

LIABILITIES OF AUDITORS

Question 1

Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud.
(6 Marks) (November 2009)

Answer

Duties & Responsibilities of an auditor in case of Material misstatement resulting from management fraud

Misstatement in the financial statements can arise from fraud or error. The term fraud refers to an 'Intentional Act' by one or more individuals among management, those charged with governance. The auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.

Fraud involving one or more members of management or those charged with the governance is referred to as "management fraud". The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.

Further an audit conducted in accordance with the standards on auditing generally accepted in India, is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement whether caused by error or fraud. The fact that an audit is carried out may act as deterrent, but the auditor is not and cannot be held responsible for the prevention of fraud and error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of financial statements will not be detected, even though the audit is properly planned and performed in accordance with the standards on auditing generally accepted in India. An audit does not guarantee that all material misstatement will be detected because of such factors, as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature.

Certain levels of management may be in a position to override control procedures designed to prevent similar frauds by other employees. Auditor's opinion on the financial statements is

based on the concept of obtaining reasonable assurance, hence in an audit, the auditor does not guarantee that material misstatements, will be detected.

Question 2

Explain the liability of the auditor under section 62 of the Companies Act, 1956, for making an untrue statement in the report (as an expert forming a part of the prospectus).

(5 Marks) (May 2010)

Answer**Liability of the auditor under Section 62 of the Companies Act, 1956**

Section 62 of the Companies Act, 1956 deals with civil liability for mis-statements in the prospectus. An Action in this case can be brought by a person who has sustained a loss or damage as a result of subscription to the shares or debentures, on the faith of the prospectus containing an untrue statement

The liability would arise if the written consent of the auditor to the issue of the prospectus, including the report purporting to have been made by him as an “expert” has been obtained.

The action would not succeed if the auditor is able to prove:

- (i) that after he had given his consent in writing, the same was withdrawn before any copy of the prospectus was delivered for registration; or
- (ii) that after registration of the prospectus but before any allotment was made thereunder, he, on realizing that the statement was untrue, had withdrawn his consent in writing and had given reasonable public notice of the withdrawal and of the reasons therefore; or
- (iii) that he was competent to make the statement and that on reasonable ground he believed and had continued to believe upto the time of allotment of shares or debentures that the statement was true.