CHAPTER 5 - THE COMPANY AUDIT-I

Applicable Important Sections

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APPOINTMENT OF AUDITOR

Appointment of the First Auditor [Section 224(5)]

The first auditor of a company can be appointed by the BoD within **one month of the date of registration** of the company to hold office **till the conclusion of the first AGM**. If the Board fails to appoint the first auditor, the company in GM is empowered to make the appointment.

The company may, **at a GM (and not AGM)**, remove such (First Auditor) an 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, **notice being given to the members of the company**, **not less than fourteen days before the date of the meeting**.

- An auditor cannot be appointed as first auditor simply because his name has been stated in the Articles of Association.
- The first auditor need not be sent intimation by the company of their appointment.

Illus. 1. Some of your friends are forming a new company. They wish to include the following clause in the Articles of Association of the company. "The first auditors of the company will be M/s SK & Co, Chartered Accountants who will hold office for five years". They seek your advice in the matter.

Ans.: *It is obvious that the above clause will not be valid. The first auditors can be appointed only by a resolution of the board of directors, or by the shareholders in a general Meeting if the board fails to appoint the first auditors. Moreover, the first auditors can hold office only until the conclusion of the first annual general meeting (provided they are not removed by the shareholders earlier at a G.M).*

Illus. 2. The first auditor of 'AB' Ltd. was appointed by the directors 2 months after registration of the Company. Comment.

Ans.: *Sec.224 states that the first auditors of the company shall be appointed by the Board of Directors within one month from the date of Registration of the Company. In case the Board fails to make the appointment within the time allowed the company in general meeting shall appoint the first auditor. In view of the above legal requirement, the appointment of the first auditor of AB Ltd. by the Board of Directors after the expiry of period prescribed is not valid.*

Illus. 3. The first auditor did not give notice to the ROC for accepting the audit.

Ans.: *The requirement of giving notice to the ROC has been prescribed only in respect of appointment in an AGM under Sec.224(1) and therefore is not applicable to appointment of First auditor being appointed by the Board of director's in board meeting.*

Appointment of Auditor by shareholders [Section 224(1)]

The shareholders are required to appoint auditor **at each AGM.** It is mandatory for every company. Thus a retiring auditor would not be reappointed automatically.

Upon an auditor being appointed in the AGM, the company is to give intimation thereof to the **concerned auditor within seven days** of the appointment and thereafter the auditor, in his turn, is required to send a written communication (in Form No. 23B) to the concerned **Registrar of Companies within 30 days** of the receipt of the intimation stating whether he has accepted or declined the appointment.

- Sub-section (1) clears that an auditor shall hold appointment **from the conclusion of one AGM to the conclusion of the next AGM**.
- **Requirement of intimation and communication** about acceptance/refusal to accept is restricted to appointment made in the AGM only.

Illus. 4. Can the shareholders delegate authority to the Directors to appoint Auditors?

Ans.: *Sec. 224 of the Companies Act, 1956 deals with the appointment of auditors. Sec.224(1) requires that every company shall appoint auditors of the company at each annual general meeting. Under no circumstances, the company can delegate its authority to the Board of Directors because it is a matter of supreme importance. He should, therefore, be independent of the management. To ensure his independence, the Board of Directors must not have any authority to appoint him. Therefore, the company cannot delegate its authority to the Board of Directors to appoint auditors.*

Appointment by the Central Government [Section 224(3) & (4)]

Where at an **AGM**, no auditors are appointed or re-appointed, the CG appoint a person to fill the vacancy. It is the **duty of the company to give notice** (no fixed form/format) of the fact, that no auditor was appointed in the AGM, **to the CG within seven days of the AGM.** In case of any default to give such notice to the CG, the company and it's every officer in default shall be punishable with fine that may extend to Rs. 5000.

Illus. 5. At the AGM of SS Ltd., SKJ is appointed as the auditor. SKJ refuses to accept the audit. The company holds another general meeting and appoints a new auditor.

Ans.: *The appointment of a new auditor in place of SKJ by the company in general meeting convened for the purpose because refusal of SKJ to accept the appointment does not result in a casual vacancy. The appointment being made, it can be deemed that auditor has been appointed by the company at its annual general meeting. Sec.224(3) cannot comes into picture (i.e. C.G. gets the power to appoint auditor) and accordingly company by calling EGM can only appoint its' auditor.*

Reappointment of auditor [Section 224(2)]

A specific resolution is required to re-appoint the auditors. The retiring auditor cannot be deemed to be re-appointed automatically at the AGM. Reappointment is subject to the following conditions:

(i) The auditor proposed to be appointed or re-appointed **must possess the qualification** prescribed under section 226.

(ii) The proposed auditor **does not suffer from the disqualifications** mentioned in sub-sections (3) and (4) of section 226.

(iii) In the case of proposed re-appointment of the retiring auditor, it should be ensured that:

a. He has not given to the company notice in writing of his **unwillingness** to be reappointed;

b. **No resolution** has been passed at the AGM **appointing somebody else** instead of the retiring auditor or providing expressly that the **retiring auditor shall not be reappointed**;

c. No notice of the **intended resolution to appoint some other person or persons in place of the retiring auditor** was received by the company that **could not be proceeded with due to death, incapacity or disqualification** of the other person or persons [Section 224(2)].

(iv) A **written certificate** has been **obtained from the proposed auditor** to the effect that the appointment or re-appointment, if made, will be in accordance **within the limits specified** in section 224(1B).

Filling of a Casual Vacancy [Section 224(6)]

'Casual vacancy' has not been defined in the Act and accordingly as per its natural meaning 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 which include death, resignation, disqualification, dissolution of the firms of auditors, etc. A casual vacancy in the office of the auditor **can be filled by the BoD**, **provided** such vacancy has **not been caused by the resignation** of the auditor which can be filled by the company in GM only. The auditor appointed to fill the casual vacancy shall hold office till the conclusion of the next AGM.

Auditor Appointed at an Annual General Meeting Failing to Accept the Appointment

The refusal of an auditor to accept the appointment as Auditor/Joint Auditor did not create a vacancy either casual or by resignation since the appointment had not become effective. Further, the appointment of an auditor having been made by the shareholders, sub-section (3) [i.e. Appointment by CG] could not be invoked. Thus, new auditor could only be appointed by shareholders at GM.

When Appointment is made to fill up a Vacancy of Resignation of the Previous Auditor

An auditor, before accepting the appointment in place of an auditor who has resigned should verify that the resolution appointing him as the auditor at the GM was duly moved and approved by the shareholders. In addition, he should refer to the resignation submitted by the previous auditor and also communicate with him so as to **ascertain**: (*i*) the circumstances which led upto his resignation; and (*ii*) whether there exist any circumstances on account of which he should not accept the appointment.

Illus. 6. At the AGM of Phuchka Ltd. Mr. Aaloo was appointed as the statutory auditor. He, however, resigned after 3 months since he wants to shift from practice to job. State how the new auditor will be appointed by Phuchka Ltd.

Ans.: *The Companies Act, 1956 in this case applies in the following manner:*

1. ***Meaning of casual vacancy*** *is not given in the act. In the opinion of the DCA, it means a vacancy in the position/office of the auditor after he was validly appointed and the appointment was accepted.*
2. ***Reasons:*** *This may arise due to death, disqualification, dissolution of the firm or resignation, etc.*
3. ***Who could fill this casual vacancy:***
    a. ***If it was due to resignation -*** *only by shareholders.*
    b. ***If it was due to other reasons -*** *By Board of directors.*

Thus, in this case Phuchka Ltd will have to call an extra-ordinary general meeting (EGM) and appoint another auditor. The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting.

Illus. 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 C.A.'s appointed as auditors dies.

Ans.: *Where any of the partners of a firm retires or dies, a change in constitution of the firm takes place. However, a partnership firm is dissolved on the death of any of the partner, if provided in the partnership deed. If partnership is dissolved casual vacancy arises. In that case directors can fill up such vacancy. However, if 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.*

Illus. 8. The auditor of BESI (P) Ltd. resigned after valid and accepted appointment whereupon the BoD appointed another auditor treating it as a casual vacancy.

Ans.: *Sec.224 states that the Board may fill any casual vacancy, provided such vacancy has not been caused by the resignation of the auditor. In the instant case, a casual vacancy has arisen on account of* *resignation since the auditor of BESI (P) Ltd resigned after accepting the appointment. Under these circumstances, the shareholder's can only fill the vacancy in the general meeting.*

Appointment of Auditor of a Government company by CAG (The Comptroller Auditor General of India)

Government company means any company in which **not less than 51%** of the **paid-up share capital** is held by the CG or by any SG or Governments or partly by the CG and partly by one or more SGs and includes a company which is a subsidiary of a Government company. – Section 617

The auditor of a government company shall be appointed or reappointed **by the Comptroller and Auditor General of India [Section 619(2)]**. The appointment even by CAG will be **subject to the ceiling.**

Section 619 also apply to another category of companies: The provisions of section 619 apply to a company in which not less than 51% of the paid-up share capital is held by one or more of the following or any combination thereof:

a. the CG and one or more government companies;
b. any SG or Governments and one or more government companies;
c. the CG, one or more SGs and one or more government companies;
d. the CG and one or more corporations owned or controlled by the CG;
e. the CG, one or more SGs and one or more corporations owned or controlled by the CG;
f. one or more corporations owned or controlled by the CG or the SG;
g. more than one government company.

Illus.9. Shweta is appointed the auditor of a government company at its AGM. Is it correct?

Ans.: *The appointment of Shweta as the auditor of a Government company at it's A.G.M is not valid. As per Sec.619, the auditor of a Government company shall be appointed and re-appointed by the Comptroller and Auditor General of India.*

Appointment of Auditor by Special Resolution (Section 224A):

A company in which **not less than 25%** of the **subscribed capital** is held by:

i. a **public financial institution** or a government company or the CG, or any SG, or
ii. any financial or other institution established by any Provincial or State Act in which a SG, holds **not less than 51%** of the subscribed share capital,
iii. a **nationalised bank** or an insurance company carrying on **general insurance** business; or
iv. any combination of the above categories,

shall appoint or re-appoint an auditor in the AGM only by passing a SR. Omission/failure to pass a SR in the AGM for appointing auditors shall be deemed resulting that no auditor or auditors had been appointed and thereupon the CG's power to appoint the auditor pursuant to section 224(3) will become operative.

Hold 25% of the subscribed capital means holding as on the **day of the closing of the register of members before the AGM**. Government has clarified that for the purposes of section 224A the composition of shareholding shall be of the day of AGM. This will virtually be same in relation to the position available on the day of the closing of the register of members stated above. **Subscribed capital includes preference share capital also**.

Illus. 10. Shareholder Ltd. is a Public Ltd. Company with 25% of Subscribed Share Capital (both equity and preference) being held by a Nationalised Bank. The auditor was appointed by the Company in General Meeting by an ordinary resolution.

Ans.: *Normally the auditor is appointed by an ordinary resolution. However, as per Sec.224 A of Companies Act, 1956, special resolution is required to be passed if not less then 25% of the subscribed share capital (both equity and preference) is held either jointly or individually by the following institutions:*

a. *Any public financial institution, Central or State Government companies.*

b. *State financial institutions created by special Acts in which at least 51% of the share capital is held by the State Government.*

c. *Nationalised Bank or Insurance Companies doing General insurance business.*

If the appointment of the auditor in such cases is by ordinary resolution instead of by special resolution, it is deemed that no auditor had been appointed and the Central Government shall have the power to fill the vacancy of auditor. Hence, the appointment by ordinary resolution is invalid.

Illus. 11. The Board of Directors of Ghazini Ltd., whose 20% of subscribed capital is held by A.P. Government, proposes to appoint Mr. Sanjay Singhania, a C.A., as its statutory auditor in the next AGM.

a. What type of resolution is necessary for his appointment?

b. Will it make any difference if the shareholding of A.P.Government is 28%?

Ans.:

a. *Provisions of Sec.224A of the Companies act is applicable here.* ***Write the complete provision of Sec. 224A (depending on marks for the question).*** *Since in the present case the shareholding is less than 25%, an ordinary resolution is sufficient for the appointment.*

b. *A special resolution will be necessary for the appointment of Mr. Sanjay Singhania as the statutory auditor in the next AGM as the shareholding by the State Government is 28%.*

Before acceptance of the appointment given by any company, an auditor should specifically satisfy himself that the company is not covered by either section 224A or section 619B which require compliance with special procedure.

Illus. 12. The auditor appointed by a company accepted the audit on the basis of a certificate issued by the directors that company has complied with the requirements of the companies Act, 1956 relating to his appointment. Subsequently it was found that the company had failed to pass the special resolution required for his appointment.

Ans.: *An auditor cannot merely rely on the certificate of the directors. The company has failed to comply with Sec.224A, and therefore the appointment is invalid. Sec. 224(3) is attracted (i.e. appointment by C.G.). Further as per C.A. act, 1949, if a member accepts audit of a company without checking that the company has complied with the requirements of Sec.224 and 225, he is guilty of professional misconduct.*

QUALIFICATIONS AND DISQUALIFICATIONS OF AN AUDITOR

QUALIFICATIONS

(1) A person shall be qualified for appointment as an auditor of a company (public or private) if he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949; provided that a firm whereof all the partners practising in India are qualified for appointment, as above, may be appointed by its firm name in which case any partner so practising may act in the name of the firm [Section 226(1)]; and

(2) Notwithstanding anything contained in sub-section (1), the holder of certificate granted under the law in force entitling him to act as an auditor of companies in the whole or in any part of Part B States, immediately before the commencement of the Part B States (Laws), 1951 is entitled to act as an auditor of companies registered anywhere in India. [Section 226(2) clause (b)]. It was only a transitional provision.

DISQUALIFICATIONS [Section 226(3)]

(3) Following persons are disqualified for appointment as auditors of a company:

(*a*) a body corporate;

(*b*) an officer or an employee of the company;

(*c*) a person who is a partner or employee of an officer or employee of the company;

(d) a person who is indebted to the company for **more than Rs. 1,000** or who has **given any guarantee or provided any security in connection with the indebtedness of any third person** to the company for more than Rs. 1000; and

(e) a person holding **any security** of that company.

Explanation - For the purposes of this section, "security" means an instrument which carries voting rights.

(4) A person is not eligible for appointment as auditor of any company, if he is disqualified from acting as auditor of that company's **subsidiary or holding company or of any other subsidiary of the same holding company**. **[Section 226(4)]**

(5) If an auditor, after his appointment, becomes subject to any of the disqualification specified in sub-sections (3) and (4), he shall be deemed to have **automatically vacated** his office. **[Section 226(5)]**

A **Chartered Accountant, being a relative of person(s) having substantial interest** in the company or in any business, expresses any opinion on financial statements without **disclosing his interest(s)** it would amount to "misconduct" under the Chartered Accountants Act, 1949.

'Relative' means a relative within the meaning of section 6 of the Companies Act; 'substantial interest' shall have the meaning as per Explanation 3 to section 13 of the Income-tax Act, 1961.

There is no bar under the Act to prohibit an auditor of a company from rendering other services in the capacity of a consultant. A person is also not disqualified for appointment as auditor of a company if his relatives or employees act as a director, secretary, or otherwise as an officer or employee of the company. But the CG's permission may have to be obtained under section 314 of the Act.

There is no provision in the Act for an auditor ceasing to hold office on becoming bankrupt or insane, yet it will not be possible for a person of unsound mind or an un-discharged insolvent to hold such office as he will not have his name on the Register of Chartered Accountants. [Sections 8 and 20 of the Chartered Accountants Act, 1949]

Illus. 13. Whether the following persons can be appointed as the auditor of a company?

a. A person who is a Chartered Accountant of the American Institute of Chartered Accountants but is not a member of the Institute of Chartered Accountants of India.

b. Mrs. Shikha is a member of the Institute of Chartered Accountants of India. The directors of a limited company say that she being a lady can't be appointed as an auditor of the company.

c. Mr. AB owes Rs. 1,000 to SS Ltd. of which is an auditor.

d. Mr. AB, a member of the ICAI, does not hold a certificate of practice.

e. Mr. A, who was a member of the ICAI, is of unsound mind.

f. Mr. A, who was a member of the ICAI, is insolvent/Bankrupt.

g. Simplified Solutions (P) Ltd is a registered company with S, K and J as its Directors. All the three Directors are Chartered Accountants. Can the Co. be appointed as auditor of another Company?

h. SKJ, a partner in the firm of M/s SK & Co., Chartered Accountants, is the Secretary of Simplified Solutions (P) Ltd. Can SKJ or SK & Co., be appointed as the Company Auditor of Simplified Solutions (P) Ltd?

i. α, Chartered Accountant, is the partner of β, who is a Director in ∞ Ltd. Can α be appointed as Statutory Auditor?

j. A, a Chartered Accountant, is a director of A Ltd., which is a subsidiary of B Ltd. The Board of Directors of B Ltd. proposes to appoint Mr. A as the auditor of B Ltd. Discuss.

Ans.:

a. He cannot be appointed as an auditor of a limited company in India. A person must be a chartered accountant within the meaning of the Chartered Accountants Act, 1949 to be appointed as an Auditor.

b. Mrs. Shikha can be appointed as an auditor of the company. There is **no bar on a lady**.

c. Mr. AB is not disqualified. He will be disqualified only if he owes **an amount in excess of 1,000**.

d. AB does not hold a COP and hence **cannot be appointed** as an auditor of a company.

e. Mr. A, being of unsound mind, **cannot continue himself to be a member of the ICAI**. Therefore, he cannot be appointed as the auditor of any company.

f. Mr. A, being insolvent, **cannot continue himself to be a member of the ICAI**. Therefore, he cannot be appointed as the auditor of any company.

g. A Body Corporate **cannot be appointed** as Statutory Auditor of a Company. In the above case, the Company cannot be appointed as Statutory Auditor of another Company.

h. SKJ, being an Officer of the Company is **disqualified**. Also, M/s SK & Co. is **disqualified** to be appointed as auditor as one of its partners is an employee of the Company.

i. α is **disqualified** to be appointed as auditor, as u/s 223(3), a person who is a partner of an officer of a Company cannot be appointed as its auditor.

j. A is **not qualified** to be appointed as auditor of B Ltd., because a person who is not qualified to be the auditor of a company would also not be qualified to be auditor of such company's subsidiary, or holding company.

Illus. 14. Can a director of the company be appointed as an auditor?

Ans.: There is no express prohibition that a director can't be appointed as an auditor. But the below given two provisions of the companies act prohibits a director to be appointed as an auditor:

a. Sec.226 enumerates that an officer of the company cannot be appointed as an auditor.

b. Sec.2(30) of companies act, which defines the officer to include the director.

Illus. 15. Mr. P is appointed auditor of PQR Ltd., at a total remuneration of Rs.50, 000, classified as under: (i) For Unit P of the Company Rs.20,000; (ii) For Unit Q of the Company Rs.20,000 and (iii) For Head Office Rs. 10,000. As per terms of appointment, P can collect his fees on progressive basis, on completion of audits of unit P and /or Q. P completed the audit of unit Q and recovered Rs.20,000 on account of the audit fees though the entire audit is not completed. Explain whether P is indebted to the Company for an amount exceeding Rs. 1,000 and therefore disqualified.

(Or) Will an auditor who received the audit fees from the company on progressive basis, is called indebted.

Ans.: Auditor cannot be said to be indebted to the Company at any stage if he recovers his fees on a progressive basis. As and when a part of the work is done, he can recover his fees in accordance with the terms of his engagement with the client, without waiting for the completion of the whole job. Hence, P is not indebted to the Company and is qualified to act as its Statutory Auditor.

CEILING ON NUMBER OF AUDITS

Before appointment is given to any auditor, the company must obtain a certificate from him that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section 224(1B).

No company or its Board of Directors shall appoint or re-appoint any person/firm/person in full time employment (and not as partner) as its auditors if such person or firm is at the date of such appointment/reappointment, holding appointment as auditor of the specified number of companies or more than the specified number of companies. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

The ceiling is 20 company audits, per person/partner, out of 20 companies only 10 should be in companies having **paid up capital of Rs. 25 lakhs or more.** If a chartered accountant is a partner in a number of auditing firms, then all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account and its' upto them to decide allocation within limit.

Specific cases for inclusion/exclusion in counting ceiling:

- Appointment even a part of a company's accounts - considered as a unit of audit.
- Joint audit - Any **joint audit held** by an auditor **will be included as one audit unit**
- Non-profit companies - Countable
- **Audit of a branch of company - is not included.**
- **Guarantee companies not having share capital - not counted**
- **Audit of corporations** which are not companies **- not to be included**
- **Foreign companies - not to be included**
- **Special audit - not to be included**
- **Investigation of companies will not be counted.**

The Companies (Amendment) Act, 2000 amended section 224(1B) by adding a proviso that ceiling shall not apply to a private company, therefore only audit of public companies would be taken into consideration. Still it holds valid in counting (Private Company) as guidelines of the Institute provide restriction in respect of private companies as well. The Notification reproduced below:

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 of the Companies Act, 1956.

- In the case of a firm of CA in practice, specified number shall be construed as the specified number for every partner of the firm.
- Where any partner of the firm of CA in practice is also a partner of any other firm(s), the number of audit assignments taken for all the firms (either in individual/partners' capacity) together in relation to such partner shall not exceed the specified number in the aggregate.

Explanation:

1. for the above purpose, the specified number of audit assignments means-

(a) in the case of a chartered accountant in practice or a proprietary firm of chartered accountant, thirty audit assignments whether in respect of private companies or other companies.

(b) in the case of a firm of chartered accountants in practice, thirty audit assignments per partner in the firm, whether in respect of private companies or other companies.

Provided that out of such specified number of audit assignments, the number of audit assignments of public companies each of which has a paid-up share capital of rupees twenty-five lakhs or more, shall not exceed ten.

2. In computing the specified number of audit assignments.

(a) the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other chartered accountant in practice or firm of such chartered accountants, shall be taken into account.

(b) the audit of the 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.

(c) the audit of one or more branches of the same company by one chartered accountant in practice or by firm of chartered accountants in practice in which he is a partner shall be construed as one audit assignment only.

(d) the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.

(e) a chartered accountant in full time employment elsewhere shall not be taken into account.

3. A CA/Firm of CA in practice shall maintain a record of the audit assignments accepted (if possible), in the prescribed manner.

Illus. 16. Mr. X a practicing chartered accountant, holds 35 company audits including 15 public companies, 7 other companies having paid capital exceeding 25 lakhs of which 2 are private companies

and the rest are audit of branches of companies. Has Mr. X violated any provisions of the companies Act, 1956 or is he guilty of professional misconduct?

Ans.: *Audits which are taken for counting as per Sec.224(1B):*

Public companies	15
Companies (> 25Lakhs, excluding private co.'s)	5

The audits are within the ceiling limit (i.e. 20 excluding private co.'s, branches etc.) prescribed by the act. Therefore there is no violation of the act.

Note: *ICAI has issued a notification which specifically restricts the number of audits to be handled by a member to 30, including audit of private companies. If the member exceeds the said ceiling, he is guilty of professional misconduct even though there may not be any violation u/s 224 (1B).*

Illus. 17. KBCP & Co. a firm of Chartered Accountants has four partners, K, B, C & P. K is also in whole time employment elsewhere. The firm is offered the audit of Star Plus Ltd. and its twenty branches. The firm already holds audit of 60 companies including audit of one foreign company.

Ans.: *In the case of firm of chartered accountants, the specified number should be construed as twenty companies (out of which not more than ten may have a paid-up share capital of rupees twenty five lakhs or more) per such partner who is not in whole-time employment elsewhere. In the firm of KBCP & Co., K is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. The total number of company audits that can be accepted by KBCP & Co., is sixty, out of which not more than thirty companies may have a paid-up share capital of rupees twenty five lakhs or more. Audits of the accounts of foreign companies are also not to be included. Since the number of audits that goes for counting is only 59, it can accept one more audit. Branch audits are not to be counted in computing this specified number (differently from audit of the HO or company as a whole). Therefore, it does not matter whether Star Plus Ltd. is having 20 branches. Thus the acceptance of audit of Star Plus Ltd. and its 20 branches will accordingly be within specified limits.*

AUDITOR'S REMUNERATION [Section 224(8)]

The remuneration of the auditors of a company is fixed:

(1) by the **directors** when auditors are appointed by directors;

(2) by the **CG** when the appointment is made by the same authority;

(3) by the **company in GM or in such manner as the company in GM may determine** and

(4) in the case of an auditor appointed under section 619 by the Comptroller and Auditor-General of India, shall be fixed by **company in GM or in such manner as the company in GM may determine**.

For this purpose, the expression "remuneration" should be deemed to include any sums paid by the company in respect of auditor's expenses. The remuneration is not required to be fixed at the same meeting of the company at which the appointment is made. Where a retiring auditor is re-appointed, his remuneration, in the absence of any resolution fixing a different remuneration, is considered to be the amount already fixed. Any remuneration for additional duty should be fixed separately and must be disclosed accordingly in the Profit and Loss Account format as required by Schedule VI Part II of the Act as:

(a) as auditor;

(b) as adviser, or in any other capacity in respect of :

  (i) taxation matters;

  (ii) company law matters;

  (iii) management services; and

(c) in any other manner.

REMOVAL OF AUDITORS

Removal of Auditor before Expiry of Term [Section 224(7)]

An auditor may be removed from office before the expiry of his term, **by the company in a GM, obtaining the prior approval of the CG in that behalf** but such approval is not required for the removal of the first auditor appointed by the Directors. Thus, first auditor, appointed by the Board of Directors may be removed by merely passing an ordinary resolution. However, a nomination notice from a member of the company of **at least 14 days** is required for the appointment of any other person in his place.

After Expiry of Term [Section 225]

For appointing a person other than the retiring auditor or for proposing that the retiring auditor shall not be re-appointed, a special notice (14 days) is required for resolution to be moved at the AGM. On receiving such a notice, the company must forthwith send a copy thereof to the retiring auditor. If the retiring auditor makes a representation in writing, not exceeding a reasonable length, to the company and requests the company to notify such representation to the members, the company shall (unless the representation is received too late), in any notice of the resolution given to the members, state the fact of the representation having been made and send a copy of the representation to every member to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. If a copy of the representation is not sent, as aforesaid, because it was received too late or because of the company's default, the auditor may require that the representation be read out at the meeting. However, if the CG is satisfied, on an application by company or any other aggrieved person, that the right is being abused to secure needless publicity for a defamatory matter, the CG may order that the representation may not be circularised or read out.

The foregoing provisions are equally applicable to a resolution to remove the first auditors, or any of them appointed by the directors under section 224(5), removal of any auditors before the expiry of their term under section 224(7) except that special notice is not required to be sent in such cases as required under sub-section (1) of section 225.

U/s 22 of Chartered Accountants Act, 1949 accepting a position as an auditor, previously held by another Chartered Accountant, without first communicating with him in writing, is a breach of professional etiquette and failure to do so would constitute a misconduct leading to an enquiry into his conduct and, if proved may result in the person declared unfit to continue to be a member of the institute.

POWERS OF AUDITORS

(a) Right of access to books, etc. - The auditor, at all times, has the right of access to the books and accounts and voucher of the company whether kept at the head office or elsewhere and he is entitled to obtain from the officers of the company such information and explanations as he thinks necessary, for the performance of his duties as auditor [Section 227(1)].

- 'books, accounts and vouchers' includes all books which have any bearing, or are likely to have any bearing on the accounts, whether be the usual financial books or the statutory or statistical books; memoranda books, e.g., stock books, costing records and the like may also be inspected by the auditor.
- Term 'voucher' includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts.
- Right of access is not limited to those books and records maintained at the registered or head office, the right also extends to the branch records, if the auditor considers it necessary to have access thereto [Section 228(2)]. If in his opinion, proper returns adequate for the purpose of his audit have not been received from branches, not visited by the auditor, this must be stated in his report [Section 227(2)(bb)].

(b) Right to require information and explanation from officers

According to section 2(30) of the Act, the term 'officer' includes any director, manager or secretary or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors are accustomed to act.

(c) Right to attend GM - The auditors of a company are entitled to attend any GM of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the GMs, which members are entitled to receive and to be heard at any GM in any part of the business of the meeting which concerns them as auditors (Section 231).

The right of the auditor is to attend any GM and to be heard there is only permissive. It is not his duty to attend or to take part in the discussion, further such a right extends only to meeting of the members and not to the meeting of directors. It is not necessary for the auditor to exercise his right except in exceptional circumstance, e.g., where he has reason to believe that the directors are concealing deliberately a serious state of affairs from the shareholders or are likely to misinterpret to them some remarks in the audit report. It is for the auditor to attend the meeting with a view to bring to the notice of the shareholders any matter which has come to his knowledge subsequent to his signing the report and if it had been known to him at the time of writing his audit report, he would have drawn up the report differently; or where the accounts have been altered after the report was appended to the accounts. But it should be borne in mind that the auditor cannot escape responsibility for any omission in his report or any inaccuracy in the accounts merely by making an oral statement or giving explanation to members at the AGM. The audit report by itself should be clear, unambiguous and complete.

Illus. 18. AB Ltd. does not send to its auditors the notice of an extraordinary general meeting on the plea that accounts are not being discussed at the aforesaid meeting.

Ans.: *This is not correct since the requirements of Sec.231 apply to all general meetings held during the period when the auditor holds his office.*

Illus. 19. The statutory auditor need not examine matters reported by the branch auditor since he is not responsible for the work of the branch auditor.

(OR) The statutory auditor while reporting on the accounts dropped all the qualifications made by the branch auditor of the company even without consulting the branch auditor.

(OR) The audit report of a branch auditor contains some qualifications. Comment.

Ans.: *Though he is not responsible for work performed by branch auditor, he is responsible to consider the Report of the branch auditor in preparing his report as required by Sec.227 (3). Further, the qualifications made by the branch auditor in his report will be dealt with by the company auditor in following two ways:*

1. ***1st way:*** *Put the same in the company auditor's audit report.*
2. ***2nd way:*** *Ignore the same in the following cases:*
   a. *The objections of the branch auditor have been met while conducting the head office audit.*
   b. *The matter on which the qualification is made by the branch auditor is not so material in comparison of the company as a whole.*
   c. *Due to the availability of information, which was not available to branch auditor, the qualifications made by the branch auditor get settled.*

DUTIES OF AUDITORS

Section 227 sub-sections (1A), (2), (3), (4) and (4A) of the Companies Act, 1956 specifies the duties of an auditor of a company.

The Companies (Amendment) Act of 1965 introduced two sub-sections (1A) and (4A) in section 227 of the Act; the sub-sections are reproduced below:

(1A) The auditor shall enquire:

(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 **transactions** of the company which are represented merely by book entries are not prejudicial to the interests of the company;

(c) where the **company is not an investment 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;
(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.

(4A) The CG may, by general or special order, direct that, in the case of such class or description of companies as may be specified in the order, that auditor's report shall also include a statement on such matters as may be specified therein:

Sub-section (1A) is independent both of sub-section (1) which narrates the powers of auditor(s), and of sub-sections (2) and (3) which states the function and duties of the auditors. It is merely a directive to the auditor to make certain specific enquiries.
The auditor is not required to report on the matters specified in sub-section (1A) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied.

Scope of Audit Report Under Section 227
Sub-section (2) requires that the auditor should report whether in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by the Companies Act, 1956, in the manner so required and that the balance sheet gives a true and fair view of the company's affairs at the end of financial year and the profit and loss account gives a true and fair view of the profit or loss for the financial year.
Sub-section (3) requires that the auditor shall report on the following matters :
(a) Whether he has **obtained all the information and explanations** which to the best of his knowledge and belief were necessary for his audit.
(b) Whether in his opinion, **proper books of account as required by law have been kept by the company**, so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him.
The proper term 'books of account' is defined indirectly under sub-section (1) of section 209, that the proper books of account shall not be deemed to be kept if such books are not kept on accrual basis and according to the double entry system of accounting. The cost records prescribed under section 209(1)(d) also from part of books of account required to be maintained under law.
(bb) Whether the **report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him** as required by section 228(3)(c) and how he has dealt with the same in preparing the auditor's report.
(c) Whether the company's **balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.**
(d) Whether in his opinion, the **balance sheet and the profit and loss account comply with the accounting standards** referred to in sub-section (3c) of section 211 of the Companies Act, 1956.
(e) in **thick type or in italics the observations or comments of the auditors which have any adverse effect** on the functioning of the company.
(f) whether **any director is disqualified from being appointed as director** under clause (g) of subsection (1) of section 274.
(g) **whether the cess payable u/s 441A has been paid and if not, the details of the amount of cess not so paid**. Section 441A provides for levy and collection of cess on turnover or gross receipt of companies.

AUDIT REPORT

The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. The auditor should consider whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements. The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole.

Basic Elements of the Auditor's Report

The auditor's report includes the following basic elements, ordinarily, in the following layout:

(a) Title;

(b) Addressee;

(c) Opening or introductory paragraph

(i) identification of the financial statements audited;

(ii) a statement of the responsibility of the entity's management and the responsibility of the auditor;

(d) Scope paragraph (describing the nature of an audit)

(i) a reference to the auditing standards generally accepted in India;

(ii) a description of the work performed by the auditor;

(e) Opinion paragraph containing

(i) a reference to the financial reporting framework used to prepare the financial statements; and

(ii) an expression of opinion on the financial statements;

(f) Date of the report;

(g) Place of signature; and

(h) Auditor's signature.

THE COMPANY AUDIT - I

Format of Audit Report

The following is an illustration of a complete auditor's report incorporating the basic elements set forth and illustrated above. This report illustrates the expression of an unqualified opinion.

"**AUDITOR'S REPORT**

(Appropriate Addressee)

We have audited the attached Balance Sheet of ……. *(Name of the entity)* as at 31st March 2XXX and also the Profit and Loss Account for the year ended on that date annexed thereto.

These financial statements are the responsibility of the entity's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. In our opinion and to the best of our information and according to the explanations given to us, the financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the Balance Sheet, of the state of affairs of ………. (Name of the entity) as at 31st March 2XXX; and

(b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date.

For ABC and Co.,
Chartered Accountants
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation)
(Membership Number)
Place of Signature:
Date:

Companies (Auditor's Report) Order, 2003

The term, "Order", as used in the following text refers to the CARO, 2003. CARO, 2003 supersedes the earlier Order issued in 1988, viz., the Manufacturing and Other Companies (Auditor's Report) Order, 1988 (MAOCARO, 1988).

General Provisions Regarding Auditor's Report

The requirements of the Order are supplemental to the existing provisions of section 227 of the Act regarding the auditor's report. However, there are certain points of distinction between the Order and the requirements of section 227, which are as follows:

(i) the provisions of sub-sections (1A), (2), (3) and (4) of section 227 are applicable to all companies while the Order exempts certain classes of companies from its application; and

(ii) the provisions of sub-section (1A) require the auditor to make certain specific enquiries during the course of his audit. The auditor is, however, not required to report on any of the matters specified in the sub-section unless he has any special comments to make on the said matters. The Order, on the other hand, requires a statement on each of the matters specified therein even if he has no comments to make on any of the matter(s) contained in the Order. In that respect, the provisions of the Order are similar to the provisions of sub-sections (2), (3) and (4) of section 227.

Applicability of the Order: The Order applies to all companies except certain categories of companies specifically exempted from the application of the Order. The Order also **applies to foreign companies as well as the audits of branch(es) of a/any company** under the Act and accordingly the report submitted by the branch auditor must contains a statement on all the matters specified in the Order, except where the company is exempt from the applicability of the Order.

Companies not Covered by the Order

(i) a **banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an **insurance company** as defined in clause (21) of section 2 of the Companies Act, 1956 (1 of 1956);

(iii) a **company licensed to operate under section 25** of the Companies Act, 1956 (1 of 1956); and

(iv) a **private limited company with a paid-up capital and reserves not more than rupees fifty lakh** and which **does not have outstanding loan exceeding rupees twenty five lakhs from any bank or financial institution** and **does not have a turnover exceeding rupees five crores** at any point of time during the financial year.

Note 1: "paid-up share capital" is, "that part of the subscribed share capital (Equity and Preference both) for which consideration in cash or otherwise has been received and includes bonus shares as well. While calculating the paid-up capital, amount of calls unpaid should be deducted from and the amount originally paid-up on

forfeited shares should be added to the figure of paid-up capital. Share application money received should not be considered as part of the paid-up capital.

"reserve" includes both capital as well as revenue reserves.

Note 2: The limit of Rs. 25 lakhs would apply in aggregate to all loans (long-term or short-term and secured or unsecured) and not with reference to each bank or financial institution. Loan exceeding Rs. 25 lakhs is not year-end balance but is loan taken during the whole year. So even if loan taken during the year is returned back and balance as on closing date is NIL still CARO is applicable

Note 3: For ascertaining the turnover limit of Rs. 5 crores:

- Sales tax or excise duty collected should not be taken into account if they are separately credited to sales tax account or excise duty account.
- Trade discounts should be deducted from the turnover.
- Commission allowed to third parties should be included in turnover.
- Sales return should be deducted from the figure of turnover irrespective of year of sale (sales return are deducted on receiving basis).
- The income, received by way of rent or dividend/interest would not form part of turnover.
- Further, the Order would not also apply in case of non-banking finance company, which converts into a banking company and as on the balance sheet date is a banking company.
- The specific exemption under the Order is given to companies licensed under section 25 of the Act. The exemption would also extend to similar companies registered under any earlier Companies Act.
- In case of companies rendering or supplying services, gross income derived from services rendered or supplied, would be shown as turnover. In cases where the principal business of the company is letting out of property of the company or it is an investment company, the rent or dividend/interest, respectively, would constitute "turnover".
- 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.

Auditor will have to report on the following matters:

(a) Fixed assets

- Whether the company is **maintaining proper records** in regard to fixed assets.
- Whether assets have been **physically verified** and whether **disposal of fixed assets affects the going concern**

(b) Inventories

- Whether **physical verification** of inventories has been conducted at regular intervals.
- Whether the company is **maintaining proper records** of inventories.

(c) Loans

- Whether the company has **taken or given any loans** (secured or unsecured) from/ to the companies, firms and other parties covered u/s 301. The maximum amount involved during the year should not be more than Rs 20 crores.
- If overdue amount is more than Rs. One lakh, whether the company has taken reasonable steps for recovery.

(d) Are there adequate **internal control** procedures for the purpose of inventory, fixed assets and with regard to sale of goods and services?

(e) **Internal audit:** Having regard to their size and nature of the business, the auditor should report whether or not the following **companies** have an internal audit system:

- Listed companies
- Companies having **paid up capital and reserves exceeding Rs. 50 lakhs** as at the commencement of the financial year concerned;
- Companies having an **average annual turnover exceeding Rs. 5 crore** for a period of three consecutive financial years immediately preceding the financial year concerned

(f) Whether the provisions of **section 58A, 58AA** or any other relevant provisions of the act and Companies (Acceptance of Deposits) Rules, 1975 have been complied with, with regard to the **deposits accepted from public.** Whether any order has been passed by Company Law Board, National Company Law Tribunal, RBI or any other court.

(g) Whether **cost records** have been made and maintained, if prescribed by Central Government u/s 209(1) of the act.

(h) Whether the company has **defaulted in repayment of dues to a financial institution or bank or debenture holders**.

(i) Whether the company has **given any guarantee for loans taken by others** from bank or financial institutions, the term and conditions whereof are prejudicial to the interest of the company.

(j) Whether **adequate records have been maintained for granting of loans and advances on the basis of security**.

(k) **Term loans were applied for the purpose for which the loans were obtained**.

(l) Whether the **funds raised on short term basis have been used for long term investment** except permanent working capital.

(m) Whether or not **securities or charges have been created in respect of debentures issued**.

(n) **Money raised by public issue**:

- Whether the management has disclosed on the end, use of money raised by public issues.
- Whether the **end use of money raised from public issues is capable of being determined**? If not, state the reason.
- Whether the **end use of money disclosed in the financial statements** by a way of note is significantly different from the actual end use?
- Examine the various documents submitted to SEBI and also examine the report of Board of Directors to find out whether the **funds have been utilised for the purpose for which they were raised**.
- In case of **a listed company where the issue size is more that Rs 500 crore ensure monitoring agency** is appointed.

(o)Whether **any fraud on or by the company has been noticed or reported during the year**, if yes, the nature and amount involved is to be indicated.

Illus. 20. You are the Statutory Auditor of a limited company is engaged in the manufacture of chemicals. The company has a turnover exceeding Rs.5 Crores for a period of three consecutive financial

T H E C O M P A N Y A U D I T - I

years immediately preceding the financial year concerned, but does not have an internal audit system. Give your views.

Ans.: *CARO 2003 requires the statutory auditor to report on the existence of internal audit system in the case of company who's paid up share capital & reserves has exceeded Rs.50 lakhs at the beginning of the current financial year or whose average annual turnover for the last 3 consecutive financial years has exceeded Rs.5 crores preceding the current financial year.*

The non-existence of Internal Audit System will have following impact on the auditor's work/report:

a. More substantive audit procedures are required since the efficacy of internal control system would itself be questionable.

b. The auditor has to report the non-existence of the Internal Audit system in his Report.

Illus. 21. The total Provident Fund dues was kept by the company and invested in the shares of a Subsidiary Company. Comment.

Ans.: *A company is required to deposit the P.F. dues of employees in special account to be opened by the company for the purpose. The employees and employer's contributions have to be deposited regularly and within the stipulated time. Hence it is wrong to keep the total amount of P.F. with the company itself and invest in the shares of its subsidiary company. The auditor should report that such action on the part of the company is in contravention of the provisions of the Act.*

UNQUALIFIED REPORT:

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements. An unqualified opinion indicates that:

(a) the F/S have been prepared using the generally accepted accounting principles, which have been consistently applied;

(b) the F/S comply with relevant statutory requirements and regulations; and

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Modified Reports

An auditor's report is considered to be modified when it includes:

(a) Matters That Do Not Affect the Auditor's Opinion

- emphasis of matter

(b) Matters That Do Affect the Auditor's Opinion

- qualified opinion: Disagreement in opinion
- disclaimer of opinion: Limitation on scope
- adverse opinion: Negative report

Matters that Do Affect the Auditor's Opinion: An auditor may not be able to express an unqualified opinion when either of the following circumstances exists and, in the auditor's judgment which are material in effect:

(a) there is a **limitation on the scope of the auditor's work** (could lead to a qualified opinion or a disclaimer of opinion); or

(b) there is a **disagreement with management** regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures (could lead to a qualified opinion or an adverse opinion).

A **qualified opinion** should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material as to require an adverse opinion, or limitation on scope is not so material as to require a disclaimer of opinion. A qualified opinion should be **<u>expressed as being 'subject to' or 'except for'</u>** the effects of the matter to which the qualification relates.

A **disclaimer of opinion** should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the financial statements.

An **adverse opinion** should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates.

Illus.22. The auditor fails to obtain sufficient information to form an overall opinion on the matters contained in the financial statements.

Ans.: *The auditor is required to obtain necessary information and explanations which he considers essential for performing his duties as an auditor. However, there may be instances when an auditor fails to obtain sufficient information to form an overall opinion on the matters contained in the financial statements. If such a situation happen Auditor should give the "Disclaimer of opinion".*

Illus.23. Garbar Ltd., closes its books on 31st March every year. For the year 2008-09, the original books comprising of cash book, purchases and sales day books, ledgers are confiscated by the CBI authorities for an inquiry on a complaint by the workers. The documents/records such as vouchers, correspondence etc. were still in the custody of the company. For the completion of the audit, the company made an extract of cash book, ledgers, etc. and duly certified the same as true copies. Assuming you is the statutory auditor of the company, how would you deal with this situation?

Ans.: *In given case, the auditor, is not justified in disclaiming his opinion, because the original documents and vouchers are still available. However, he should qualify his audit report by mentioning the fact of the confiscation of the ledgers, day book etc. by the authorities. He has to mention that he is unable to examine whether proper books of accounts as required by law are maintained due to non-availability of original ledgers. The fact that Xerox copies of such books and ledgers have been produced to him shall also be included in the report.*

Illus.24. The premises of Champat Private Ltd. were raided by the income tax authorities on 15-12-2008. All accounting and statistical records were seized by the department. The company managed to obtain photo copies of cash book and ledger only. The records of the remaining period after the raid up to the date of closing accounts i.e. 31-3-1998 were complete. You are the statutory auditor of Champat Private Ltd. Comment.

Ans.: *In the given case, the auditor has to disclaim his opinion because the substantial part of the books of the accounts is not available, since they have been confiscated by the authorities. In the given case, even the original vouchers have been confiscated. This results in limitation of the scope.*

Illus.25. Mr. SKJ, a fellow member of the Institute of Chartered Accountants of India, working as Manager of SK & Co., a Chartered Accountant firm, signed the audit report of Simplified Solutions (P) Ltd. on behalf of SK & Co. Whether Mr. SKJ can sign the report?

OR Mr. Accident a practicing chartered Accountant met with an accident and hence authorised his employee Mr. AM who is a qualified chartered Accountant to sign the audit report of the company as it was getting delayed. Explain and justify your views.

Ans.:

1. ***Companies act:*** *As per Sec.229 of the act the audit report shall be signed by:*

a. *If the appointment is made in the individual name - Only by the person appointed as an auditor Or*

b. *Where a firm is appointed - By any of the partners in the firm practicing in India.*
Therefore, Mr. SKJ, a fellow member of the Institute and a manager of M/s SK & Co., Chartered Accountants, can't sign on behalf of firm, since he not being the partner of firm.

2. ***Chartered accountants act:*** *Further, the Chartered Accountants act says that a chartered accountant shall not allow any person to sign the audit report on his behalf unless the other person is a chartered accountant & partner of him.*

THE AUDITOR'S LIEN

Any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

Therefore on fulfillment of the following conditions the right could be exercised:

(i) Documents retained must **belong to the client** who owes the money.

(ii) Documents **must have come into possession** of the auditor on the authority of the client.

(iii) The auditor can retain the documents only if he has **done work on the documents assigned to him**.

(iv) Such of the **documents can be retained which are connected with the work on which fees have not been paid**.

AUDIT OF BRANCH OFFICE ACCOUNTS [Section 228]

The accounts of the branch office of a company are required to be audited either by the company's auditor appointed under section 224 or by any person qualified as per section 226. Where the branch office is situated in a foreign country, either by the company's auditor or by a person qualified as aforementioned or by an accountant duly qualified to act as an auditor in accordance with the laws of that foreign country.

In case accounts of the branch office are audited by a person other than the company's auditor, the latter would have a right to visit branch office, if necessary, and also to have access at all times to the books and accounts and vouchers maintained at the branch office except in the case of a banking company having foreign branch office, in which case it would be sufficient if the auditor of the company 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.

A company may at GM decide whether it shall have accounts of its branch office audited by a person other than the company's auditor or authorise the Board of Directors to appoint such an auditor in consultation with the company's auditor.

The auditor so appointed in either case will have the same powers and duties as the statutory auditor. It will be the duty of the branch auditor to prepare a report on the accounts of the branch office examined by him and to forward the same to the company's auditor who shall, while preparing his report deal with the same in such manner as he considers necessary.

Exemptions to Branches: To prevent any hardship, the CG has been empowered to make Rules so as to exempt branch offices from audit [section 228(4)]. In exercise of this power the CG has framed certain rules, "The Companies (Branch Audit Exemption) Rules, 1961".

These summarized rules are:

(1) Exemption based on quantum of activity - Higher of these:

(i) the aggregate value of the goods and articles produced, manufactured or processed, or

(ii) the aggregate value of the goods or articles sold and of service rendered, or

(iii) the amount of the expenditure, whether of a revenue or capital nature, incurred by a branch office of a company during a financial year, (i.e., the financial year of the company in respect of which exemption from branch audit is to be determined) **does not exceed Rs. 2 lakhs or 2% of the average of the total turnover of the company**.

(2) Grant of exemption in certain other cases - When an application for exemption is made to the CG, it may, after making the necessary inquiry, exempt the branch office from the provisions of audit in section 228 on any one of the following grounds:

(i) that the company carrying on activities **other than those of manufacturing or processing, or trading,** has made satisfactory arrangements for the security and check, at regular intervals, of the accounts of the branch office by a responsible person competent to scrutinise and check the accounts;

(ii) that the company has made **arrangements for the audit of the accounts** of the branch office by a person otherwise qualified for appointment as branch auditors, even though such a person is an employee of the company;

(iii) that **having regard to the nature and the 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; and

(iv) that, **for any other reason, the CG is satisfied that exemption may be granted.**

SPECIAL AUDIT

Section 233A empowers the CG, in certain cases, to call for a 'special audit' where it has reasons to believe:

(*i*) that the **affairs are not being managed on sound business principles** or according to prudent commercial practices; or

(*ii*) 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; or

(*iii*) that the **financial position of the company is such as might endanger its solvency**.

The audit may be conducted either by the company's auditor or another chartered accountant who may or may not be engaged in a practice, appointed by the CG.

The auditor so appointed has the same powers and duties in the matter of special audit as the statutory auditor, except that he must report to the CG in place of the members of the company. The special auditor's report must include, as far as may be practicable, all the matters required to be included in a normal auditor's report under section 227 and where the CG so directs, also a statement on any matters which may be referred to him by the Government. On receipt of the report, the CG may take such action as circumstances might warrant, according to the provisions of the Act or any other law for the time being in force. In case the CG does not take any action within four months from the receipt of the report, it must send the report to the company either to circulate the copy or the extracts among the members or to get it read at its next GM.

The expenses of or incidental to a special audit, including the remuneration of the special auditor as fixed by the CG (and its decision in this regard is final), must be paid by the company.

Illus.26. Special audit can be ordered by the central government U/s 233A of the companies act if a company sustained losses continuously for two years and the special auditor may not be a chartered accountant in practice. Comment.

Ans.: *Special Audit U/s 233 A of the Companies Act, 1956 can be ordered by the Central Government, if it is of the opinion:*

- a. *Where the companies affairs are not carried on according to commercially prudent practices.*
- b. *Where the companies affairs are managed in such a manner as to damaging the industry to which the company belongs.*
- c. *When the financial position of the company may result into solvency.*

In view of the aforesaid provisions, mere incurrence of loss continuously for two years may not be a valid ground for ordering special audit unless the solvency of the company is endangered. Therefore, the statement is false. However, this section empowers the Central Government to appoint a Chartered Accountant (whether or not such chartered accountant is in practice) or the company's auditor himself to conduct special audit. Hence the second part of the statement is true.

T H E C O M P A N Y A U D I T - I

COST AUDIT (Section 233B)

Qualification of a Cost Auditor: A cost audit is to be conducted by a Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959

Disqualification for a cost auditor:

(i) Disqualifications contained in sections 226(3) and 226(4) of the Act.

(ii) Holding appointment as the statutory auditor under section 224 of the Act.

(iii) On becoming subject to any of the disqualifications mentioned above after being appointed as the cost auditor.

A cost auditor shall be appointed by the Board of Directors of the company with the previous approval of the CG. Before the appointment of any cost auditor, the Board shall obtain written certificate from the auditor that the appointment, if made, will be within ceiling as per sub-section (1B) of section 224.

The cost audit is in addition to, and independent of the normal financial audit carried out under section 224 of the Act. The cost auditor shall have the same powers and duties as are prescribed under section 227(1) of the Act for the Statutory Auditor(s).

- The cost auditor must forward his **report to the CG and to the company within 120 days of the closing of the year** to which the audit relates. The report is to be given in the form prescribed for the purpose. The auditor must further report on the adequacy of cost accounting records maintained by the company as prescribed under section 209(1)(d) to confirm that they give a true and fair view of the cost of production, processing, manufacturing, or mining activities, as the case may be.
- The cost audit will not be required annually but only for the financial year or years specified in the order.
- The copy of the cost audit report sent to the CG should be sent to the company concerned simultaneously. The **company shall within 30 days,** from the date of the receipt of the copy of report, **furnish to the CG with full information and explanations on every reservation or qualification contained in such report**. The CG, after consideration of the report and the information and the explanations furnished by the company, may seek further explanation from the company if it so needs.

Illus.27. The Company had also appointed a Cost Auditor and therefore, the management had requested you not to review the cost records. Comment.

Ans.: *As per Sec.209 of the companies act the term books of accounts included the cost records and the auditor has the duty to state in the audit report u/s 227(3) whether proper books of accounts as required by law have been kept by the company. Accordingly, the auditors cannot be requested not to review the cost records as a cost auditor has been appointed by the company. The statutory auditor's duties cannot be limited in any way either by the Articles or by the Directors or members. This is confirmed by the judgement given in Newton vs. Birmingham small arms co. case.*

STATUTORY REPORT

Statutory audit of a public company implies the audit of the transactions of the company which are the subject-matter of the report under section 165(4). The auditor has to certify only the Statutory Report as relates to the shares allotted by the company, cash received in respect of such shares and other receipts and payments of the company. The auditor, therefore, must:

(*a*) examine the internal check with regard to the control over amounts collected; and

(*b*) study the MoA, AoA and the Prospectus for ascertaining the amount of authorised capital, its composition, terms of issue, particulars of any underwriting contract entered into and the rate of commission, shares agreed to be issued for consideration other than cash and particulars of important agreements entered into by the company. Additionally, the auditor should carry out an audit of the issue of shares.

The under mentioned steps are also necessary:

(1) Vouch the payment of the **underwriting commission**.

(2) Vouch the **brokerage** paid on issue of shares. Refer to minutes of the Directors authorising the payment of such brokerage. Also see that the provisions of section 76 have not been contravened.
(3) Vouch the payment of **Preliminary Expenses** and check amount paid does not exceed the amount fixed by Articles/ Prospectus.
(4) Vouch all other receipts and payments of the company up to date within 7 days of the report, specially on capital account.
(5) Check in detail amounts deposited/withdrawals in the bank and a certificate as to the bank balance upto Statutory Report date.
(6) Verify that the amounts receivable and payable which have been adjusted in the books of account but have been excluded from the balance of receipts and payments.
The audit is concerned, in the Abstract of Receipts and payments made upto a date within 7 days of the report, exhibiting under distinctive heads, receipts of the company from shares, debentures and other sources, payment made and balance left in hand. The Statutory Report is required to be certified by the auditors of the company, in so far as the report relates to shares allotted by the company, cash received in respect of which the checking of accounts, as per details given above, has been carried out.

REVIEW

Appointment of Auditor

- Obligatory on every company to appoint an Auditor i.e. STATUTORY AUDITOR
- The Auditor, if Individual, should be a Chartered Accountant.
- In case of Firm of Auditors, every Partner should be qualified for appointment as an Auditor in the Firm's name.
- **Statutory auditor cannot be internal auditor.**

Who cannot be appointed as Auditor, i.e., Disqualifications U/s 226(3) & 226 (4)

- A Body Corporate
- An Officer or Employee of the Company
- A Person who is a Partner, or in the employment, of an Officer or Employee of the Company.
- A Person who is indebted to the Company for an amount> Rs.I 000.
- A Person holding any **security** of that Company after a period of one year from the date of commencement of the Companies Amendment Act 2000
- Holding or Subsidiary
- **Automatic vacation in case of disqualification u/s 226 (3) & (4)**

Restrictions

- Should not be in 'FULL TIME EMPLOYMENT'
- Auditor of max 20 Companies - only 10 can be Big Companies [Section 224{1B)]
- Big Companies - paid up capital $\geq$ 25 lacs
- In a Firm of Auditors, the limit of 20 Companies is per Partner.
- **Private Companies will not be taken into account for counting the limit of 20 Companies.**
- Joint audit assignments - to be counted as one company.
- Branch Audits - not included
- Guarantee companies having no share capital- also excluded.
- Foreign companies audit - not included.
- **ICAI Notification: Audit u/s 224 & 228 $\leq$ 30**

Appointment & Removal of First Auditor

- Appointed by BoD within 1 month of registration of the company. Sec. 224(5)
- If BoD fails to appoint, the company may appoint at a General Meeting.
- Holds office until the conclusion of first AGM.
- Members at any GM may remove such auditor and appoint another in his place, of whose nomination special notice has been given. Proviso to section 224(5)
- ➢ Appointment of first auditors through the MoA &AoA -not a valid appointment.

Appointment of Subsequent Auditors

- Appointed at each AGM to hold office until the conclusion of next AGM. See 224(1)
- Intimation to the auditor within 7 days.
- Auditor to file form 23B to ROC within 30 days. See 224(IA)
- ➢ Appointment of auditor is mandatory in the AGM for the ensuing year. ICAI v. J Saikia.

Tenure of Auditor

- Tenure of Auditor is not for a particular year or financial year.
- Tenure-From one AGM to another AGM.
- If AGM not held- will continue up to the factual conclusion of the AGM.

Re-appointment of Retiring Auditors- Sec 224(2)

- Normally, retiring Auditor is appointed for the next year.
- He shall be re-appointed unless:
  - ✓ he is not qualified for re-appointment.
  - ✓ he has given the Company notice of his unwillingness to be re-appointed .
  - ✓ a resolution has been passed at that meeting appointing somebody instead of him or expressly providing that he shall not be re-appointed .
  - ✓ notice has been given of an intended resolution to appoint some other person but the resolution can not be proceeded with .
  - ✓ A retiring Auditor shall re-appointed except in four types of cases referred in 224(2). But the passing of resolution is essential for the re-appointment of the retiring Auditor.

Removal of Auditor

- Special notice required - Section 225(1)
- Auditor can be removed before expiry of his term by Company in GM after previous approval of Central Govt (powers delegated to Regional Director). Section 224(5)
  - ✓ Approval of Central Govt. not required for removal of First Auditor.
  - ✓ Prior approval of Central govt. required before actually removing an Auditor. Though resolution for removal can be passed before.

How to Appoint New Auditor in place of Old (Existing/Retiring) Auditor

- Check whether old\auditor is first auditor or subsequent auditor;
- Accordingly write the provisions of section 225 relating to "Removal of Auditor";
- After that write the provisions of Section 224 relating to appointment of "Subsequent Auditor";
- Every new auditor has· to communicate with the old auditor before accepting the appointment (CA Act, 1949)

Filling up of Casual Vacancy

- BOD may fill any casual vacancy See 224(6)(a)
- Vacancy caused by resignation (not a casual vacancy) - filled by the company in GM
- Such Auditor holds office till conclusion of next AGM. See 224(6)(b)
  - ✓ A casual vacancy is not a vacancy created by a deliberate omission on the part of the company to appoint an auditor at its AGM. ICAI Vs. J. Saikia
  - ✓ Where an auditor refuses to accept appointment or re-appointment, its not a casual vacancy and only GM can make appointment.
- If there is a complete change in the constitution of the firm of Auditors i.e. all the earlier partners retire and new partner(s) joins - Casual Vacancy.

Appointment of Auditor by Central Government

- If no Auditor appointed at an AGM- Central Govt. may appoint. Sec. 224(3)
- Company to give notice to Central Govt. within 7 days after AGM that no auditor has been appointed. Sec. 224(4)
  - ✓ Delay in giving such notice does not affect the jurisdiction of the Central Govt.
  - ✓ Powers of Central Govt. - Delegated to Regional Director.

Appointment of Auditor by Special Resolution - Sec. 224A

- Where not less than (i.e. ≥) 25% of subscribed share capital is held by

- Public Financial Institution/ Govt. Company/Central Govt./ State Govt.
- any institution established under State/ Provincial Act in which State Govt. holds ≥ 51 % of subscribed share capital.
- Nationalised bank/Insurance company carrying on General Insurance Business

- Any combination of above would also be covered for section 224A
  - ✓ Material date for 25% holding of subscribed share capital: date of AGM at which Special Resolution is to be passed and not the date of notice of meeting.

Auditor’s Remuneration u/s 224(8)

May be fixed at GM; or

- GM may authorise BoD to fix it;
- BoD fix remuneration for First Auditor;
- CG fix remuneration for auditor appointed by it;
- Additional expenses considered as part of remuneration;
- Fees for Expert Opinion by auditor not audit remuneration;
- Fees can be recovered on progressive basis

Branch Auditor - Section 228

- May be the Company's Auditor or some other person qualified to be appointed as Auditor.
- Where Branch Auditor is different from Company's Auditor, he is appointed either by the Company in GM or BOD if they are authorised by AOA to appoint him in consultation with Company's Auditor.
- Same powers as Company's Auditor.
- Forwards his report to the Company's Auditor.

Branch Auditor

CG may exempt a Branch from audit requirements on following factors:

1. Nature and quantum of branch activity for previous 3 years;
2. Availability/non-availability of branch auditor at reasonable cost;
3. Any other factor as per CG opinion

Branch Audit Exemption Rules: Steps

1. Quantum of activity = highest of total value of goods & articles (produced/processed/manufactured; or sold or services rendered)

   Capital-as well revenue expenditure
2. Average Quantum of Activity = (Step 1) divided by 1/2/3 (it may be shorter period also);
3. Higher of Rs. 2 lakhs or 2% of Avg. Turnover (3 years);
4. If Step 2 $\leq$ Step 3 = Branch Audit Exemption

SPECIAL AUDITOR (Sec 233A)
- → CG may either Appoint C.A. or Company's Auditor
- → Same powers as Company's Auditor
- → Makes his report to Central Govt

COST AUDITOR (Sec 233B)
- → Appointed by the BoD with previous Approval of CG
- → Same powers & duties as that of Statutory Auditor
- → Submits report to CG and Co. both
- → Stat. Auditor can’t be appointed as Cost Auditor (ICAI Notification)

Special Auditor - appointed by CG when company's affairs not managed as per:

1. Sound business principles; or
2. Prudent commercial practices;

- Company is managed in a manner that may:
1. Cause serious injury; or
2. Damage to the interests of trade, industry or business to which it relates

Danger of insolvency

CARO, 2003

Not Applicable to:

- Banking Company
- Private Company, if:

(i) (Paid up Capital + Reserves) <= Rs. 50 Lacs; and
(ii) Outstanding Loan <= Rs. 25 Lacs; and
(iii) Turnover <= Rs. 5 Crores at any point of time during the financial year.

Clause 4(i): Fixed Assets

- **Proper** Record
- **Physical Verification** at reasonable intervals
- Material **discrepancies properly dealt**
- **Substantial part of fixed assets disposed**

Clause 4(ii): Inventories

- **Physical verification** at Reasonable intervals
- **Procedure of physical verification is Reasonable**
- **Proper records** maintained
- **Material discrepancies** properly dealt

Clause 4(iii) [(a) - (d): Loans Granted

- **Number of parties and amount** involved
- **Terms and conditions** are prejudicial
- Reasonable **steps taken to recover in case overdue** amount is more than Rs. 1 Lac.

Clause 4(iii) [(e) - (g): Loans Taken

- **Number of parties and amount** involved
- **Terms and conditions** are prejudicial

Clause 4(iv): Internal Control System

- **Commensurate with the size and nature** of the company and its business -
- **Major weaknesses** (if any) and **Continuing failure to correct**

Clause 4(v): Section 301 Contracts or Arrangement

- **Completion of entries** in Register
- **Transaction >Rs. 5 lacs: Reasonable**

Clause 4(vi): Public Deposits

- **Compliance with RBI Directives-Examination of System**

Clause 4(vii): Internal Audit

- **Commensurate with nature & size of business**

Clause 4(viii): Cost Records

- **Proper cost records as prescribed**

Clause 4(ix): Undisputed Statutory Dues

- Statutory dues to be **deposited regularly**

- Identification of **undisputed amount**
- **Amounts involved in dispute not deposited and the forum**

Clause 4(x): Sick Company

- **Computation of Accumulated Losses**
- **Computation of Net Worth & Adjust Qualification**

Clause 4(xi): Default in repayment of dues

- **What constitutes Default: Nature of default**

Clause 4(xii): Adequacy of Documents

- **Maintaining adequate records**

Clause 4(xiii): Chit Fund Companies

Clause 4(xiv): Companies dealing in shares, etc.

- Proper records

Clause 4(xv): Guarantees for loans taken by others

- **All guarantees are recorded properly**
- **Terms and conditions are not prejudicial to interests of company**

Clause 4(xvi): Application of Term Loans

- **Purpose of term loans**
- **Actual utilisation of term loans**
- **Funds Flow Statement**

Clause 4(xvii): Application of Funds - Short-term

- **Preparing movement of funds** - Source and Application

Clause 4(xviii): Preferential Allotment

- **Valuation in case of unlisted companies**

Clause 4(xix): Debentures

- **Proper Security or charge** has been created

Clause 4(xx): Disclosure of End-use of funds - Public Issue

- Raising of funds through public issue
- **Amount raised and amount used: Relation**

Clause 4(xxi): Frauds

- Audit Plan to **conform with AAS 4**
- **Reports of Internal Audit**
- Enquiries made to management