COMPANY AUDIT – 1st

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<tr><td>224</td><td>(1)</td><td>Appointment of subsequent auditor by Shareholders at an AGM
➢ At every AGM the auditors are appointed or reappointed by every company (Except govt & foreign Co')
➢ By an Ordinary Resolution (But if sec. 224A applicable then by special Resolution)
➢ Such Auditors hold office from the conclusion of that meeting until the conclusion of next AGM.
➢ The company shall with in seven days of the appointment, give intimation thereof to every auditor so appointed.</td></tr>
<tr><td>224</td><td>(1A)</td><td>Acceptance / Refusal by Auditor appointed u/s 224(1) in AGM to ROC within 30 days (of the receipt of intimation) through Form No. 23B.</td></tr>
<tr><td>224</td><td>(1B)</td><td>Ceiling Limits on number of Audit assignments **
This section introduces a ceiling on the number of companies of which a C.A. could be the auditor.
No company or its BOD shall appoint/ reappoint any person or firm as its auditor if such a person or firm is at the time of appointment/reappointment, holding appointments as an auditor equal to or more than the "Specified Number" of company.

➢ Here Specified Number means – Maximum 20 Public companies
(Out of these 20 public companies, maximum 10 Co' may be those whose paid-up capital is More than or Equal to Rs. "25 Lakh" – see it on date of appointment)
➢ Limit specified u/s 224 (1B) is per annum & per chartered accountant.
➢ This limit is applicable on following type of companies and Audit –
<table>
<tr><th>Companies u/s 224(1B)</th><th>Audits u/s 224(1B)</th></tr>
<tr><td>1. Public Company
2. Government Company
3. Company's incorporated u/s 25
4. Branch of public company with head office</td><td>1. Statutory Audit
2. Cost Audit –Section 233B</td></tr>
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➢ In case of joint audit, each of the joint auditors should consider 1 unit at his part for the purpose of calculating the ceiling limit of audits.
➢ Limit as per ICAI Notification dated 8/5/2001
As per the notification issued by ICAI, a chartered accountant can accept maximum audits of 30 companies (including private companies), non- observance of this ceiling would amount to professional misconduct.
➢ Audit limit in case of CA firm = (No of partners x 20 or 10 or 30 as the case may be).</td></tr>
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		a. Exclude the partner who is in full time employment elsewhere. b. When 1 person is partner in more than 1 firm and also practicing individually, he is allowed to have maximum 20 audits only.
224	(2)	<u>**Compulsory Re-appointment of an Auditor**</u> According to Section 224(2) at each AGM, a retiring auditor shall be reappointed unless;- 1. The auditor is suffering from disqualification u/s 226(3) and 226(4); 2. He has given to the company notice in writing of his unwillingness to be re-appointed. 3. Section 224(1B) Limits have been completed 4. A resolution has been passed appointing somebody else instead of him. 5. By reason of death, insolvency and incapacity of auditor. 6. A special notice has been given by shareholders to appoint some other person & to remove existing auditor (Before 14 days from Date of AGM) *Retiring auditor cannot be deemed to be reappointed automatically. For reappointment resolution is required.
224	(3)	<u>**Appointment by Central Government**</u> ➢ Where at an AGM, no auditor are appointed or re-appointed the Central Govt has a right to appoint the Auditor. ➢ The central govt has right to appoint the auditors only when appointment fails in AGM [Section 224(1)]. ➢ If the appointment u/s 224(1) (2) is void-ab-initio, then in such case appointment by Central Government u/s 224(3) will be attracted.
224	(4)	**Company's duty** to **give notice to Central Government** that **no auditor was appointed** in AGM, **within 7 days of the failure**, in **form 29B**, with **4 Proposed names of auditors**.
224	(5)	<u>**Appointment of the First Auditor**</u> ➢ Appointed <u>by BOD</u> within <u>one month</u> from the date of registration. ➢ Such auditor <u>holds office</u> until the conclusion of the first AGM. ➢ If the BOD fails to appoint the first auditor within 1 Month, the company (Shareholder) in general meeting is empowered to make the appointment. <u>**Note-**</u> 1. An auditor cannot be appointed as first auditor simply because his name has been stated in the AOA or MOA of the company. 2. The first auditor is themselves not required to inform the Registrar of Companies about their acceptance or refusal of such an appointment. 3. The need to send written information to the Registrar by the auditor is applicable only to the appointment of the auditor in the AGM not at an EGM. 4. The first auditor need not be sent intimation by the company of their appointment.
224	**(6)**	<u>**Filling of Casual Vacancy**</u> <u>Meaning-</u> If after validly appointment and the appointment was accepted, there is a vacancy in the office of auditor, this is called casual vacancy.

		Reasons Of Casual Vacancy – This may arise due to Death, insolvency, incapacity, disqualification, resignation of auditor or dissolution of CA firm etc. Who could fill the Vacancy – ➢ If it was **due to resignation** – Only by **shareholders** (Even fails then again by shareholders) ➢ If it was **due to other reason – By BOD** (If BOD fails then by shareholders)
224	**(7)**	**Removal of an Auditor may be at two times-** 1. Removal before expiry of his term ➢ Removal of first auditor – removed by passing Ordinary resolution + By shareholder + in EGM ➢ Removal of Subsequent auditor u/s 224(7)- Step 1st – Take Prior Approval of Central Government Step 2nd – Ordinary resolution in GM, by Shareholder 2. Removal after expiry of term – cannot be removed because u/s 224(2) compulsory reappointment is required. But if reappointment not possible then remove by complying section 225
224	**(8)**	**Remuneration of an auditor** **Remuneration of an auditor is generally determined by the appointing authority.** ➢ Appointed by BOD – By BOD's (If BOD doesn't then co' in General Meeting) ➢ Appointed by shareholders – By Shareholder (Company) in AGM ➢ Appointed by Central Govt - By C.G. (If C.G. doesn't then co' in General Meeting) **Exception**- if auditor has been appointed by the C&AG of India in case of a government company then remuneration shall be fixed by shareholder in general meeting. **Remuneration other than audit fees** – in many cases, the auditors is to be paid extra fees for the various additional services rendered like 1. Company law services, 2. Taxation matters, 3. Management services etc. **Disclosure of Remuneration in P&L A/c** As per part II of the schedule VI of the company act 1956, the P&L A/c must disclose the auditors remuneration :- a. As auditor b. As advisor or in any capacity in respect of 1. Company law services, 2. Taxation matters, 3. Management services c. In any other manner (audit expenses)
224A	**Head**	**Appointment of an Auditor By passing Special Resolution** All those companies in which **not less than 25% of the Subscribed Share Capital** (if in Q. paid up capital is given then assume "Subscribed = Paid up") is **held** (See holding on the date of AGM) whether individually or in any combination by: a. A public financial institution (LIC) or a govt company or Central govt or any of the state govt;

		b. <u>State level financial institutions</u> in which a state govt. holds not less than 51% of the subscribed share capital; c. A <u>Nationalised Bank</u> or any <u>General Insurance Company</u>; If the company fails to pass such special resolution, it shall be deemed failure in appointment. In such a case, central Govt [u/s 224(3)] will appoint the auditor.
<u>225</u>	**<u>Head</u>**	**<u>Provisions as to appointing/removing Auditor</u>** **<u>(Removal of an Auditor after expiry of his Term)</u>**
225	(1)	Special 14 days notice is to be given to all the members- ➢ Appointing another person as an auditor; ➢ Proposing that retiring auditor shall not be reappointed.
225	(2)	A <u>copy of such notice</u> is <u>to be given to the retiring auditor</u> also. <u>Auditor has</u> <u>right to make a representation</u> in writing to the co' and request the co' to circulate it to the members.
225	(3)	If the C.G. is satisfied on an Application by company or any member that the <u>right is being abused to secure needless publicity</u>, the CG may order that the representation may not be circulated or readout, also that the co's cost on such application should be paid by auditor.
<u>226</u>	**<u>Head</u>**	**<u>Qualifications and Disqualifications of an Auditor</u>**
226	(1)	An auditor should be a Chartered Accountant defined under 'The Chartered Accountant Act of 1949'
226	(2)	A **firm** whereof <u>all the partners</u> are <u>practicing chartered accountants in India</u> are qualified for appointment as aforesaid, may be appointed by its firm name to be auditor of a company, in which case any partner so practising may act in the name of the firm.
226	(3)	Restricted State Auditors **<u>Disqualifications</u>**: Following persons are not qualified for appointment as an auditor of the company- **a.** a <u>body corporate</u> (A co' of CAs, as the liability of members of a co' is limited); **b.** an <u>officer or an employee</u> of the company; **c.** a person who is a partner, or who is in employment of an officer or employee of the company; **d.** a person who is <u>indebted</u> to the company for <u>more than Rs.1,000</u> or who have provided any security or <u>guarantee</u> against a third person who is indebted to the company for more than Rs.1,000; and **e.** A person who holds the <u>security</u> (With voting right) of the company.
226	(4)	If a person is disqualified to be an auditor of a subsidiary company, then he is disqualified to be auditor of its Holding Company and its other subsidiaries
226	(5)	If a person is disqualified to be an auditor under sub-sections (3) and (4), then he have to <u>vacant his office</u>
<u>227</u>	**<u>Head</u>**	**<u>Powers and Duties of an Auditor</u>**
227	(1)	Right of access to books of accounts & right to require information and explanation from officers.
	(1A)	**Duties of an Auditor as to enquiry:** a. <u>Loans & Advances</u> made by the company secured & prejudicial to the interest of

		the company, 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 as defined in Sec.372 or Banking Company, which sells its assets & securities at the price less than its purchase price. d. Loans & Advances have been shown as deposits. e. Whether personal expenses have been charged to P&L account. f. If no cash has been received in respect of shares then whether the position stated in balance sheet is correct, regular and not misleading. (Auditor have to give reason for both negative & positive remarks)
227	(2)	Auditor should report whether the said accounts complies with all the compliances of The Companies Act, 1956.
227	(2bb)	If proper returns as required by auditor of the branches not visited by him are not received by him then he must state this fact in his audit report.
227	**(3)**	**The auditor should 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 accounts as required by law are kept by the company and proper returns have been received by him of the branches not visited by him.
	(bb)	Whether the reports on accounts of any branch offices audited u/s 228 have been forwarded to him as required u/s 228(3)(c) & the manner in which he have dealt with it for preparing auditor's report.
	(c)	Whether the companies Balance Sheet & P/L Account are in agreement with the books of accounts & returns.
	(d)	Whether in his opinion Balance Sheet & P/L A/c complies with the AS u/s 211(3c).
	(e)	Auditor has highlighted adverse effects in companies functioning by thick or italic type.
	(f)	Whether any director has been disqualified from being appointed as director u/s 274(1) (g).
	(g)	Whether cess payable u/s 441A (levy & collection of cess on turnover or gross receipts of the company) has been paid, if not, details of amount not so paid.
227	(4A)	**CARO, 2003 as amended by CARO (Amendment) order 2004** ➢ CARO – Companies Auditor's Report Order (an annexure to the audit Report) ➢ Section 227 (4A) empowers the central government to direct that the auditor's report of such companies as specified in the order shall also include a statement of such maters as specified in the order. ➢ *Auditor must state the reasons only for negative remarks made by him in his report. **Applicability** CARO is applicable to all companies including Foreign companies but it excludes – ➢ A Banking Company as defined under section 5(C) of BRA, 1949

- An Insurance company as defined under section 2(21) of Company Act, 1956
- A company licensed to operate under Section 25 of Company Act, 1956
- A small Private limited company shall be exempted from the provisions of CARO, if it fulfills all the following conditions:—

1. Paid-up capital(Equity + P/S + Bonus) & Reserves (P&L A/c + General Reserve + Capital Reserve +Revaluation Reserve) shall not exceed Rs.50 Lakh at any time during F.Y.,
2. Outstanding loans from Bank (Indian) /Financial Institution shall not exceed Rs.25 Lakhs at any time during F.Y, and
3. Turnover shall not exceed Rs.5.00 Crore. In Turnover –

Consider – Sales Return, Trade Discount
Don't Consider – VAT, Freight, Goods sent on approval/ Consignment etc.

Matters of CARO (*Important clauses 3, 4, 5, 7, 9, 11, 13, 17, 18)

As in 227(1A) auditor is required to report only in case of dissatisfaction. In the reporting matters under CARO auditor should report about each clause, whether he satisfied or not satisfied. Even he has to report that the particular clause is not applicable to the company.

1) Related to Fixed Assets

- Whether co' is maintaining proper records (Quantity + Location) of fixed assets
- Whether Fixed assets are Physically Verified by management at reasonable interval

(here reasonable interval means if assets is centrally located – once in a year; whereas for multi located assets reasonable time is once in 3 years)

- Whether any substantial part of fixed asset have sold and have it affected going concern.

2) Related to Inventory

- Physical verification + By management + At reasonable interval

(here reasonable interval means if assets is centrally located – once in 6 Month; whereas for multi located assets reasonable time is once in a year)

- Is the process of physical verification is adequate (Ex ABC analysis for stock)
- Whether proper records of stock is maintained or not & if any deviation found during verification and is the same dealt with BOA?

3) Loan Given to/ Loan Taken from Section 301 Parties ***

A. Section 301 Parties

- Director of a company
- Relative or partner of such director
- A firm in which such director or his relative is a partner
- A private co' in which such director is a director

- Has the company either given or taken any loans, secured or unsecured to/from sec. 301 parties covered in the register maintained u/s 301 of the act. If so, give the name/ numbers of parties and amount involved in such transaction.
- Whether the terms & conditions of loan given or taken by the company, are

prima facie prejudicial to the interest of the company.
- Whether payment of the principal amount & interest are regular.
- If overdue amount is more than Rs. 1 Lakh, whether reasonable steps have been taken by the company for recovery of principal and interest (see it if loan given)

4) Adequate Internal Control System
- For purchase of inventory & fixed asset
- Failure to rectify major weaknesses
- For sale of goods & service

5) Transaction u/s 301
- All particulars entered in register maintained
- Transactions made at reasonable prices (for transactions exceeding Rs. 5 Lakh for each party for each year)

6) Public Deposits
- Non-compliance if any with provisions of RBI, Act & order of CLB

7) Adequacy of internal audit system
Applicability
- All listed companies
- All unlisted companies with
  - Paid up share capital & reserves at commencement of F.Y. > Rs. 50 Lakh
  - Avg annual turnover for preceeding 3 consecutive FYs > Rs. 5 Crore

8) Maintenance of Cost Records
- If prescribed u/s 209, whether made & maintained

9) Statutory dues
- Undisputed dues paid regularly, if not, amt o/s > 6 Months on B/S Date
- Disputed tax (Income, wealth, excise, VAT) due, with amount and forum where pending.

10) Net Worth erosion (Sick industrial company)
- Applicability – Companies registered >= 5 Years
- Accumulated losses if > 50% of net worth
- Cash losses in current or previous year

11) Default in repayment of dues
- Dues of banks / Financial institutes/ debenture holders
- State period & amount of dues

12) Record of loans & advances Granted
- Applicability – loan against security of shares, debentures & other securities
- Adequate record if maintained; deficiencies if any – report

13) Company dealing (Trading) in share/ debenture/ securities

		➢ Proper record & timely entry ➢ Ensure that investment if any in share/debenture, then held in company's own name **14) Guarantee given to Bank / Financial institutions** ➢ Terms & conditions, if prejudicial to the interest of company **15) Application for term loan** ➢ Used for the purpose for which it was obtained **16) Application of short term loan** ➢ Short term loan if used for long term purpose, then <u>specify nature & amount</u> **17) Preferential allotment to person covered u/s 301 –** <u>Price of issue, if prejudicial</u> **18) Charge on debenture** <u>Audit Process</u>- (1). Refer debenture trust deed. (2). Find out detail of asset on which charge is created. (3). Check whether charge is registered within time with ROC u/s 125. **19) End use of money raised by public issue** ➢ Whether management has Disclosed end use of public money; and ➢ The disclosure has been Verified by the auditor **20) Fraud (on the company or by the company) –** Report on Nature & amount of fraud
<u>**228**</u> 228 228 228 228	<u>**Head**</u> (1) (2) (3) (4)	<u>**Audit of Accounts of Branch Office of the company**</u> **Auditor –** ➢ By the person appointed u/s 224 (Company Auditor) or the person qualified u/s 226 or, ➢ If foreign branch then by any competent person qualified to do the audit as per the rules of that nation. If the accounts of the branch office are audited by the person other than the companies auditor, then the latter have <u>right to visit the branch office</u> & <u>to access to the books of accounts</u>, except in case of the banking companies having foreign branch offices, the accounts of such branches may be transmitted to the head office in India for the auditor's inspection. Branch auditor shall have the same powers and duties as the company's auditor **Reporting-** It will be duty of the branch auditor to prepare the audit report for that branch & forward it to the company's auditor. **Remuneration & Term of office –** Appointing authority will decide it. **Power of Central Government to exempt the branch offices** from audit to the extent as specified in rules, entitled "The Companies (Branch Audit Exemption) Rules, 1961". In making such rules, the Central Government shall have regard to all or any of the following matters, namely:—

		a. the arrangement made by the company for the audit of accounts of the branch office by a person otherwise qualified for appointment as branch auditor even though such person may be an officer or employee of the company; **b.** the nature and quantum of activity carried on at the branch office during a period of three years immediately preceding the date on which the branch office is exempted from the provisions of section 228; **c.** the availability at a reasonable cost of a branch auditor for the audit of accounts of the branch office; **d.** Any other matter which in the opinion of the Central Government justifies the grant of exemption to the branch office from the provisions of section 228. **Exemption Rule-** Branch Audit Exemption if Average "QOA" of a Branch <= Higher of - a. Rs. 2 Lakh ; or b. 2% of Avg total turnover of Co' Here, **Average means** – preceeding 3 years from the year of audit **QOA means** – Quantum of activity, calculated for each year separately. Higher of following- a. Value of goods produced in case of mfg unit b. Sale value / service value c. Capital + revenue expenses of the year
229	**Head**	**Signing of the Audit Report** → When a single C.A is practising, there can't be any question of any firm name. → When a firm of a C.A is appointed as an auditor, then only a partner may sign the report.
230	**Head**	**Reading and Inspection of the Auditor's Report** Audit report of the company must be read out before the shareholders at an annual General Meeting and should be kept for inspection at the company's registered office for the inspection of every member of the company.
231	**Head**	**Right of an auditor to attend an Annual General Meeting** The auditor can attend any Annual General Meeting of the company (not restricted to those at which the accounts audited by them are to be discussed) and is entitled to all the notices and other communications related to the general meeting for which a member of that company is entitled, but it is not obligatory at his part to attend the AGM. He can hear in the meeting but can't take part in the discussions.
232	**Head**	**Penalty for non-compliance with Sections 225-231** For non-compliance of Sections 225-231, the company, and every officer of the company who is in default, will be liable to the fine which may extend up to Rs.5,000/-
233	**Head**	**Penalty for non-compliance by the auditor with Section 227 and 229** An auditor may be penalized at the extent of Rs.10, 000/- for non-compliance of the Sections 227 and 229.

233A	**Head**	**Special Audit** **Objectives for conducting special audit** The Central Government may order for a special audit, if it is of the opinion:— a. that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or b. that any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade or business to which it pertains; c. that the financial position of any company is such as to endanger its solvency; **Auditor appointed by central Government (Who may conduct special audit)** The audit may be conducted by the company's auditor or by any C.A, who may or may not be engaged in practising. **Remuneration –** will be decided by Central govt and paid by company. **Powers and duties of special auditors** Auditor so appointed is conferred with all those powers as mentioned u/s 227, except he have to report to the Central Government instead of the members of the company [Section 237(2)]. **Follow up of report (Action by the Central Government)** On receipt of the report, the central government may take such action as it considers necessary. In case the central govt doesn't take any action on the report within 4 months from the date of receipt of report, the govt shall send to the company either a copy or relevant extracts from the report within its comment thereon and require the company either to circulate that copy or extracts to the members or to read it before the company as its next general meeting. Auditor will be penalized for Rs.500/- for non-compliance of the order that is issued by the central government.
233B*	**Head**	**Cost Audit** **When** - On Direction of Central Government. **Auditor –** ➢ Cost accountant within meaning of ICWAI ; or ➢ Practicing CA qualified u/s 226(1) & (2) & not disqualified u/s 226(3) & (4) **Appointment** – By BOD with prior approval of Central Government **Reasons for cost Audit-** ➢ For identifying cost of product of any article. ➢ To verify that utilization of material & labour is optimum or not. ➢ Varity truthfulness & fairness of cost records maintained u/s 209(1) (d). **Reporting**- the cost auditor must forward his report to the central government and to the company within 120 days from the closing of the year to which the audit related. **Contents of Audit Report** ➢ Cost record reflects true & fair view. ➢ Cost accounting policies and principles are followed. ➢ Cost records are adequate according to section 209(1) (d). ➢ Additional information demanded by central government (in form of annexure) **Duties of Board of Directors** ➢ Obtain written certificate from auditor u/s 224(1B)

		➢ Provide all records, information and explanation to the auditor. ➢ Circulate whole report or part of report to the members as per directions issued by central government.
617	**Head**	Appointment of an auditor by '**Controller and Auditor General of India'** for any government company defined u/s 619 and for all those companies defined u/s 619B.