Company Auditor

- **Qualification of Auditors [Sec. 226 (1) & (2)]:-**
  (1) He is a "CA" within the meaning of Chartered Accountant act, 1949
  - A firm where of all the partners practicing in India are qualified for appointment as auditor, it may be appointed by its firm name

  (2) The Holder of a certificate under the restricted auditors certificates Rules, 1956 shall be entitled to be appointed as on auditors of companies.

- **Disqualification of Auditors [Sec.226 (3),(4) & 226(5)]**
  The following person shall not be qualified for appointment as auditor of a company.
  (a) A body Corporate.
  (b) An officer or employee of the company.
  (c) A person who is a partner or who is in the employment, of an officer or employee of the company.
  (d) A person who is indebted to the company for an amount exceeding Rs.1000 or who given any guarantee of any third party to the company for amount >Rs.1000.
  (e) A person holding any security of the company which carries voting rights.
  (f) Sec. 226(4), A person shall not be qualified for appointment as auditor of a company if he is statutorily disqualified for appointment as auditor of any other body corporate which is ,
    (1) A subsidiary of that company.
    (2) A holding company of that company.
    (3) A subsidiary of that company's holding company.
    (4) Would be so disqualified if that body corporate were a company.

Sec.226 (5):- An auditor, who after his appointment becomes subject to any disqualification, shall be deemed to have vacated his office as an auditor.

- **Appointment by Shareholders [Sec. 224 (1)]**
  - Every company shall at each AGM, appoint auditor
  - Tenure: This AGM to next AGM
  - An after appointment, Company shall within 7 day intimates the auditor about his appointment.
  - Company should obtain the Certificate from Auditor that he is not disqualified u/s 224(1B)

- **Intimation to ROC within 30 days after receipt of intimation by company in Form 23B [Sec. 224 (1A)]**

- **Ceiling on number of Audits [Sec. 224 (1B)]**
  - No company or its BOD shall appoint any person who is full time employment elsewhere "or" On the date of appointment already holds appointment of more than specified number (i.e. 20)[Out of which not more than 10 should have paid up capital more than or equal to Rs. 25 lakhs]
  - **Included:-**
    i. Joint Audits
    ii. Sec. 25 company
    iii. Company limited by guarantee & having share capital
    iv. Govt. company Audit
  - **Not counted:-**
    i. Branch Audit if doing the HO also
    ii. Private companies
    iii. Foreign companies
    iv. Special Audit u/s 233A
    v. Company limited by guarantee & not having Share Capital
    vi. Bank Audit
    vii. Investigation & Audit of non corporate bodies
  - **ICAI Notification [53/2003]**
    i. Limit 45 companies including private company
    ii. Out of which not more than 10 companies have paid up capital >=25 lakhs

- **Reappointment of Audit [Sec. 224(2)]**
  Generally, At AGM, the retiring Audit shall automatically be reappointed unless –
  (a) He is not qualified for reappointment.
  (b) He shows his unwillingness to be reappointed.
  (c) A resolution has passed at AGM
    - To appoint somebody other than him
    - To provide expressly that he shall not be reappointed
  (d) Where notice has given of any resolution proposing the appointment of some other person in the place of retiring auditor
  (e) Reappointment of the retiring auditor shall also not be made if he is already holding auditor ship in specified number of companies [Sec. 224(1B)]

- **Appointment by Central Government [Sec. 224(3) & (4)]**
  - Where at Any AGM, no auditor appointed or reappointed, within 7 days of such meeting, company shall intimate this to CG who may appoint.
  - If Company fails to give information, the company & every officer in default, shall be punishable with a fine which may extend to Rs. 5,000

- **Appointment Of First Auditor [Sec. 224(5)]**
  - First auditor may be appointed by BOD within 1 month from date of registration of company
  - Tenure :- Till First AGM
  - Merely naming in the AOA will not recognised as appointment
  - First auditor removed in General Meeting or by nomination notice of 14 days should be given before AGM
  - First auditor not required to file intimate with ROC u/s 224 (1B)

- **Appointment in case of Casual Vacancy [Sec. 224(6)]**
  - The term "Casual Vacancy" has not defined in Companies Act.
  - In natural sense, it means vacancy in office of audit resulting form accidental.

Casual Vacancy caused by	Appointing Authority
Resignation of Exiting Auditor	Company in a General Meeting
Other than resignation	Board of Directors

  - Refusal of a person to accept his appointment or reappointment as auditor will not result in casual vacancy.

- **Removal of Auditor [Sec. 224(7)]**

  <u>Removal on the expiry of term of office</u>
  - Sec. 225 lays down procedures to remove an auditor after expiry of the term.
  - Special Notice is required for resolution at an AGM for appointing another person or providing expressly that retiring auditor shall not re-appointed
  - Time period :14 days before such meeting
  - Retiring auditor has the following rights
    1. to make a representation of a reasonable length to the company
    2. to request that such representation shall be circulated among member
    3. to require that representation read out in AGM
  - In following situation representation need not to be circulated to member
    - When it is received too late by the company
    - If CG is satisfied that right of representation is being misused by auditor to secure needles publicity, on the application of Company or any shareholder

  <u>Removal before expiry of term of office</u>
  - Previous approval of CG is required
  - Send intimation of proposal for changing auditor to member and auditor
  - Follow procedures u/s. 225

- **Fixing of Remuneration [Sec. 224(8)]**
  - Generally determined by appointing agency.
  - In natural sense, it means vacancy in office of audit resulting form accidental.

Appointment Authority	Remuneration fixed by
Company in AGM (By shareholder)	Shareholders
BOD	Directors
Central Government	CG
C & AG	the company in GM & manner determine in GM

  - Disclosure Requirement [Schedule VI, Part II, Clause (4B)].

- **Appointment by Special Resolution [Sec. 224A]**
  - Special Resolution is required for appointing or reappointing of auditor in case of company in which not less than 25 % of share capital is held
    - ✓ A PFI or A Government Company or CG or SG
    - ✓ Any financial or other institution establish under a provincial or state Act and in which a SG holds not less than 51 % share capital
    - ✓ A Nationalized Bank or an Insurance Com. carrying general insurance business
  - Where company omits or fail to appoint by a SR, the CG shall have the power to appoint the auditor
  - For determining 25% holding, the material date shall be date of AGM

- **Appointment by Comptroller & Auditor General of India [Sec. 619]**
  - The auditor of Govt. Company shall be appointed or reappointed by C & AG
  - Sec. 619B deals with any company in which not less than 51 % share capital held by one or more following combination
    - ✓ CG or one or more Govt. Company
    - ✓ SG or one or more Govt. Company
    - ✓ CG or one or more corporation owned or controlled by Govt.
    - ✓ CG or one or more SG or one or more Govt. Company
    - ✓ CG or one or more SG or one or more Corporation owned /controlled by Govt.
    - ✓ More than one Govt. Company

    The auditor of Company shall be appointed or reappointed by C & AG

Company Auditor

- **Rights & Powers of an Auditor:-**

(1) Right of access to books and vouchers [Sec. 227(1)]
(2) Right to obtain Information & Explanation [Sec. 227(1)]
(3) Right to visit branch offices and access to branch account [Sec. 228(2)]
(4) Right to receive notice and to attend general meeting [Sec. 231]
   - This right does not extended to Board meetings

(5) Right to have Audit Report read at AGM [Sec. 230]
(6) Right to sign Audit Report [Sec. 229]
(7) Right to receive remuneration [Sec. 224(8)]
(8) Right to seeking opinion of an expert
(9) Auditor's Lien:
   - Conditions:
      i. Document/ Books belong to Client
      ii. Must be in possession of auditor
      iii. Some work must be done on it
      iv. Document on which fees is outstanding

- **Duties of An Company Auditor**

(1) Duty to Report [Sec. 227 (2) & (3)]: It is the duty of auditor to repot to the member on account examined by him and on Balance Sheet, P & L Account & and any other documents which is part of it

Sub section (3) requires that the auditor shall report on following matter:

(a) Whether he has obtained all the information & explanation which to the best of his knowledge & belief were necessary for his audit.

(b) Whether in his opinion, proper books of account as required by law have been kept by company, so far as appears from his examination of those books and proper return adequate for the purpose of his audit have been received from branches not visited by him.

(bb) Whether the report on the account of any branch audit u/s 228 by other auditor has been forward to him as required and how he has dealt with the same in preparing the auditor's report

(c) Whether the Company's balance sheet & P& L Account dealt with by the report are in agreement with the books of account & return

(d) Whether in his opinion, the balance sheet and P & L Account comply with the AS refereed u/s 211(3c).

(e) In thick type or in italics the observation & comments which have any adverse effect on the functioning of the company.

(f) Whether any director is disqualified from disqualification u/s 274(1)(g).

(g) Whether the cess payable u/s 441A has been paid & if not, the details of the amount of cess not paid.

(2) Duty to Inquiry [Sec. 227 (1A]: It is the duty of auditor to inquiry on following matter

(a) Whether loans & advance made by the company in the basis of security have been properly secured and whether the terms have been made are not prejudicial to the interest of the company
(b) Whether the transactions of the company which are represented merely by book entries are not prejudicial to the interest of the company
(c) Where company is not an investment company or banking company, whether so much assets consist of shares, debentures and other securities have been sold at a price less than purchased by the company
(d) Whether loan & advances made by the company have been shown as deposits.
(e) Whether personal expenditure have been charged to revenue account.
(f) Where it is stated that any share have been allotted for cash, whether actually cash has been received in respect of such allotment, whether the position as stated in books and the balance sheet is correct not leading misleading.

(3) Duty to Under CARO, 2003 [Sec. 227 (4A]: The CG can direct, by General or Special order that the auditor's report shall include a statement of such matter specified in its order.

Companies Auditor's Report Order, 2003

CARO was born on 1st July, 2003 and it applies to reports made by auditor on account in respect of financial year which ends on after 1st July, 2003.

Applicability

- CARO applies to every company, including a foreign company as defined in section 591 of companies Act, 1956.
  But the order **does not apply** to
  (1**) Banking Company** as defined in sec. 5(c) of Banking Regulation Act, 1949.
  (2) **Insurance Company** as defined in sec. 2 (21) of the Companies Act.
  (3) A Company incorporated under **sec 25** of the companies Act.
  (4) **A Private Company**, if satisfies:
  1. Paid up Capital and Reserve of company **does not exceed Rs. 50** Lakhs anytime during the year.
  2. The Company does not have aggregate Outstanding Loan Liability from any bank or institution in **exceed of 25 Lakhs**, any time during the year
  3. The Company's turnover **does not exceed Rs.5 Crores** at any time during the yea.

Matters to be Reported by Auditor:-

- CARO comprises of 21 canine Clauses & Numerous sub Clause.

1] **Fixed Assets:-**

The Auditor under this clause has to report:-

(A) Whether the Company is marinating proper records showing full particulars, including quantitative details and situation of fixed assets.
(B) Whether the management has carried out physically verified at reasonable intervals. Whether any material discrepancies were noticed on such physically verification and if so, whether same have been properly dealt with in the books.
(C) Whether substantial part of Fixed Assets have been disposed off during the year, which affected the going concern.

2] Inventories:-

The Auditor under this clause needs to comment on the following:-

(A) Whether physical verification is done by management at reasonable intervals.
(B) Whether procedures for physical verification are taken with the size & nature of the organization. If not, such inadequate of procedures should be reported.
(C) Whether the company is maintaining proper records of inventory. Whether any material discrepancies were noticed on such physically verification and if so, whether same have been properly dealt with in the books of account.

3] Terms & Conditions of loan & Advances:-

The Auditor has requires to report:-

(A) Whether company granted or taken any loan, whether secured or unsecured, to companies, firm or other parties covered under sec. 301 of the Act. If so, give the number of parties and amount involved in transaction.
(B) Whether rate of Interest and other terms are prejudicial to interest of Company.
(C) Whether the receipt/Payment of Principal amount and interest are also regular.
(D) If overdue is >1 Lakh, whether reasonable step have been taken by Company.

4] Internal Control Adequacy:-

The Auditor has requires to report:-

(A) Whether the internal control system is commensurate with size of the Company and nature of business, for the purchase of inventory, fixed assets & for the sale of goods and services
(B) Whether there is a continuing failure to correct major weakness in internal control system.

5] Section 301 transaction:-

The Auditor has requires to report:-

[A] Whether particulars of contracts or agreement referred in section 301 have been entered in the statutory register.
[B] Whether transaction made in pursuance of such contracts or arrangements have been made at market price.
[This information is required if transactions exceeding the value of Rs. 5 lakh in respect of any party and in any one financial year.]

6] Public Deposits:-

The Auditor has requires to report:-

(A) Whether a company which has accepted deposits from the public has complied with
- Section 58A, 58AA & other relevant provisions of Companies & Other Act.
- The directives of RBI

(B) Whether the CLB or NCLT or RBI or any court or Tribunal has passed any order regarding public deposit has complied.

7] Internal Audit System:-

This clause is applicable only to

(A) Listed companies

(B) Unlisted companies – satisfying certain condition
The Auditor has requires to report:-
Whether a company has internal audit system commencement with the size and nature of its business.

8] Cost Records:-
The Auditor has requires to report whether cost records have been kept as prescribes by Central Government u/s 209(1)(d), wherever it is mandatory.

9] Depositing undisputed Statutory Dues:-
The Auditor needs to comment on the regularity of the company in depositing the statutory dues as P.F., ESI, Income tax, Wealth tax, Services tax, Custom duties, cess & any other statutory dues. And if not, the extent of the arrears of outstanding statutory dues at the last day of financial year concerned for a period of more than six month form the date they became payable.

10] Net Worth Erosion:-
Whether in case of a company which has been registered for a period not less than 5 year, its accumulated losses at end of financial year are not less than 50 % of its net worth with cash losses in current year or immediately preceding financial year

11] Default in repayment of dues to banks/FI/ Debentures holders':-
If default in repayment of dues to Banks, Financial Institution & Debentures holders, then period and amount of default to be reported.

12] Loan gives against Pledge of Securities:-

The Auditor has to report whether sufficient and appropriate records are maintained in case where company has advanced loans against pledge of Shares, debentures and other securities.

13] Chit Fund/ Nidhi/ Mutual Benefits Societies:-

14] Records for dealing in Securities:-
The Auditor needs to comment in case of companies dealing in shares, debentures, securities & Investment whether records of transaction and contracts have been maintained and timely entries have been made therein.

15] Guarantee for loans:-
The Auditor needs to comment whether the company gives any guarantee for loans taken from bank or financial institution, the terms & conditions are prejudicial to the interest of company.

16] Application of terms loans:-
Whether term loans were applied for the purpose for which loans were obtained.
17] Short term funds for Long term Purpose:-
The Auditor needs to comment whether the funds raised on short term basis have been used for long term investment. Nature and amount is to be indicated.

18] Preferential Allotment:-
Whether the company has made any preferential allotment of shares to parties under sec. 301 of the Act and if so, whether the price at which shares have been issued is prejudicial to the interest of the company.

19] Securities & Charge created on debentures issued:-
The Auditor needs to comment whether securities or charge has been created in respect of debenture issued.

20] End use of money raised by Public Issue:-
The Auditor is required to report whether the management has disclosed the end use of money raised through public issue and same has been verified.

21] Fraud Noticed or Reported:-
Whether any fraud on or by the company has been noticed or reported during the year. The nature and amount involved is to be indicated, if any.

- **Audit Report**
  The auditor's report should contain a clear written expression of opinion in financial statements taken as a whole.
  Basic Elements of the Auditor's Report
  (a) Title
  (b) Addressee
  (c) Opening or Introductory Paragraph
    (i) identification of financial statements audited
    (ii) a statement of responsibility of the entity's management and the auditor
  (d) Scope Paragraph (describing the nature of Audit)
    (i) a reference to the Auditing Standards generally accepted in India
    (ii) a description of the work performed by the auditor
  (e) Opinions Paragraph
    (i) a reference to the financial reporting framework used to prepare the financial statements
    (ii) an expression of opinion on the financial statement
  (f) Date of Report
  (g) Place of Signature
  (h) Auditor's Signature

- **Types of Audit Report:-**
  (1) Standard unqualified report or Clean Report
  - When a report of the auditor does not contain any qualification, it is a clean or unqualified report. It is issued when the Financial Statement [FS]
    - Presents true & fair view
    - Prepared in accordance with GAAP
    - Comply with relevant statutory requirements
    - Disclosure is adequate
  - If the auditor makes various statutory affirmations contained in section 227 without any reservation, he is said to be issued an unqualified/ clean report.

(2) Unqualified report with an 'Emphasis of matter' Paragraph

- In certain cases auditor may attach a paragraph to an unqualified opinion to put 'emphasis on a matter' regarding FS due to its importance but doesn't change the nature of audit report as it related to the matter that doesn't affect the auditor's report..
- Such a matter is, generally, included in a note to FS which discusses it in detail.
- Examples of the situation in which an auditor introduces 'emphasis of matter' paragraph are-
  1. Going concern doubt
  2. Significantly uncertainty

(3) Qualified Audit Report

- The report which contains certain qualification, exception or reservation is a qualified report.
- The auditor should give a qualified opinion when the subject-matter of qualification matter is not highly material & pervasive & he believes that the overall FS give a true & fair view.-
- A qualification should be preceded by the words 'subject to' or 'except that'.
- The auditor should state the reasons for his qualification.
- If the auditor makes various statutory affirmations contained in section 227 with any reservation, the report would be term as qualified audit report.
- It is important that such a matter should be brought to the attention of shareholders.
- A qualified report can result from:
  - Where the auditors are unable to obtain all information for the purpose of audit.
  - Where the proper books of accounts have not been kept in accordance with the law.
  - Where the accounts do not disclose a true & fair view.
  - Contravention of the provisions of the MOA & AOA of the company.
  - Disagreement with management with regard to departure from GAAP or adequacy of disclosure or where accounting principles are violated

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(4) Disclaimer of Opinion

- The auditor issues a disclaimer of opinion if the subject-matter involved is material & pervasive & is unable to obtain sufficient appropriate evidence to express an opinion on it.
- A disclaimer can result because material & pervasive uncertainties could not be resolved, there is going concern doubt or there is material limitation on the scope of the audit.
- The auditor should always state the reasons for not giving his opinion.

(5) Adverse or Negative Report

- Where there is a sufficient basis for the auditor to form an opinion that the accounts & FS, taken as a whole, do not present a true & fair view of the financial condition & results of operations.
- A adverse report can result from
  - A substantial departure from GAAP
  - An material misstatement in the statements
  - An omission of a material disclosure.

- **Branch Auditor [Sec. 228]:-**
  1. **Appointment [Sec. 228(1)]:** Same Sec. 224(1) & Sec. 226(1)
  2. **Appointment of persons other than Auditor as a Branch Auditor [Sec. 228(3)(a)]:** In AGM or Delegate power to Board of Directors
  3. **Rights of Branch Auditor [Sec. 228(3)]**
  4. **Exemption from audit of Branch Audit [Sec. 228(4)]**
     The CG make rule to exempt branch from audit.
     A. Exemption based on quantum of activity
        1. Carrying on manufacturing, processing & trading activity
        2. Branch have a 'average quantum of activity' does not exceed -
           - Rs. 2 lakhs or
           - 2 % of average of total turnover of the Company **[WEH]**
     B. Exemption on Specific Application
        - Application to CG in prescribe form
        - With prescribe fees
        - Ground of exemption
          a. Company made satisfactory arrangement for the security and check by responsible person
          b. Brach Activity is not likely to have an Auditor at a reasonable cost.
          c. For any other reason, the CG may satisfy.

- **Special Audit [Sec. 233A]:-**
  1. **Circumstances warranting Special Audit:** Companies Act provides the power to CG to direct a special audit of a company, if it opinion any of following exist –
     - The affairs of company are not being managed in accordance with sound business principal or prudent commercial practices or
     - The Company is being managed in a manner likely to cause serious injury to industry
     - The financial position of the Company is such as a endanger its solvency
  2. **Appointment:** The CG may appoint
     - A CA whether or not he is in practice or
     - The Company auditor himself
  3. **Remuneration: Fixed by CG but paid by Company**

- **Cost Audit [Sec. 233B]:-**
  1. **When a company is required to maintain the cost records u/s 209(1)(d), the CG may direct the company to conduct a cost audit**.
     Cost Audit is required to be conduct only if all the following conditions are satisfied
     - The company is engaged in production, processing, manufacturing or mining activities
     - The company pertains to the class of companies that are required by CG to maintain cost records
     - An order is issued by the CG directing the company to conduct cost audit
     - The cost audit is required only for that year in which order has been issued.
  2. **Qualification of Cost Audit** : He is a "CMA" within the meaning of Cost & Works Accountant Act, 1959

3. **Disqualification of Cost Audit**:-
   - Same as in Sec. 226(3) & 226(4)
   - The Statutory Auditor of company shall not appointed as the cost auditor
   - An internal Auditor shall not appointed as the cost auditor.
   - A person who is an employee or partner of the CA firm which is appointed as company auditor u/s 224
4. **Rights of Branch Auditor [Sec. 228(3)]**
5. **Provision regarding cost audit report**.
   A. Cost auditor makes report to CG in form **23C within 180** days of the close of financial year. Also forwards report to company
   B. The company shall, within **30 days from** the receipt of audit report, furnish the CG with full information and explanation in every reservation or disqualification contained in report.
   C. The **CG may call further** information & explanation
   D. The CG **may take such action** in report, in accordance with provision of Act.
   E. The CG **may direct to circulate** the whole or part of report to members