores, a part of which had been exported at a discounted price. He will also have to satisfy himself that whether such part left with the company has also been damaged on account of moisture content. If required, the auditor may obtain a certificate from an expert about the condition of the inventory. Thereafter, it should be verified whether the principle of valuation enunciated in AS 2 (Revised) "Valuation of Inventories" have been followed in such a case. The standard requires that the inventories should be valued at the lower of cost or net realisable value. AS 2 (Revised) defines the net realisable value as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Accordingly, such part of inventory which is damaged should be valued at estimated realisable value if the same is lower than the cost. In the present case the auditor shall satisfy himself whether the balance inventory lying with the company is carrying the same quality issue. If yes, than value of inventory will be revised based on the past performance as per its net relisable value.

(b) **Declaration of Interim Dividend:** Interim dividend can be declared by the Board of Directors only if there is an authorisation in the Articles of Association to do so. An interim accounts should be prepared to ascertain the amount of profits that has been made. Assuming that interim accounts have been prepared and they disclose profits sufficient for the declaration of dividend after making appropriate provisions for depreciation, compulsory transfers to reserves, bad debts and other contingencies, only then the proportion of profits which have to be distributed as interim dividend may be decided.

In the present case, the company has suffered a net loss at the end of the year, obviously the directors have miscalculated the performance of the company about the second half of the year. If the company had a sufficient balance in the profit and loss account as at the beginning of the year, the dividend declared could be paid out of the same. The balance had also to be sufficient to transfer the relevant amounts to reserves. In such a case the auditor need not report anything. Moreover, if such balance was not available, the dividend could also be paid out of reserves. In the situation of dividends to be declared out of reserves, a maximum of only 10% dividend is allowed. In this case, since the dividend was declared @ 30%, the said provisions would have been violated and thus the auditor would have to mention the said fact. If, however, there is no balance in the profit and loss account nor any reserves were available, the dividend would be clearly paid out of capital. The auditor would have to qualify his report mentioning the fact of the dividend having been paid out of capital.

P 7. As a Statutory Auditor of a Public Company defaulted in the repayment of deposits together with interest on the due date for more than a year and the Chief Accountant contends that the auditor need not report on the default committed by the company?

Ans: - **Default in Repayment of Deposits and Auditor's duties:** The auditor's reporting requirements are contained in section 227 of the Companies Act, 1956. As far as requirements relating to deposits are concerned, CARO 2003, issued under section 227 of the Companies Act, 1956; and, clause (f) of Section 227(3) read with section 274 (1) (g) require auditor to specifically report on this aspect. Hence, the contention of the chief accountant is not correct. Under Clause (f) of section 227(3) of Companies Act, 1956 the auditor has to report whether any director is disqualified from being appointed as a director under clause (g) of sub-section (1) of section 274. On a perusal of section 227(3)(f) it is apparent that the auditor has to report upon whether any of the directors of the public company, are disqualified from being appointed as a director in terms of clause (g) of sub-section (1) of section 274.

In addition, the CARO under section 227(4A) of the Companies Act, 1956 under Para (vi) has to state whether in case the company has accepted deposits from the public, whether the directives issued by the Reserve 8ank of India and the provisions of sections

58A, 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated; if an order has been passed by Company Law 8oard or National Company Law Tribunal or Reserve 8ank of India or any Court or any other Tribunal whether the same has been complied with or not?

In view of the above situation, the auditor is required to make report on defects committed by the company.

P 8. As an Statutory Auditor of the M/s OPQ you found that in the books of accounts of M/s OPQ Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year.

Ans: - **Difference between Control Accounts and Subsidiary Records:** The huge differences found between control accounts and subsidiary records in the books of M/s OPQ Ltd. indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date.

Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements.

Further, when the auditor encounters circumstances that there is material misstatement, the auditor should perform procedures to determine whether the financial statements are materially misstated. If as a result of such examination the auditor comes across any material information involving fraud or gross irregularity the same shall be reported by him appropriately

P 9. A company has a branch office, which recorded a turnover of ₹ 1,90,000 in the financial year 2012-13. No audit of the branch has been carried out. The statutory auditor of the company has made no reference of the above branch in his report. The total turnover of the company is 10 crores for the year 2012-13. Comment.

Ans: - Section 228 of the Companies Act, 1986 requires that the accounts of a branch office of a company are required to be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. So, normally speaking, the audit of branch office has to be carried out unless the company has obtained exemption under the Companies (Branch Audit Exemptions) Rules, 1961 formulated u/s 228(4), having regard to quantum of activity.

The Rules provide for the exemption of a branch office of a company carrying on manufacturing, processing or trading activity from the provisions of section 228, if the average quantum of activity of the branch does not exceed rupees two lakhs or two per cent of the average of the total turnover and the earnings from other sources of the company as a whole, whichever is higher. Since in the instance case, no such exemption has been obtained and accordingly, the company is liable.

The auditor is also required to mention this fact in the audit report and deal appropriately.

P 9. P Ltd. of whom you are the Statutory Auditor appoints M/s XYZ as Branch Auditors for one of its branches. M/s XYZ conducted the audit of the branch without visiting the branch and instead getting the books at the H.D. M/s XYZ has submitted their Branch Audit Report to you.

Ans:- **Branch Auditor's Report:** As per provisions of the Companies Act, 1986, the accounts of a branch office of a company are required to be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. It is not necessary for branch auditor M/s XYZ to visit the branch and conduct the audit only at branch's premises. It is a matter of professional judgement for the branch auditor to decide as to whether he needs to visit the branch. At the same time, the statutory auditor has the right to visit branch offices and to have access to the books of accounts and vouchers maintained at the branch office in this case.

In any case, the principal auditor i.e. the statutory auditor of Head Office P Ltd is entitled to rely on the work of branch auditor unless there are special circumstances to make it essential for him to visit the branch and examine the books of account and voucher records. As per basic principles governing an audit, the principal auditor is entitled to rely upon the work performed by others provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. As per SA 600(R), "Using the work of another auditor", the principal auditor is not required to evaluate professional competence because branch auditor happens to be member of ICAI. The statutory auditor is also required to deal with the Branch Auditor's report in the manner, he considers necessary.

Therefore, the statutory auditor is required to deal with M/s XYZ's report in the manner it considers fit under the circumstances.

P 10. A company wants to amend its accounts after the completion of the audit and adoption of the Accounts by the Board, but before circulation to the shareholders. It requires its statutory auditor to report on the amended accounts. State the steps the statutory audit should adopt in such a situation.

Ans: - ***Amendment of accounts after the completion of the audit and adoption of the Accounts by the Board before circulation to the shareholders*:** This pertains to the manner in which the statutory auditor should report upon amended accounts. The Companies Act does not contemplate the revision of accounts and a further report by the statutory auditor on the amended accounts. At the same time, it is entirely within the competence of the Board of Directors to amend the accounts and resubmit the same to statutory auditors for report before the accounts are placed before the annual General Meeting. The report issued by the statutory auditor on such amended accounts will be in substitution of the report issued before the amendment. Unless all copies of the original accounts and reports are returned to the auditor, such substitution is not possible.

Members, when called upon to issue a report on amended accounts for the same period due to amendments to the accounts, should ensure all copies of the original accounts and reports are returned to him, adequate disclosure about the revision of accounts already reported, appears as a specific note on the amended accounts. If the Statutory auditor is satisfied about the adequacy of disclosure, there may not be any need for him to refer to the revision of balance sheet and/or the profit and loss account in his report otherwise he has to refer to the revision in his report.

P 11. As Auditor of Act Fast Ltd. what steps will you take to ensure that the dividend has been paid only out of profit?

Ans: - The auditor may take the following steps to ensure that the dividend has been paid only out of profits.

1. Check whether the dividend was declared out of profits arrived at after providing for depreciation.
2. If no depreciation has been provided, ensure that the approval was obtained from the Central Government before declaring dividend.
3. Check whether
   (i) The depreciation was provided according to provision of section 208(2).
   (ii) The minimum prescribed amount has been transferred to reserves before declaring any dividend.
   (iii) Conditions governing transfer of higher percentage is complied with.
   (iv) A board resolution recommending dividend was passed.
   (v) Dividend was declared (resolution was passed) only in the Annual General Meeting.
   (vi) Dividend has been paid in the prescribed manner within 30 days of time to the registered holder or their order.
   (vii) Amount of dividend deposited in a separate bank account within five days from the date of declaration of dividend.
   (viii) Permission of Reserve Bank of India has been obtained for payment to non- resident shareholders before the remittance of dividend to their account.
   (ix) Intimation sent to Stock Exchange in the case of listed company.
   (x) There were any complaints of nonpayment/delayed payment of dividend and the corrective action taken.

P 12. S Ltd. issued Bonds to the tune of ₹100 lakhs and provided security to the tune of ₹ 80 lakhs for the same. It insists that it will disclose the Bonds as "Secured" in the Balance Sheet of the Company.

Ans: - Prima facie, the Bonds issued to the tune of ₹ 100 lakhs are provided with security to the tune of ₹ 80 lakhs i.e. neither fully secured nor unsecured. Guidance Note on the "Terms used in Financial Statements" issued by ICAI, states "Secured Loans" as loan secured wholly or partly against an asset. Hence the Bonds should be classified under 'Secured Loans' for the purpose of disclosure in the Balance Sheet. However the nature of security should be clearly specified.

P.13 A infrastructure company has constructed a mall and entered into agreement with tenants towards license fees (monthly rental) and variable license fees, a percentage on the turnover of the tenant (on an annual basis). Chief Finance Officer wants to account1recognize license fee as income for 12 months during current year under audit and variable license fees as income during next year, since invoice is raised in the subsequent year. As an auditor, how would you deal and state in the statement of Accounting policies?

Ans:- Revenue Recognition: AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Further, as per accrual concept of fundamental accounting assumptions given in AS 1 "Disclosure of Accounting Policies", revenue should be recognised as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate.

In the present case, monthly rental towards licence fees and variable licence fees as a percentage on the turnover of the tenant though on annual basis is the income related to common financial year. Therefore, recognising the fees as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognised in the financial year of accrual.

Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9 and hence the auditor may qualify the report indicating the understatement of income1profit and that the profit and loss account does not exhibit a true and fair view of the profit or loss.

Miscellaneous Topics

1. AUDITOR'S SEPARATE REPORT TO DIRECTORS

1. The management of the company may require from the auditor a separate report in addition to his report under section 227 of the Act.
2. The objective of such reports is to provide the management with detailed information regarding procedures, systems, weaknesses in internal controls etc.
3. Such reports should be detailed enough to highlight the weakness and suggestions to improve.
4. However, the auditor should take care that matters, which are material enough to be reported to the shareholders are not contained in his report to the directors.
5. Thus, auditor's separate report to director cannot be substituted for an otherwise modified report.

2. AUDIT CERTIFICATES AND AUDIT REPORT

1. A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
2. The auditor's certificate represents that he has verified certain figures and is satisfied about their accuracy.
3. However, a report is a formal statement made after an enquiry or examination of the specified .matters under the report and the auditor's opinion thereon.
4. Thus the opinion may differ from one auditor to another as it involves personal judgement.

3. AUDIT OF COMPANY PROSPECTUSES

According to section 2 (36) of the Companies Act, 1956 'Prospectus' means any document described or issued as a prospectus and includes any notice, circular advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate.

In order to protect the investors from deceiving offers, the Companies Act has specified certain information to be furnished in detail in the prospectuses.

Reports to supplement the prospectus

Two reports on financial aspects to be included in a prospectus are

- ✓ Reports of the statutory auditor or joint auditors of the company; and
- ✓ Report of the accountant.

Note →A person who is eligible to be appointed, as an auditor shall be qualified to act as an accountant.

3.1 Aspects Concerning the Auditor –

- ☞ ***Signing of the Report*** **-** The requirements of signing of these reports are same as in case of signing of audit report under the Companies Act, 1956.
- ☞ ***Fees for issue of reports*** **-** The fees for making a report to be attached to the prospectus would be determined on the basis of agreement between the auditor and the directors of the company.
- ☞ ***Consent Letters*** **-** According to section 60 (3) of the Act, the auditor should give in writing his consent to act in such capacity. The letter should accompany the prospectus when submitted for registration.
- ☞ ***Liability for misstatements in prospectus*** **-** According to section 62 of the Companies Act, 1956 every person who _as authorized the issue of prospectus will be liable to compensate every person who has incurred any loss or damage due to untrue statement in the prospectus. Section 60 (3) provides that Chartered! Accountants will be

liable only for untrue statements made by them in the capacity of expert. Where the auditor is made to compensate for any loss, he may claim contribution from other persons.

☞ ***However, a professional accountant will not be so liable if he can prove that***

✓ The prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his consent; or

✓ He withdrew his consent in writing before delivery of the prospectus for registration; or

✓ After the delivery of prospectus for registration but before allotment of shares, on becoming aware of the untrue statement, he withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reasons therefore; or

✓ He was competent to make the statement and that he had reasonable ground to believe and did upto the time of allotment of shares or debentures believe that the statement was true.

☞ ***Rights of the auditors* -** The auditors have right to access the books of account, other records and call for any necessary information from the company.

☞ ***Communication of the report* –** The reports of auditors are addressed to the Board of Directors of the company.

3.2 Aspects Concerning the Accountant -

The reporting accountant is required to report on the profits and losses for the preceding five years and on the position of assets and liabilities. He should separately disclose items of extra ordinary nature in the profit statement. He may also have to adjust the figures in income statement on the following grounds –

✓ All prior items should be adjusted in the year to which they relate and not in the year in which they came to be known;

✓ All items of material nature which are not likely to recur should be adjusted in the preparation of profit trend statement, such items may be

- Heavy repairs and renovation; or
- Discontinued operations / business; or
- Abnormal losses

✓ Where accounting policies have not been consistently followed, the accountant should compute the figures for all periods under report based on the policies applied in the latest period.

✓ Where the statement of trend of profits contains an interim period or broken period, the accountant may adopt either of the two approaches.

- He may treat the interim period as part of the whole year. In this case, the items of the income and expenditure should be based on the yearly trend for the period covered by the report; or
- He may view the interim period as a separate accounting period and items of income and expenditure will be reported at actual for the period. Similar will be the treatment for estimated provisions in the accounts.

✓ With preparing the report to be included in the prospectus, the accountant takes up great responsibility. Thus he should take a note of the following:-

- The manner in which the directors, in their estimate of current and future profits, have dealt with the figures shown in the accountant's report and with the matters to which the directors' attention was drawn in that report;
- Material facts known to him, in relation to directors' estimates;
- The manner in which the directors have dealt with any special circumstance.
- Various certificates and representations submitted to him by the management.

✓ In case there is a misstatement in his report and a liability to compensate a person for loss incurred as a result of the misstatement arises, the accountant can protect himself from such liabilities in the manner as discussed for the statutory auditors.

4. AUDIT REPORTS / CERTIFICATES ON FINANCIAL INFORMATION IN OFFER DOCUMENTS

SEBI has been issuing several guidelines for disclosure and investor protection, which include certain financial information to be disclosed. This is in addition to information required as per schedule II to the Companies Act, 1956. This information is required to be audited by a Chartered Accountant.

4.1 Requirement regarding audit of financial information in offer documents –

Para 4 of Part A-1 of clarification XIV requires that all financial information forming part of offer documents shall be audited. The following are the various financial information which form parts of offer documents.

1. ***Auditor's Report***

   The offer document should include Auditor's Report on the profit and loss statement for the five years immediately preceding the issue of prospectus and on the assets and liabilities as on the date of issue of prospectus.

   ☞ ***Adjustments in statement of profit or loss and assets and liabilities:***

   Clause 20 *at* Part HI of Schedule II to the Companies Act, 1956 requires that "any report required under Part II of this schedule shall either (i) indicate by way of note any adjustments as regards the figures of any profits or losses or assets and liabilities dealt with by the report which appear to the persons making the report necessary or (ii) make those adjustments and indicate the fact that the adjustments have been made.

   Where there is a qualification by the auditor with regard to statement of profit or loss, assets and liabilities, all adjustments shall be made in the respective statements itself.

   ☞ ***Extraordinary Items***

   Profit or loss arrived at before and after considering the extraordinary items should be disclosed. The disclosure of such item should be on "net of tax basis".

2. ***Material Changes in Activities***

   ☞ The offer documents shall also disclose the changes in the activities of the issuer, which may have had a material effect on the financial statements. For example,

   - ✓ Discontinuance of lines of business.
   - ✓ Loss of agencies or market and other similar factors.
   - ✓ Addition of new lines of business.

   ☞ It is not intended to identify the impact of each change which is part of normal business activities e.g. updating the technology, normal change in product mix, change in ordinary agency relationship. The intention is to identify the changes, which pertain to separate major lines of business.

   ☞ The management shall prepare the statement disclosing the above. The auditor should check the correctness of the information based on his knowledge of the company's operations. In the case of discontinued operation the-following information shall be disclosed.

   - ✓ Nature of the discontinued operation
   - ✓ Effective date of discontinuance for the accounting purposes.
   - ✓ Manner of discontinuance (sale / abandonment etc.)
   - ✓ Turnover of the discontinued operation.

3. ***Significant Accounting Policies***

   ☞ All significant accounting policies followed in the preparation of offer document should be disclosed.

4. ***Transactions with Companies in "Promoter Group"***

   ☞ Disclosure in offer document is called for in respect of

- ✓ Sales or purchases between companies in the promoter group when sales or purchases exceed in value, in aggregate, 10% of the sales or purchases of the issuer.
- ✓ Material items of income or expenditure arising out of transactions within the promoter group.

5. ***Disclosure under the heading "Other Income"***

☞ Where such income exceeds 20% of net profit before tax the various details of "other income" shall be disclosed, viz.,

- ✓ Sources and other particulars of such income
- ✓ Indication whether it is recurring or non-recurring and has arisen out of business activities / other than the normal business activities.

☞ The computation of 20% has to be made in relation to net profit or net loss before tax and extraordinary item. The concerned income should be after netting off of expenses, and such netting off is only for computing the relevant "other income". For the purpose of disclosure in the relevant statement of profit or loss the incomes / expenses should disclosed at gross amounts in the usual manner.

The disclosure should be

- ✓ Source;
- ✓ Nature;
- ✓ Amount;
- ✓ Recurring or non recurring; and
- ✓ Whether on account of normal business activity or not.

6. ***Disclosure of Bifurcated Turnover***

- ✓ Turnover of products manufactured by the company
- ✓ Turnover of products traded by the company and
- ✓ Details of products not normally dealt in by the company but included in above should be mentioned separately.

5. *Financial Information in Respect of which the Auditor should give Separate Report to the Management*

There is some other financial information that should be provided by the management and the same should be audited by the auditor of the issuer company. The report should also be contained in the offer documents.

(a) ***Tax shelter***

For proper understanding of future maintainable profits the incidence of tax should be properly explained by way of appropriate disclosure. The auditor should examine the detailed computations made by the management to arrive at the figure of provisions for taxation, which has been disclosed in the annual accounts.

(b) ***Accounting Ratios***

The following accounting ratios for each of the accounting periods for which financial information is given

(1) Earnings Per Share

(2) Return on Net Worth and

(3) Net Asset Value Per Share

(4) The auditor should satisfy himself that for making various computations for the above accounting ratios, the various items of profit / loss assets and liabilities have been properly adjusted.

1. Earnings per share –

It may be (i) basic earnings per share or (ii) diluted earnings per share.

$$\text{Basic Earnings per Share} = \frac{\text{Net Proift/ loss for he period attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the period}}$$

$$\text{Diluted Earnings Per Share} = \frac{\text{Net profit attributable to equity shareholders (after adjustment for diluted earnings}}{\text{Average number of weighted equity shares outstanding during the period (assuming the conversion of diluted potential equity shares)}}$$

2. Return on Net Worth –

☞ ***The formula used is -***

$$\frac{\text{Net profit before extraordinary items but after adjusted tax}}{\text{Net worth excluding revaluation reserve at the end of the year}}$$

☞ The term adjusted tax refers' to tax provided for the period after adjusting tax attributable to extraordinary items. While calculating net worth, the effect of, revaluation should be ignored. In order words, the asset would be valued on historical cost basis.

3. Net Assets Value Per Share –

- NAV shall be calculated on the basis of the latest audited balance sheet
- It can be computed either by net assets method or net equity method.
- In the case of net asset method the total liabilities and preference capital are deducted from the total assets.
- In the case of net equity method, equity share capital is added to reserves and surplus, deducting there from miscellaneous expenditure and debit balance of profit and loss account.
- ***The auditor should consider***
  - ✓ Intangible assets are not taken into account (unless they have been paid for);
  - ✓ Revaluation of assets have not been taking into account;
  - ✓ 'Arrears of preference dividend' should be provided for;
- The formula for NAV per share is

$$\frac{\text{Net Asset Value}}{\text{Equity shares at the end of the accounting period}}$$

(c) ***Capitalization Statement***

☞ The capitalization statement shows total debt and net worth and the debt *I* equity ratio before and after the issue is made. Where there is a change in the share capital since the date as of which the financial information has been disclosed in the offer document, a note shall be included explaining the nature of the change.

(d) ***Disclosure of Project Expenditure***

☞ The following information should be annexed to the Offer Document

- ✓ Actual expenditure incurred on the project upto a date not earlier than 2 months of filling the prospectus with SEBI or Register of Companies whichever is later
- ✓ Means and sources of financing such expenditure
- ✓ Year wise break Lip of the 'expenditure proposed to be incurred on the said project.

☞ The auditor should obtain a management representation regarding details of project expenditure and the means and sources of financing such expenditure and year-wise break-up of expenditure proposed to be incurred on the project. There is no need to audit the information as it is based on estimates arrived at by management.

(e) ***Bridge Loans***

- Details of bridge loans or other financial arrangement if any, for incurring expenditure on the project and which would be repaid from the proceeds of, the

(f) ***Loans***

- The principal terms of loans and assets charged as security should be disclosed.

(g) ***Disclosure under "Basic of Issue Price"***

- The following information shall be disclosed
  - ✓ EPS i.e. EPS pre-issue for the last three years (adjusted for changes in capital)
  - ✓ P/E pre-issue - comparison with PIE of industry (giving source of information) Average return on net worth in the last three years
  - ✓ Minimum return on increased net worth required maintaining pre-issue EPS.
  - ✓ NAV per share after issue and comparison thereof with the issue price.

(h) ***Auditor's Certificate on Profit Forecast***

- The offer documents should also include a forecast of estimated profits for the financial year ending immediately before the date of offer document (if such information is not already given in the offer document) and for the financial year ending immediately after the date of the offer documents. This should be supported by an auditor's certificate, which lists the major assumptions on which the forecast is based and gives assurance on the arithmetical calculations derived, from such assumptions.

Appendix – I

The resolutions, notices, letters connected with Statutory Auditor under Section 224, 225, 228, 233A and 233B the Companies Act, 1956 at one place for your reference and record.

SPECIMEN OF LETTER OF INTIMATION TO THE AUDITOR FOR APPOINTMENT

To,
M/s ABC & Associates
Chartered Accountants
Lucknow (UP)

Sub: **Appointment as the auditors of the company**

Dear Sir,

We are pleased to inform you that the Board of directors of the company at their first Board meeting held on 29th May, 2013 have appointed your firm as the Statutory Auditors of the company and to hold office upto the conclusion of the first annual general meeting of the company on such remuneration as may be decided by the Board.

You are requested to confirm your acceptance for our further needful.

Thanking you,

Yours faithfully,
For, **AFA LIMITED**

DIRECTOR
Encl.: Certified copy of the Resolution

SPECIMEN OF LETTER FOR ELIGIBILITY U/S 224(1B) OF THE COMPANIES ACT

To
The Board of directors
XYZ Ltd
Lucknow (UP)

Dear Sir,
In reference to the discussion had with Shri AB, a member of the company, we would like to inform that pursuant to the provisions of section 224(1B) of the Companies Act, 1956, if the appointment made by the members at the annual meeting of the company, it shall be within the ceiling prescribed under the Companies Act, 1956.

Thanking you

Yours faithfully

For ABC & ASSOCIATES
CHARTERED ACCOUNTANTS
Mr. Ramesh
PARTNER

SPECIMEN OF BOARD RESOLUTION FOR APPOINTMENT OF THE FIRST AUDITORS

The Chairman informed that the first auditors of the company are to be appointed in the Board meeting within one month from the date of incorporation of the company. He informed that he had got consent of M/s A Jain & Associates, Chartered Accountants, for their appointment as the first auditors of the company. The Board considered and passed the following resolution unanimously:

"RESOLVED THAT pursuant to the provision of section 224 of the Companies Act, 1956, M/s A Jain & Associates, Chartered Accountants of Meerut from whom certificate pursuant to section 224(1B) of the Companies Act has been received, be and are hereby appointed as the first auditors of the company to hold office until the conclusion of the first annual general meeting of the company at a remuneration to be determined by the Board of directors of the company.

SPECIMEN OF THE RESOLUTIONS PASSED BY THE MEMBERS

I. FOR APPOINTMENT OF AUDITORS AT THE ANNUAL GENERAL MEETING

"RESOLVED THAT M/s ABC & Co. Chartered Accountants, the retiring Auditors be and are hereby reappointed as Auditors of the Company to hold office until the conclusion of the next Annual General Meeting and that they be paid a fee of ` 6,500 (Rs. Sixty Five Hundred Only) for Auditing the Accounts of the Company plus out of Pocket Expenses incurred by them."

II. ORDINARY RESOLUTION PASSED AT THE EGM FOR REMOVING EXISTING AUDITORS SUBJECT TO APPROVAL OF REGIONAL DIRECTOR

"RESOLVED THAT pursuant to the provision of section 224(7) of the Companies Act, 1956 and subject to the approval of the Central Government (Powers delegated to the Regional Director), M/s ABC & Co., Chartered Accountants of Kanpur, who were appointed as the Auditors of the Company at the last Annual General Meeting to hold office up to the conclusion of the next Annual General Meeting of the Company, be and are hereby removed from such office of the Auditors, before the expiry of their term."

III. ORDINARY RESOLUTION PASSED AT THE EGM FOR APPOINTING NEW AUDITORS SUBJECT TO APPROVAL OF REGIONAL DIRECTOR

"RESOLVED THAT pursuant to the provision of section 224, 224(1B) and 225 of the Companies Act, 1956 and subject to the approval of the Central Government (Powers delegated to the Regional Director) for the removal of the existing Auditors of the Company, M/s Jain & Co., Chartered Accountants of Mysore, M/s Malhotra & Associates, Chartered Accountants of Kanpur, be and are hereby appointed as the Auditors of the Company to hold office from the date of order of removal of the Auditors as approved by the Regional Director up to the conclusion of the next Annual General Meeting of the Company on a remuneration of ` 6,500 plus out of pocket expenses.

SPECIMEN OF THE BOARD RESOLUTION FOR AUTHORIZING TO FILE APPLICATION

"RESOLVED THAT an application in the prescribed e-Form 24A for approval for the removal of Auditor u/s 224(7) of the Companies Act, 1956 be made to the Regional Director, Ministry of Company Affairs, Western Region, Mumbai.

RESOLVED FURTHER THAT Mr. Manoj, Director and/or Company Secretary of the Company be and is hereby authorised to sign the application on behalf of the Board and execute an affidavit verifying the contents of the application.

RESOLVED FURTHER THAT Company Secretary be and is hereby authorised to file the above said application with the Regional Director, Western Region, Department of Company Affairs and to appear before the Regional Director on behalf of the Company and to do all such acts, deeds and things as may be required in the matter and to give all details, statements as may be required by the Regional Director."

SPECIMEN OF THE SPECIAL NOTICE/REQUISITION RECEIVED FROM A MEMBER TO CALL AN EGM

From –

Raj Verma

Member,

Cipla Ltd.

Lane-34, 1st Floor

Meerut (U.P.)

To –

The Board of Directors,

Cipla Ltd.

Z-4, Borivali,

Mumbai (M.H.)

Sub: Requisition for calling an Extraordinary General Meeting u/s 169

Sir,

I, the under signed member of the Company holding 37.20% of the paid up share capital issued by the Company as set out in the Schedule hereto requires you in terms of section 169 of the Companies Act, 1956 and Article 129 of the Articles of Association of the Company to convene an Extra Ordinary General Meeting of the members of the Company, to transact the following businesses by Ordinary Resolution:

(1) REMOVAL OF AUDITORS

RESOLVED THAT pursuant to the provision of section 224(7) of the Companies Act. 1956 and subject to the approval of the Central Government (Powers delegated to the Regional Director), M/s Jain & Co., Chartered Accountants of Kanpur, who were appointed as the Auditors of the Company at the last Annual General Meeting to hold office up to the conclusion of the next Annual General Meeting of the Company be and are hereby removed from such office of the Auditors, before the expiry of their term.

(2) APPOINTMENT OF NEW AUDITORS:

RESOLVED THAT pursuant to the provision of sections 224, 224(18) and 225 of the Companies Act, 1956 and subject to the approval of the Central Government (Powers delegated to the Regional Director) for the removal of M/s Jain & Co., Chartered Accountants, the existing Auditors of the Company, M/s Malhotra & Associates,. Chartered Accountants of Meerut be and are hereby appointed as the Auditors of the Company to hold office from the date of Order of Removal of the Auditors as approved by the Regional Director up to the conclusion of the next Annual General Meeting of the Company on a remuneration of ₹ 6,500 plus of out of pocket expenses.

Name of the requisitionist – Raj Verma

L. F. No.: 253

Shares held: 1,02,800

% Holding: 37.20%

Signature:

PLACE: Meerut

DATED:

SPECIMEN OF ELIGIBILITY CERTIFICATE OF PROPOSED AUDITORS U/S 224(1B)

ABC & Associates,

Chartered Accountants

Lane-5, Bada Chowk,

Meerut (U.P.)

To,

The Board of Directors,

ABC Private Limited,

Meerut.

Reg.: Appointment as Statutory Auditor of your Company "Consent and Eligibility"

Dear Sir,
With reference our discussion and your offer for our appointment as the Statutory Auditors of your Company, we do hereby declare and confirm that we are duly qualified and eligible for this appointment as per the provisions of section 224(1B) and 226(1) of the Companies Act, 1956.

Thanking you

Yours Sincerely

For ABC & ASSOCIATES

CHARTERED ACCOUNTANTS

Mr. Ramesh

PARTNER

SPECIMEN OF GENERAL MEETING RESOLUTION FOR FILING THE CASUAL VACANCY CAUSED BY RESIGNATION OF THE AUDITORS

The Chairman took the matter for appointment of M/s Ram & Shyam, Chartered Accountants, Rampur, in place of M/s Rohit & Mohit, Chartered accountant, the retiring Auditors who have expressed their unwillingness for re-appointment and who has to vacate their office at the conclusion of this Meeting.

The Chairman informed that the Company has obtained an eligibility letter from M/s Ram & Shyam in terms of section 224(1B) of the Companies Act, 1956 and proposed the resolution for approval of the members:

"RESOLVED THAT M/s Ram & Shyam, Chartered Accountants of Rampur, be and are appointed as the Auditors of the Company, in place of M/s Rohit & Mohit, Chartered Accountants, to hold the office of Auditors from the date of this Meeting to the conclusion of the next Annual General Meeting of the Company on such remuneration and out of pocket expenses as may be decided by the Board.

Explanatory Statement

M/s Rohit & Mohit, Chartered Accountants, the existing Auditors of the Company has resigned from the office of Auditor of the Company, therefore creating casual vacancy in the office of Auditors. The Company has received a notice from member alongwith a letter u/s 224 of the Companies Act, 1956 informing the eligibility signifying his intention to appoint M/s Ram & Shyam, Chartered Accountants, to fill the casual vacancy. In terms of the provision of section 225 of the Companies Act, the appointment of Auditors in place of existing Auditors of the Company requires the approval of General Meeting by way of Ordinary resolution.

Therefore, the Board recommend to pass necessary resolution by way of ordinary resolution to appoint M/s Ram & Shyam, Chartered Accountants, as the casual Auditors of the Company in place of M/s Rohit & Mohit, Chartered Accountants to hold office of the Auditors of the Company till the conclusion of the next Annual General Meeting on the remuneration as may be fixed by the Board.
A copy of the resignation tendered by the Auditors and eligibility letter as referred elsewhere are available for inspection of the members till the date of the meeting during business hours.
None of the director of the Company is concerned or interested in the proposed resolution.

SPECIMEN OF SPECIAL NOTICE FOR APPOINTMENT OF AUDITORS OTHER THAN THE RETIRING AUDITORS

From …………. (Member) Dated 17th May, 2013

To
The Board of directors
Cipla Ltd.
Kanpur (UP)

Sub: **Notice under section 225(1) of the Companies Act, 1956 for appointment of auditors M/s Subash & Co., Chartered Accountants, in place of M/s Agarwal & Co. Chartered Accountants.**

Dear Sir/s

This has in reference to your notice, dated 12th May, 2013 for the 17th Annual General Meeting of the Company to be held on 9th June, 2013.
I would like to inform that I have …… Equity Shares of the company constituting …… % of the total paid up capital of the company and in reference to the provisions of section 225(1) read with the provisions of section 190 of the Companies Act, 1956, I hereby give a notice that M/s Subash & Co., Chartered Accountants of Kanpur be appointed in place of M/s Agarwal & Co. Chartered Accountants, the retiring auditors of the company.

I hereby submit a draft of the resolution for approval at the annual general meeting to be held on 9th June, 2013.

You are requested to please do the needful as per provisions of the Companies Act, 1956.

Thanking you

Yours faithfully
(……………..)

Member, Folio No……..

Encl.: 1. Draft of the resolution

2. Eligibility letter given by M/s Subash & Co., Chartered Accountants.

SPECIMEN OF THE RESOLUTION TO BE SUBMITTED BY MEMBER'S ALONGWITH THE NOTICE

"RESOLVED THAT M/s Subash & Co., Chartered Accountants of Kanpur be and is hereby appointed as the auditors of the company in place of the retiring auditors M/s Agarwal & Co., Chartered Accountants to hold the office of the auditors till the conclusion of the next annual general meeting on such remuneration as may be determined by the Board of directors of the company."

SPECIMEN OF LETTER FOR NOTICE TO THE RETIRING AUDITOR BY THE COMPANY

20th May, 2013

To,
M/s Agarwal & Co.,
Chartered Accountants
Kanpur (UP)

Sub: Notice under section 225(1) of the Companies Act, 1956 received from a member for appointment of auditors M/s Subash & Co., Chartered Accountants, Kanpur in place of retiring auditors.

Dear Sir/s

Kindly find enclosed a copy of the notice received from ………. a member of the company under section 225(1) read with the provisions of section 190 of the Companies Act, 1956 regarding notice for appointment of M/s Subash & Co., Chartered Accountants of Kanpur in place of retiring auditors.

In terms of the provisions of section 225(2) of the Companies Act, 1956, we hereby submit a copy of the notice for your kind information.

Kindly acknowledge the receipt of letter for our reference and record.

Thanking you,

Yours faithfully
For, Cipla Ltd.
DIRECTOR
Encl.: a/a

SPECIMEN OF INTIMATION LETTER BY THE NEW AUDITORS TO THE EXISTING AUDITORS FOR APPOINTMENT AND SEEKING THEIR NO OBJECTION LETTER

14th June, 2013

To,
M/s Agarwal & Co.
Chartered Accountants
Kanpur (UP)

Sub: Appointment as the auditors of M/s Cipla Limited

Dear Sir,

We would like to inform that we have received a letter from Cipla Limited informing that the company at their annual general meeting held on 9th June, 2013 has appointed our firm as the Statutory Auditors of the company.
Being the retiring auditors, kindly give us your no objection letter to accept the assignment by us. In case if you have any observation or reservation, please inform us accordingly.

Thanking you,

Yours faithfully

M/s Subash & Co.

CHARTERED ACCOUNTANTS

PROPRIETOR

SPECIMEN OF RESOLUTION FOR FIXING REMUNERATION OF AUDITOR OF GOVERNMENT COMPANY

"RESOLVED THAT pursuant to the requirement of sub-section 8(*aa*) to section 224 of the Companies Act, 1956, the Board of Directors of the Company be and are hereby authorized to fix the remuneration and other terms and conditions, including reimbursement of out of pocket expenses in connection with the audit work, to the Statutory Auditors as appointed by the Comptroller and Auditor-General of India for the year 2012-2013."

Explanatory Statement to the above Resolution

As per section 619 of the Companies Act, 1956, the Statutory Auditors of a Government Company are appointed by the Comptroller and Auditor General of India (C&AG). The sub-section 8(*aa*) to section 224 of the Companies Act, 1956 requires that the remuneration of an auditor appointed under section 619 of the Companies Act, 1956 shall be fixed by the Company in general meeting or in such manner as the Company in general meeting may determine.

The Statutory Auditors for the Company for the financial year 2001-2002 is yet to be appointed by the C&AG.

Necessary resolution has been placed before the members for authorizing the Board of Directors to fix up the remuneration and reimbursement of other out of pocket expenses to the Statutory Auditors of the Company for the financial year 2012-2013, as and when the appointment is made by the C&AG. None of the Directors is interested in the resolution. Directors recommend the resolution as proposed in the Notice for Member's approval.

SPECIMEN OF GENERAL MEETING RESOLUTION FOR APPOINTMENT OF COMPANY'S AUDITOR OR ANY OTHER QUALIFIED PERSON AS BRANCH AUDITOR

"RESOLVED THAT the Board of Directors be and is hereby authorized to appoint the Company's Auditors and/or in consultation with Company's Auditors any person or persons qualified for appointment as auditor or auditors of the Company under section 226 of the Companies Act, 1956, so far as branch offices of the Company situated in countries outside India, in accordance with the laws of the country in which the branch offices of the Company are situated, to audit the accounts for the year ending of such Company's Branch offices in India and abroad respectively and to fix the remuneration (which in the case of the Company's Auditors shall be in addition to their remuneration as the Company's Auditor) and the terms and conditions on which they shall carry out the audits.

Explanatory Statement

The Company has branch (sales) offices at different places in India, namely, Kanpur, Ratlam, Mumbai, Delhi, Kolkata and it is proposed to authorize the Board of Directors to appoint the Company's Auditor and/or, in consultation with the Company's Auditors, persons other than the Company's Auditors qualified for appointment as Auditors of the Company under section 226 of the Companies Act, 1956, to audit the accounts of all branch (sales) offices in India at such remuneration and upon such terms and conditions as the Board of Directors deem fit, pursuant to the provisions contained in sub-section (3) of section 228 of the Act.

The Company has a branch office in Canada and depending upon the development of business the Company may open branches in some other countries. For the branches of the Company situated outside India, it is proposed to authorize the Board of Directors to appoint persons qualified for appointment as auditors or duly qualified accountants as envisaged under the provisions of section 228 of the Act to audit the accounts of such branches upon such terms and conditions as the Board of Directors may deem fit.

The resolution is proposed to give the necessary authority to the Board of Directors in this behalf. No director is interested or concerned in the resolution.

SPECIMEN OF BOARD RESOLUTION FOR TAKING ON RECORD THE APPOINTMENT OF SPECIAL AUDITOR

"**RESOLVED THAT** appointment of special auditor and fixation of his remuneration by the Central Government *vide* its Order No. ________dated _________ in accordance with the provisions of section 233A, a copy of which has been placed before the meeting and initialed by the Chairman for the purpose of identification, be and is hereby noted.

RESOLVED FURTHER THAT all expenses of special audit pursuant to the order of the Central Government be borne by the Company."

SPECIMEN OF BOARD RESOLUTIONS

I. For appointment of Cost Auditor

"**RESOLVED THAT** pursuant to the provisions of section 233B of the Companies Act 1956 and the Central Government's order, directing the audit of Company's Cost accounts relating to _______ for the year ended _______, M/s Mittal & Co, Cost Accountants be and are hereby appointed the cost auditors of the Company at a remuneration of ₹ 3,500.

RESOLVED FURTHER THAT an application be made in Form 23C to the Central Government and that Company Secretary be and is hereby authorised to submit the application to Central Government, obtain the certificate under section 233B from the proposed appointee and to comply with all other formalities in this regard."

II. For submission of cost audit report to the Central Government

"**RESOLVED THAT** the report of the Cost Auditors for the financial year 2013 – 14, placed before the meeting and initialed by the Chairman for the purpose of identification, be and is hereby recorded.

RESOLVED FURTHER THAT the report together with detailed reply of the Company be forwarded to the Central Government and that Company Secretary be and is hereby authorised to forward the report to Central Government and comply with all other formalities in this regard."

Appendix – II

Forms Related to Company Audit		
Form No.	**Pursuant to section**	**For Filling**
23B	224(1A)	Information By Auditor To Register
DD-B	274(1)(g)	Report By A Public Company
22	165	Statutory Report
23AA	209(1)	Notice For Address At Which Books Of Accounts Maintain
24B	314(1B)	Application To Central Government For Prior Approval Of Holding Office Of Place Of Profit By Certain Person
24B	22, 25, 224(3), 224(7) & 297	Application To Central Government (R D)

Past Exams Questions