

Chapter 7

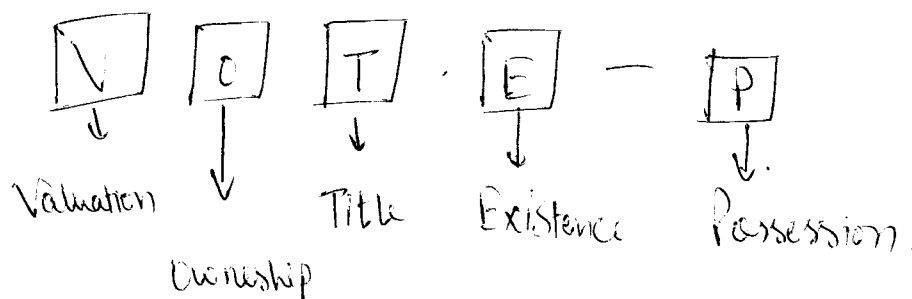
Verification

7.1 INTRODUCTION

- Verification is a process to verify the ownership, valuation, possession and existence of a particular Asset or liability. *NOTE*
- Verification establishes the correspondence of actual facts or details with those represented in accounts. *at a point of time*

Verification	Vouching <i>is a process of verifying book entries with documentary evidence thing</i>	1. It pertains to entries relating to transactions recorded in books. 2. Vouching is usually done <u>throughout the year</u>. 3. To verify the completeness, accuracy and validity of transactions. 4. Vouching is based only on documentary examination. 5. Vouching is a routine matter, which is generally conducted by junior staff or audit clerks. 6. Vouching does not include valuation.
	Verification <i>is a process of verifying value, ownership, possession of assets & liabilities</i>	1. Verification relates to the assets and liabilities appearing in the balance sheet. 2. Verification is generally carried out at <u>the end of year</u>. 3. To confirm the existence, ownership, possession, completeness, valuation and disclosure of items relating to balance sheet. 4. Verification is based on observation as well as documentary examination. 5. Verification requires experienced people and done by the senior staff. 6. Verification includes valuation.

Objectives of Verification of Assets	The objective of verification of assets is:—	
	Cost	: To ascertain the cost of Asset to the entity.
	Authorisation	: To ascertain that the transactions w.r.t. asset are authorised.
	Valuation	: To find out the accuracy of valuation of Asset.
	Existence	: To ensure that the particular Asset is actually in existence.
	Charge	: To ascertain the charge, if any, created on that particular Asset.
	Ownership	: To ascertain the actual ownership title of that particular Asset.
	Disclosure	: To check appropriate disclosure of the Asset in the books of Accounts.



7.2 VERIFICATION OF ASSETS

Verification of Building

Schedule

Can properly recorded

Dep → Building not Land

WIP

CapExp or Revenue Exp

Freehold Land

Title deed

Freehold Property

Land Purchased

Charge

Non depreciable Asset

Basis of valuation

Lease hold property

Plant and Machinery

Schedule

Authorization for purch

Installation Cost → Capital

Profit & loss on sale

Dep.

AS-10

- (a) Obtain a schedule of buildings from the entity.
 - (b) Ascertain whether original cost of purchase of buildings have been properly recorded.
 - (c) Ensure that costs of land and buildings are segregated for the purpose of depreciation as depreciation is charged on Building but not on Land.
 - (d) In case building has been constructed, the auditor should examine bills and certificates given by contractor and architect.
 - (e) For construction work in progress at the end of financial year, auditor should ascertain the cost of construction by reviewing architect's certificate.
 - (f) Ensure that distinction between capital and revenue expenditure is properly made by entity.
 - (g) Examine that the charge, if any, against the building is properly disclosed.
 - (h) Check the rate and method of computation of the depreciation.
 - (i) Examine the Title deed of the Building.
- (a) Auditor should inspect title deed and purchase deed.
 - (b) Ensure that freehold land has been shown separately in the balance sheet.
 - (c) Examine that additional land purchased during the year is properly registered in client's name and shown properly in Accounts.
 - (d) Examine that the charge, if any, against land is properly disclosed.
 - (e) Verify that the amount of profit or loss on sale of land has been correctly accounted for.
 - (f) As it is a non-depreciable asset, the same should be disclosed in the financial statements at cost.
 - (g) Basis of valuation should be verified, specially when it has been revalued during the year.
 - (h) If valuation is done by Valuer, auditor should obtain certificate from him and co-ordinate with him as per AAS-9.
- (a) Terms and conditions of lease contract should be examined by checking the lease deed.
 - (b) If a part of the leasehold property has been sublet, examine the tenant's agreements.
 - (c) Ensure that lease deed is complete in all respect.
 - (d) Verify relevant documents to check cost of property.
 - (e) Ensure that AS-19 on Accounting for lease has been followed.
- (a) Obtain schedule of plant and machinery from the entity and study it carefully.
 - (b) Verify authorisation for purchase of new plant and machinery.
 - (c) Examine whether installation costs and other charges incurred in this connection have been capitalised.
 - (d) Ensure that routine maintenance charges are debited to P&L Account.
 - (e) Auditor should examine the existence of charge by inspecting register of charges.
 - (f) Examine whether the profit or loss on sale of the machinery has been calculated and disclosed properly in the financial statements.
 - (g) Examine whether the provision for depreciation has been made in accounts at appropriate amounts.
 - (h) In case of revaluation of fixed assets, obtain MRL.
 - (i) Ensure compliance with AS-10.
 - (j) Examine the internal control over this area as per provisions of CARO.

Furniture and Fixture ↓ Schedule ↓ Physical Verification ↓ Unique ID No. ↓ Dep ↓ Loss on damaged	(a) Furniture is a moveable property, which can be easily removed from one place to other e.g. chair, table etc. (b) Fixture means an asset, which is so affixed to land or building that in fact it becomes a part of it, e.g. laboratories in the college. (c) Study the schedule of furniture containing details of type, location, cost and date of acquisition. (d) He should physically verify furniture and fixtures. (e) Examine whether every furniture has been given a unique identification number and painted on that furniture to identify that particular furniture in future. For example, in school or banks, every furniture item is given a unique number. (f) Ensure that depreciation has been properly charged on the items as per acceptable & consistent policy. (g) Ensure that the lost/damaged furniture and fittings have been written off in the profit and loss account. (h) Examine compliance with disclosure requirements.
Small Tools ↓ List ↓ Method of valuation ↓ Disclosure	(a) List of inventory of tools as well as details of date of acquisition, copy of invoice etc should be obtained. (b) Examine whether there is strict control over its issuance and storage. (c) Method of valuation should be examined to ensure whether it is regularly followed. (a) If there is change in method of valuation, it should be disclosed in the financial statements. (b) Ensure that the inventory does not include any worn out or defective article, whose life has already exhausted. (c) Ensure compliance with accounting principles and disclosure requirement.
Motor Vehicles ↓ Insurance Policy ↓ Dep Cost Capitalized ↓ (Charge if any) ↓ Dep	(a) Examine whether the entire consideration has been properly paid. (b) Examine insurance policies taken for vehicles. (c) Ensure that all costs relating to acquisition has been capitalized. (d) Examine the registration certificate to confirm the ownership and other details. (e) If a charge has been created on them, it should have been disclosed in the balance sheet. (f) Ensure that these have been valued and disclosed at cost less depreciation. (g) In case of purchase of second hand motor vehicle, confirm the details w.r.t. cost and ownership of same.
Patents ↓ List ↓ Existence, Ownership ↓ Renewal fees. ↓ AS 26.	(a) A patent is an official document providing right to investor to make, use or sell his invention. (b) Study the list of patents owned by client as on balance sheet date. (c) Verify the existence and ownership of a patent by examining certificates or patent letters. (d) Examine whether renewal fees have been paid on due dates. (e) Ascertain that the patent has not been lapsed by carefully examining the receipts of amount paid on renewal including details thereof. (f) Ensure the compliance with Accounting Standard 26.

Copy Rights ↓ Schedule ↓ Agreement ↓ Proper valuation	(a) A copyright provides the exclusive legal right to the owner to produce or reproduce some kind of literary work. (b) It is the legal protection provided to owner of the copyright so that copying his work by others can be prohibited. (c) The auditor should obtain a schedule of copyrights from client. (d) Auditor should examine agreements and other supporting evidence. (e) The auditor should ensure that valuation has been made on a fair and reasonable basis.
Trademarks ↓ Certificate of Reg ↓ Invoice of Purchase → check Purchase document ↓ Renewal slip ↓ B/S → disclosure	(a) A trademark means a distinctive sign or brand name, so that the customers can easily identify the product. (b) Examine the certificate of registration. (c) If trademarks are purchased, the agreement with the seller should be verified. (d) Examine copy of receipt w.r.t. renewal payments made. (e) Ensure that trademarks are shown in the balance sheet at their cost less amortization charges.
Goodwill ↓ Board Authorization for Pur ↓ AS (No self generated g/w) ↓ Disclosure B/S	(a) Goodwill is determined when the business is earning a profit, which is above normal profit in similar business. (b) Examine board authorisation for purchase or rising of goodwill. (c) Examine consistency of method of valuation of goodwill. (e) Ensure the compliance with generally accepted Accounting principles and AS 26. (f) Ensure that there is adequate disclosure of goodwill in the balance sheet.
Investments ↓ Schedule ↓ Purchase agreement ↓ Auth. authorization ↓ Cr & Long term Asset has been classified ↓ Invests → Custor NRV ↓ ↓ Title deed ↓ Possession	(a) Obtain schedule of securities and shares in hand at beginning and at end of the period. (b) Obtain schedule of securities and shares purchased and sold during the year. (c) Examine whether the investments made by the entity are properly authorised. (d) In case, investments are in physical form, inspect the investment certificates at the end of the accounting period. (e) In case, investments are kept in DMAT form, obtain statement from depository. (f) Check if current & long term investments have been properly classified. (g) Current investment should be carried at lower of cost or realizable value. (h) Inspect the investment certificates to confirm the title of client. (i) Inspect title deeds for investment in immovable properties. (j) Ensure that the market value of investments is in accordance with the market quotations. (k) Ensure the compliance with the provision of Accounting Standard 13, CARO 2004 and section 227(1A), (4A) of The Companies Act.

Debtors

1. <i>Checking of records</i>	(a) Examine the existence, accuracy and recoverability of debtor balances. (b) Ensure whether the balances shown in the ledger accounts are consistent with balances as per control accounts. (c) Examine the following:— ▪ Credit policy of the entity. ▪ The aging of debtors. (d) Ensure that bad debts have been written off with proper authorisation. (e) In case of claims made against insurance companies, railways etc., the auditor should examine the correspondence to ascertain whether the claims has been acknowledged as debts.
2. <i>Direct confirmation from debtors</i>	(a) He should directly communication with debtors to ascertain whether the balances are genuine and undisputed. (b) Method of requesting confirmation and the selection of debtors are to be determined by the auditor using his professional judgement. (c) The form of requesting confirmation may be either: I. POSITIVE FORM: Reply whether he agrees or not with the balance shown or fill up required information. <i>Must Reply</i> II. NEGATIVE FORM: Reply only if he disagrees with the balance shown. <i>Reply only in case of disagreement.</i> (Note: Students may mention points from AAS 30)
3. <i>Analytical review procedures</i> <u>ARP</u>	Auditor should make comparison of : (a) current year's aging schedule with that of the previous year. (b) significant ratios relating to debtors with the standards. (c) actual closing balances of debtors with the corresponding budgeted figure. (d) closing balance of debtors with the corresponding figures of the previous year. (e) current year debtor balances and the current year sales with budgeted figures w.r.t. same.
4. <i>Disclosure</i>	Ensure the compliance with the provisions of the Companies Act, 1956 and AS 18.
Cash at bank ↓ Cash book ↓ FD Receipt ↓ RRS ↓ Bank Confirmation	(a) Compare the entries in ledger of the client with entries in cash book/ bank statement. (b) Examine fixed deposit receipts and bank advices for verification of fixed deposits made. (c) Cash in transit should be verified with reference to their subsequent credit in bank account. (d) Examine the bank reconciliation statement to ascertain the differences. (e) Examine the total number of bank accounts maintained by the entity. (f) Obtain balance confirmation from bank.

Cash in hand

↓
Physical verification
↓
Surprise check
↓
Proper disclosure
↓
Postage & revenue slip
shown sep

- He should carry out physical verification of cash in hand at the year end
- He should also carry out surprise check on cash any time during the year
- Examine all items of cash balance e.g. Main cash, petty cash, imprest balances with the employees etc. simultaneously. This is required to rule out the possibility that the shortage in one balance is made good by transfer of amount from others.
- Ensure disclosure of cash in the financial statements as per recognized practices and relevant statutory requirements.
- Ensure that temporary advances are not included in cash-in-hand.
- If postage and revenue stamps exists in a substantial number, they should be shown separately and not included in cash-in-hand.
- A cash summary should be prepared on the verification date which should be signed by both cashier & auditor and auditor should keep one copy.

Inventories

↓
I.C.
↓
Attend stock verification or count
↓
Charges if any
↓
ARP
↓
Classification
↓
Disclosure → AS.

- It means tangible assets that are held for sale or use in the production of goods and services. Inventory includes:
 - Raw materials
 - Work-in-Progress
 - Finished goods
 - Stores, supplies and spare parts
- Examine internal controls for stock movement and ensure that the same has been operating effectively throughout the period.
- Examine various stock records like receiving reports, inspection reports, material issue notes etc.
- Attend & observe physical count of inventory conducted by the management.
- Enquire about charges on inventory.
- Ensure that a proper cut-off procedure has been followed.
- Perform Analytical Review Procedure.
- Ensure the compliance with Accounting Standard 2.
- Ascertain that inventories have been properly classified and disclosed in the financial statements as per recognized accounting principles and statutory requirements.

Stock lying with third party

↳ MRL
↓
Direct Confirmation
↓
Stage of Completion
↓
Disclosure

- Obtain MRLs as regards to reasons of stock lying with third parties.
- Such stock can lie with agents in usual course of business.
- Obtain direct confirmation from third parties regarding existence and condition of stock in their possession.
- He can crosscheck the subsequent receipt of such stock after balance sheet date.
- In case, such goods are semi finished, he should confirm stage of completion of goods to ascertain their valuation.
- Obtain evidences as per AAS-34.

Bills Receivable

↓
→ Renewal.
→ op balance
→ Reasons for overdue
→ MRL.
→ Certificate from bank in case
→ In case of bill dishonoured
Check bank advice

- Examine opening balance of bills receivable w.r.t. last year's audited balance sheet.
- In case of bills which have been matured but the amount in respect thereof has not been received, ensure that these have been renewed subsequently.
- Examine reasons for any long outstanding or overdue bills and enquire the reasons thereof.
- Obtain a confirmation certificate from the bankers for bills held by them for collection.
- Examine that adequate provision has been made for dishonoured bills.
- Examine that these have been properly shown in the Balance Sheet.

Prepaid Expenses

↓
 Loans & Adv.
 ↓
 Calculation
 ↓
 Disc.losure

- (a) Prepaid expenses are assets representing expenditure already incurred, some portion or whole of which relates to a period subsequent to the date of the Balance Sheet.
- (b) Prepaid expenses are disclosed under the head 'Loans and Advances' in the asset side of the Balance Sheet.
- (c) The auditor should ensure the proper calculation and accounting of prepaid expenses.
- (d) Examine whether all prepaid expenses have been taken into account.

**Stock Policies/
Endowment
Policies**

- (a) Endowment policies or Sinking fund policies may be taken for purposes like redemption of debentures etc. where a lump sum amount is required at a certain future date.
- (b) These are generally considered as Quasi Fixed Assets.
- (c) Inspect the policy to ascertain the purpose for which it has been taken.
- (d) Determine the amount of premium payable and the due date for payment.
- (e) Ensure that value of the policy has been properly disclosed in the Financial Statements.

7.3 VERIFICATION OF LIABILITIES

**Loans and
Borrowings**

↓
 MOA/AOA
 ↓
 Certificate of Security
 ↓
 Purpose
 ↓
 Charge on asset
 ↓
 T.S. O/S.

- (a) Examine the MOA and AOA to check whether the company is authorised to borrow the money.
- (b) Examine the resolutions by shareholders for excess borrowings.
- (c) Obtain a certificate from the bank regarding securities deposited with the bank in case of secured loans.
- (d) Examine whether these have utilised for specified purpose only.
- (e) If the loan is secured by a charge on the asset of the company, examine the particulars of the assets charged.
- (f) Obtain confirmations from lender w.r.t. loans and borrowings outstanding and interest payable on them.
- (g) Ensure the compliance with legal requirements for disclosure.

Trade Creditors

↓
 Schedule of Crs.
 ↓
 Purchase Ledger
 ↓
 Prov. for dis.
 ↓
 Purchase near B/S date
 ↓
 MRL
 ↓
 Direct Confirmation

- (a) Study the schedule of creditors and examine it with individual creditor's accounts.
- (b) The purchase ledger should be examined with the invoices etc.
- (c) Provisions for discount on creditors should be examined carefully.
- (d) Examine compliance with conditions of agreements in case of goods purchased on hire purchase basis.
- (e) Examine goods inward book to check that all the goods received near the balance sheet date have been duly accounted for.
- (f) Ascertain compliance with recognized accounting principles and relevant statutory requirements.
- (g) Obtain MRL if few accounts have remained unpaid for a long time.
- (h) Obtain confirmations of the amount due, directly from the creditors.

Contingent Liabilities

MRL
↓
Lawyer
↓
AS
↓
Footnote

- (a) It means obligation relating to past transactions or other events or conditions which may or may not arise in future.
- (b) Obtain MRL containing a statement of contingent liabilities.
- (c) Review list of pending legal cases and discuss with management and lawyer.
- (d) Ensure that contingent liabilities do not include such item on which there is a probability of loss, as these should be shown under confirmed liabilities.
- (e) Examine the compliance with Accounting Standard 29.
- (f) Ascertain whether contingent liabilities have been shown as a foot note to the balance sheet, containing the general nature and amount of each contingent liability.

Bills Payable

Schedule
↓
I.C.
↓
(Confirmation)
↓
Charge on asset

- (a) Obtain a schedule of bills containing details of terms, conditions and amount.
- (b) Review the internal control procedures for acceptance of bills.
- (c) Obtain confirmation from drawers of bills payable regarding amounts due thereon.
- (d) Reconcile the total of bills payable outstanding at the end of the year with the balance in bills payable account.
- (e) Examine payments made on maturity of bill or earlier and confirm that the relevant bills have been cancelled.
- (f) Examine appropriateness and disclosure of the charge, if any, created on any asset for the payment of bills.

Amount due to subsidiary companies

MOA
↓
Int Rate
↓
Terms & Conditions
↓
B/S

- (a) Examine whether the subsidiary company is authorised by its MOA to advance loan to the holding company.
- (b) Verify the interest rate at which loan has been obtained.
- (c) Examine the terms and conditions w.r.t. same.
- (d) Verify the balance sheet of subsidiary company to examine whether loan is duly reflected in its balance Sheet.
- (e) Examine compliance of AS-18.

Outstanding Expenses

List
↓
AR?
↓
all provided
↓
Documentary Evidence

- (a) Obtain a list of outstanding expenses as on the Balance Sheet date, detailing nature of expense.
- (b) Perform Analytical Review Procedures. For example-compare current year's outstanding expenses with that of last year to identify significant variations.
- (c) Ensure that all usual outstanding expenses like salaries, wages, rent etc have been provided.
- (d) Verify the documentary evidence supporting the outstanding expenses.
- (e) Ensure that the outstanding expenses have been shown as Current Liabilities in Balance Sheet.
- (f) Examine whether expenses like wages, interest etc. for which amount can be ascertained, have been accounted at appropriate amount. For others, check whether provision has been made with reasonable accuracy.

Some Accounting Concepts

8.1 DIFFERENCE BETWEEN CAPITAL AND REVENUE EXPENDITURE

BASIS	CAPITAL EXPENDITURE	REVENUE EXPENDITURE
Meaning	It means expenditure incurred for acquiring assets including incidental expenses.	It means expenditure incurred to carry on operations of an entity during an accounting period.
Example	Installation charges incurred w.r.t. machinery. <i>Machinery</i>	Salary to staff, travelling expenses, regular maintenance charges w.r.t. machinery.
Effect on earning Capacity of Entity	It <i>increases</i> the revenue earning capacity of the business.	It helps in <i>maintaining</i> the revenue earning capacity of business.
Accounting Treatment	Amount of capital expenditure is debited to Asset account and shown in Balance Sheet after charging depreciation.	It is debited to respective nominal account and finally shown in P & L account. However, deferred revenue expenditure is written off over a period of time.

8.2 DEPRECIATION

Meaning- AS 6	Measure of wearing out, consumption or loss of value of a depreciable asset.		
It arises due to	1 Use; 2 Effluxion of time; or 3 Obsolescence. of technology Thus, it is necessary to provide for depreciation on assets even when they are not in use because depreciation may arise due to effluxion (passage) of time also.		
Difference between Depreciation and fluctuation in value	Basis	Depreciation	Fluctuation
	Meaning	Reduction in value of an asset	Increase /decrease in value of an asset
	Asset in question	Fixed asset	Current asset
	Reason	Due to internal causes like wear and tear, <i>use, effluxion of time</i>	Due to external causes like market rates
	Nature	Permanent	Temporary
	Treatment	It should be provided	It can be ignored
	Earning capacity	It affects the earning capacity of the Assets	It does not affects the earning capacity of the Assets

Depreciation - Purposes	Adherence to matching concept	The cost of use of fixed asset during a financial year (depreciation) is charged to the same accounting year's revenue, resulting in matching of expense and revenue.
	Keeping the capital invested in fixed assets intact	Sinking fund is usually created to retain the amount of depreciation charged in the P&L account.
	Compliance with statutory requirements	Depreciation should be provided on fixed assets at specified rates as per the requirements of the Companies Act, 1956.
	Presenting a true and fair view of the assets of an entity	Cost of fixed assets decreases due to use, effluxion of time or obsolescence. The amount of depreciation is reduced from the historical cost of the asset. Thus, the assets are recorded at a true and fair value in the balance sheet.
Amount of depreciation	The amount of depreciation is charged to the P&L account of the accounting year.	
Method of providing for depreciation	▪ Straight Line Method (SLM) ▪ Written Down Value (WDV) Method.	
Change in method	The method of providing for depreciation should be consistently applied. However, as per AS-6, a change in the method of providing depreciation would be made if new method: → ▪ is required by statute; or → ▪ is required for compliance with an accounting standard; or ▪ results in a better preparation or presentation of the financial statements.	
Disclosure requirements in financial statements	▪ The historical cost or other amount substituted for historical cost of each class of depreciable assets; ▪ Total depreciation for the period for each class of assets; and ▪ The related accumulated depreciation. Historical Cost less: Accumulated dep. = Net Depreciable Cost	
Requirements of Companies Act, 1956 w.r.t. Depreciation	Basis for providing depreciation	Depreciation is to be calculated at the rate specified in Schedule XIV; or Depreciation should be arrived at by dividing ninety-five per cent of the original cost of the depreciable asset by the "specified period" in respect of such asset.
	Depreciation on low value items	▪ Assets costing upto Rs. 5,000 shall be depreciated at the rate of 100%. ▪ If the aggregate cost of individual items of plant and machinery, costing upto Rs. 5,000, constitutes more than 10% of the total cost of plant and machinery, depreciation will be provided on such items at the rate mentioned in the Schedule.
	Rates higher than the rates specified in the Schedule	▪ The rates specified in Schedule XIV are minimum rates. ▪ If higher rates of depreciation are charged, such rates should be disclosed properly in annual accounts.

Provision for depreciation before declaring dividend

- It is mandatory to provide for depreciation for the current year as well as for arrears of depreciation before declaring dividends out of current profits.
- However, CG has the power to allow any company to declare dividends for any financial year out of the profits for that year without providing for depreciation at all or at a rate lower than prescribed rates.

Different methods of depreciation for different assets

but it should be consistently followed.

- A company may adopt different methods of depreciation for different assets provided the system is followed consistently
- For example, SLM may be used for depreciating furniture and fixtures and WDV may be used for depreciating buildings.

but the same shd be followed in the next yrs also.

8.3 DIFFERENCE BETWEEN PROVISION AND RESERVE

Basis	Provision	Reserve
Meaning- As per the Companies Act' 1956	It includes an amount— 1. written off; or 2. retained by way of providing for depreciation or reduction in the value of assets; or 3. retained by way of providing for any known liability	It includes amount in the business which cannot be classified as provisions
✓ Provides for	Known liabilities and anticipated losses	Increase in capital employed
✓ Nature	Charge against profits	An appropriation of profits
✓ No profits in a year	Required even in absence of profits, i.e., compulsorily to be made	Not required in absence of profits
✓ Example	Provision for tax, provision for bad debts	General reserve

8.4 DIFFERENCE BETWEEN GENERAL AND SPECIFIC RESERVE

Basis	General reserve	Specific reserve
Purpose	For strengthening the financial position of the company and making funds available for any future contingencies.	For providing for a specific liability.
Requirement	For declaring dividends, it's creation is mandatory under the Companies (Transfer of Profits to Reserves) Rule, 1975.	Sometimes, creation of specific reserve is mandatory for the limited companies. (Eg. <u>Debenture redemption reserve</u>).
Use	It can be used for many general purposes (Eg: declaration of dividend, purchase of fixed asset).	It can be used only for the purpose it was initially made such as debenture redemption reserve.

Chapter 9

Company Audit-1

9.1 QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS (Sec. 226)

1. Qualifications	(a) A chartered accountant holding a certificate of practice. C A (b) A holder of certificate in 'Part B' State entitling him to act as an auditor.
2. Disqualifications ↳ A Pvt Co. ↳ A partner of the Co. ↳ Employee of the Co. ↳ Debt of more than Rs. 1,000 ↳ security of company ↳ A person who is disqualified to become an auditor of company's subsidiary or holding company.	(a) A body corporate. (b) An officer or employee of the company. (c) A person who is a partner of an officer or employee of the company. (d) A person who is an employee of any officer or employee of the company. (e) A person who is indebted to the company or who has given any guarantee of any third person to the company, if the amount of debt or guarantee exceeds Rs. 1,000. (f) A person holding any security of the company. The expression 'security' means any instrument, which carries voting rights. (g) A person who by virtue of any of the aforesaid provisions is disqualified for appointment as an auditor in the company's subsidiary or holding company, or a subsidiary of that company's holding company.
3. Vacation of office AGM & AGM	The auditor shall vacate his office if after appointment as an auditor any of the disqualifications are attracted to him.
4. Examples	(a) If an auditor purchases on credit goods of the company of a value exceeding Rs. 1,000, he shall be indebted to the company, and consequently he shall vacate the office of auditor held by him. It is immaterial that the credit period allowed to the auditor is allowed to all the customers in the ordinary course of business. (b) If an auditor recovers fees from the company on a progressive basis, even though the audit has not been completed, he cannot be said to be indebted to the company, and therefore, he shall not vacate the office of auditor held by him.

9.2 CEILING ON NUMBER OF AUDITS [Sec. 224(1B)]

1. What is the ceiling?	<i>In case the auditor is an individual</i>	The ceiling is 'specified number' 20
	<i>In the case of a firm of auditors</i>	The ceiling is 'specified number' for every partner of the firm.
	<i>Where any partner of the firm is also a partner of any other firm of auditors</i>	The ceiling is 'specified number' for such person in all the firms taken together.
	<i>Where any partner of a firm of auditors is also practicing in his individual capacity</i>	The ceiling is 'specified number' for such person in the partnership firm and in his individual capacity taken together.

20 - 10 more of public to establish more

2. Meaning of specified number	'Specified number' means – – not more than 20 companies – of which not more than 10 should be companies having a paid up capital of Rs. 25 lakhs or more.								
3. Audits excluded	Following audits shall not be included while computing 'specified number': (a) Audit of a private company. <i>Pvt</i> (b) An audit of a guarantee company having no share capital. <i>Guarantee</i> (c) An audit of a foreign company. <i>F</i> (d) An internal audit. <i>I</i> (e) Audit of cooperative societies, trusts and corporations. <i>Comp</i> (f) Tax audits under Income Tax Act, 1961. <i>IT</i> (g) Special audit and investigations. <i>SA</i> (h) A branch audit. <i>Branch</i>								
4. Audits included	Following audits shall be included while computing 'specified number': (a) A joint audit (b) An audit of a company licensed u/s 25.								
5. Maximum number of audits	An auditor can accept a maximum of 30 audits including the audits of private companies (Notification issued by ICAI). Non-observance of this ceiling would amount to professional misconduct.								
6. Certificate by the auditor	<table> <tr> <td><i>Certificate given by whom?</i></td><td>The auditor</td></tr> <tr> <td><i>Certificate given to whom?</i></td><td>The company</td></tr> <tr> <td><i>Time of giving certificate</i></td><td>Before the appointment of auditor</td></tr> <tr> <td><i>Requirements of certificate</i></td><td>The certificate shall state that the appointment of auditor, if made, will be within the ceiling on number of audits as specified u/s 224(1B).</td></tr> </table>	<i>Certificate given by whom?</i>	The auditor	<i>Certificate given to whom?</i>	The company	<i>Time of giving certificate</i>	Before the appointment of auditor	<i>Requirements of certificate</i>	The certificate shall state that the appointment of auditor, if made, will be within the ceiling on number of audits as specified u/s 224(1B).
<i>Certificate given by whom?</i>	The auditor								
<i>Certificate given to whom?</i>	The company								
<i>Time of giving certificate</i>	Before the appointment of auditor								
<i>Requirements of certificate</i>	The certificate shall state that the appointment of auditor, if made, will be within the ceiling on number of audits as specified u/s 224(1B).								

9.3 FIRST AUDITORS

[Sec. 224 (5)]

1. Manner of appointment	<table> <tr> <td><i>Appointment by whom?</i></td><td>The Board</td></tr> <tr> <td><i>Time limit for appointment by Board</i></td><td>Within 1 month of registration of the company</td></tr> <tr> <td><i>Failure of Board to appoint the first auditors within 1 month – Consequences</i></td><td> ▪ Appointment shall be made by members in GM. ▪ The appointment requires an ordinary resolution. </td></tr> <tr> <td><i>Articles naming the first auditors are void</i></td><td>The only method of appointment of first auditors is as laid down in Sec. 224(5). Therefore, the auditors of a newly formed company cannot be appointed through the memorandum or articles of association.</td></tr> </table>	<i>Appointment by whom?</i>	The Board	<i>Time limit for appointment by Board</i>	Within 1 month of registration of the company	<i>Failure of Board to appoint the first auditors within 1 month – Consequences</i>	▪ Appointment shall be made by members in GM. ▪ The appointment requires an ordinary resolution.	<i>Articles naming the first auditors are void</i>	The only method of appointment of first auditors is as laid down in Sec. 224(5). Therefore, the auditors of a newly formed company cannot be appointed through the memorandum or articles of association.
<i>Appointment by whom?</i>	The Board								
<i>Time limit for appointment by Board</i>	Within 1 month of registration of the company								
<i>Failure of Board to appoint the first auditors within 1 month – Consequences</i>	▪ Appointment shall be made by members in GM. ▪ The appointment requires an ordinary resolution.								
<i>Articles naming the first auditors are void</i>	The only method of appointment of first auditors is as laid down in Sec. 224(5). Therefore, the auditors of a newly formed company cannot be appointed through the memorandum or articles of association.								
2. Tenure of office	The first auditor shall hold his office until the conclusion of the first AGM.								
3. No notice of appointment	▪ There is no requirement regarding intimation of appointment to the first auditors by the company. ▪ Similarly, first auditors are not required to inform the registrar as to whether they have accepted the appointment or not.								

Within 1 month
First Auditor
BoD
for OK

for OK
Special Resolution

9.4 SUBSEQUENT AUDITORS

(Sec 224)

1. Appointment at an AGM <i>2 P 3</i>	<i>Nature of meeting</i>	At every AGM, the auditors are appointed or reappointed by the company.
	<i>Nature of resolution</i>	Ordinary resolution
	<i>Nature of business</i>	Ordinary business
2. Tenure of office	The auditors hold office from the conclusion of the meeting in which they are appointed to the conclusion of the next AGM.	
3. Notice of appointment	<i>Notice by the company</i> <i>2 P 3</i>	- The company shall give notice of appointment or reappointment to the auditor. - Such notice shall be given <i>within 7 days</i> of the appointment or reappointment.
	<i>Notice by auditor</i> <i>2 P 3</i>	- The auditor shall give notice to the registrar - Such notice shall be given <i>within 30 days</i> of receipt of notice of appointment or reappointment from the company. - The notice shall state as to whether he has accepted or refused the appointment.

9.5 REAPPOINTMENT OF RETIRING AUDITOR

[Sec. 224(2)]

1. Reappointment of retiring auditor	- At an AGM, - the retiring auditor, <i>by whatsoever authority appointed</i>, - shall retire and he shall be reappointed.
2. Exceptions <i>→ disqualification</i> <i>→ notice to be given</i> <i>→ resolution passed</i> <i>→ notice given</i>	The retiring auditor shall not be reappointed in the following cases: - Where he is not qualified or is disqualified for reappointment. - Where he has expressed his unwillingness in writing to be reappointed. - Where a resolution has been passed at the AGM appointing somebody instead of him or providing expressly that he shall not be reappointed. - Where notice has been given of an intended resolution to appoint some person in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person, the resolution cannot be proceeded with.
3. AGM not held within time – Whether auditor vacates his office?	- The auditors hold office from the conclusion of the meeting in which they are appointed to the conclusion of the next AGM. As such, the appointment of auditors is made in terms of this period and not for any FY. - Therefore, an auditor shall continue in his office even if AGM is not held within the time limits specified u/s 166 and 210.

NO AGM - RET.

9.6 APPOINTMENT OF AUDITORS BY CG**[Sec. 224(3), (4)]**

1. Notice to CG	<i>Notice by whom?</i>	The Company shall give notice to CG.
	<i>When is notice required?</i>	If no auditors are appointed or re-appointed at an AGM.
	<i>Time limit for giving notice</i>	The notice shall be given by the company <i>within 7 days</i> of conclusion of AGM.
2. Appointment by CG	On receipt of notice from the company, CG shall fill the vacancy.	
3. No auditor is appointed – Examples	(a)	Where the appointment of a person appointed as an auditor in an AGM is void <i>ab initio</i> .
	(b)	Where OR is passed, but the appointment of auditors requires SR.

9.7 CASUAL VACANCY IN THE OFFICE OF AUDITORS**[Sec. 224(6)]**

1. Meaning of casual vacancy	A casual vacancy means a vacancy arising in the office of an auditor before the expiry of his term in normal course. Where a partnership firm is appointed as an auditor, then admission, death or retirement of a partner in the firm will amount only to a reconstitution of the firm. It does not amount to a casual vacancy, and therefore, Sec. 224(6) is not attracted.	
2. Manner of filling casual vacancy	<i>Casual vacancy arising by resignation of auditor</i>	The vacancy shall be filled by the shareholders in GM.
	<i>Casual vacancy arising by any other reason</i>	The vacancy shall be filled by the Board.
3. Other joint auditors may act	Till the time a casual vacancy continues, the remaining auditor or auditors (<i>i.e.</i> , the other joint auditors), if any, may act.	
4. Tenure of office	Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.	

9.8 APPOINTMENT OF AUDITORS BY SPECIAL RESOLUTION**(Sec. 224A)**

1. When is special resolution required for appointment of auditor?	If not less than 25% of the subscribed share capital is held by –	
	(a)	CG
	(b)	SG
	(c)	A Government Company
	(d)	Public Financial Institution
	(e)	Any financial or other institution established by any State Act in which SG holds not less than 51% of the <i>subscribed share capital</i>
	(f)	A nationalised bank
	(g)	An insurance company carrying on general insurance business

2. Failure to pass special resolution – Consequences	No appointment of auditor	It shall be deemed that no auditor had been appointed by the company.
	Duties of the company	- The company shall give notice of that fact to CG. - The notice shall be given <i>within 7 days</i> of conclusion of AGM.
	Appointment of auditors	CG shall make the appointment of auditors.
3. Material date for reckoning 25% capital is the date of AGM	- The material date to determine whether Sec. 224A is attracted, is the date of AGM. - In other words, Sec. 224A must be complied with if the shareholding of institutions specified u/s 224A is – - less than 25% as on the date of despatch of notice of AGM; <i>but</i> - the shareholding exceeds to 25% or more as on the date of AGM.	

9.9 REMUNERATION OF AUDITORS

[Sec. 224(8)]

1. Right to fix remuneration <i>600 → 800</i>	If appointment is made by members	(i) The remuneration shall be fixed by the members in GM. (ii) Alternatively, the GM may determine the manner in which the remuneration shall be fixed.
	If appointment is made by Board	The remuneration shall be fixed by the Board.
	If appointment is made by CG	The remuneration shall be fixed by CG.
	If appointment is made by CAG	(i) The remuneration shall be fixed by the members in GM. (ii) Alternatively, the GM may determine the manner in which the remuneration shall be fixed.
2. Meaning of 'remuneration'	- Any sum paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression 'remuneration'. - Out-of-pocket-expenses of the auditors shall be included in the remuneration unless the resolution fixing the remuneration specifically provides that such expenses shall be paid separately. - Remuneration for other services is permissible without sanction of shareholders. However, disclosure in P&L A/c is required.	

9.10 REMOVAL OF AUDITORS

(Sec. 224, 225 and 408)

1. Removal of first auditor before expiry of his term (i.e., before the 1st AGM) (Sec. 224(5))	(a) OR shall be passed at a GM. (b) No special notice is required, for such removal. (c) Procedure prescribed u/s 225(2) and (3) shall be followed. (d) Any other person may be appointed in his place of whose nomination a notice has been given to the members <i>not less than 14 days</i> before the date of the meeting.
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2. Removal of auditor or before expiry of his term (i.e., before the AGM) [Sec. 224(7)]	(a) Previous approval of CG is required. (b) OR shall be passed at a GM. (c) No special notice is required for such removals. (d) Procedure prescribed u/s 225(2) and (3) shall be followed.	
3. Removal of auditor (whether first auditor or subsequent auditor) at an AGM (Sec. 225)	(a) Previous approval of CG is not required. (b) OR shall be passed at a GM. (c) Special notice is required for such removal. (d) Procedure prescribed u/s 225(2) and (3) shall be followed. <i>Special notice may require that –</i> (a) the retiring auditor shall not be reappointed; or (b) some person, other than retiring auditor, shall be appointed as an auditor.	
4. Removal by CG (Sec. 408)	<i>When can CG exercise its powers u/s 408?</i>	Where appointment of nominee directors is made u/s 408 to end the oppression or mismanagement.
	<i>Nature of powers of CG</i>	- Amongst other powers, CG has power to give directions to the company u/s 408. - The directions may include a direction to remove the existing auditor. - The directions given by CG shall come into effect as if all the provisions of the Act in this behalf have been complied with.
	<i>Effect of direction of CG</i>	The existing auditor shall vacate office without requiring any action for his removal.

Procedure prescribed u/s 225(2) and (3)

1. Notice to auditor	The company shall send the notice of removal to the auditor.	
2. Rights of the auditor	(a) Right to be heard orally at the meeting. (b) Right to make a representation in writing to the company. (c) Right to get his representation circulated amongst the members.	
3. Duties of the company	(a) To send a copy of the representation to every member of the company. (b) To state the fact of the representation having been made in the notice given to the members.	
4. Reading of representation	If a copy of representation is not sent by the company to the members, the auditor may require that the representation shall be read out at the meeting.	
5. Intervention by CLB	<i>Application to whom?</i>	An application may be made to CLB.
	<i>Application by whom?</i>	- The company; or - Any other aggrieved person.
	<i>Satisfaction of CLB</i>	The right to make a representation is being abused by the auditor to secure needless publicity for defamatory matter.
	<i>Orders by CLB</i>	(a) Copies of representation need not be sent to the members. (b) The representation need not be read out at the meeting. (c) Costs on such an application shall be paid by the auditor.

9.11 RIGHTS OF AUDITORS**(Sec. 227)**

1. Right to access to books of account	The auditor has the right of access <i>at all times</i> to all the books, accounts and vouchers of the company.	
2. Right to obtain information and explanations	The auditor has the right to obtain such information and explanations as he may think necessary for the performance of his duties as an auditor.	
3. Right to attend GM	▪ Every notice of GM shall be sent to the auditor (Sec. 172). ▪ The auditor has the right to attend any GM (Sec. 172).	
4. Right to be heard at GM	The auditor has the right to speak on any matter <i>which concerns him as an auditor</i> (Sec. 231).	
5. Rights in respect of branch office	<i>When are the rights available?</i>	If the accounts of any branch office are audited by a person other than company's auditor.
	<i>Nature of rights</i>	(a) Right to visit the branch office. (b) Right of access at all times to the books, accounts and vouchers of the company maintained at the branch office.
6. Right of lien – Conditions	(a) The books must belong to the company. (b) The documents must have come into the 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.	
7. Right to receive remuneration		
8. Right to receive notice of removal		
9. Right to make a representation on removal		

9.12 DUTIES OF AUDITORS**(Sec. 227 and 229)**

1. Duty to make an audit report	<i>Report to members</i>	It is the duty of the auditor to make a report to the members. However, he is not required to send his report to every member.
	<i>Reading of auditor's report</i>	▪ The auditor's report shall be read before the company in GM. ▪ The report shall be open to inspection by any member (Sec. 230).
	<i>Scope of audit report</i>	The audit report shall relate to – (a) the accounts examined by him; (b) B/S of the company; (c) P&L Account of the company; <i>and</i> (d) documents annexed to the B/S and P&L a/c.

2. D

make

Report on true and fair view

The auditor shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the B/S and P & L A/c give –

- (a) the information required by the Act; *and*
- (b) a true and fair view of state of affairs of the company.

Report on principal assertions

The audit report shall also state–

- (a) whether he has obtained all the information and explanations;
- (b) whether, in his opinion, proper books of account have been kept;
- (c) whether the report of branch auditor has been forwarded to him and how he has dealt with the same in preparing his audit report;
- (d) whether the B/S and P&L account are in agreement with the books of account and returns;
- (e) whether AS have been complied with;
- (f) the observations or comments of the auditors which have any adverse effect on the functioning of the company in thick type or in *italics*;
- (g) Whether any director is disqualified from being appointed as a director u/s 274(1)(g);
- (h) Whether cess payable by the company has been so paid.

Report on CARO

The auditor has to report on all the matters specified in CARO.

Report on specific enquiries

- (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.
- (b) Whether book entries are prejudicial to the interests of the company.
- (c) Whether the sale price of the shares, debentures and other securities held by the company is less than their purchase price.
- (d) Whether loans and advances made by the company have been shown as deposits.
- (e) Whether personal expenses have been charged to revenue account.
- (f) Where it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.