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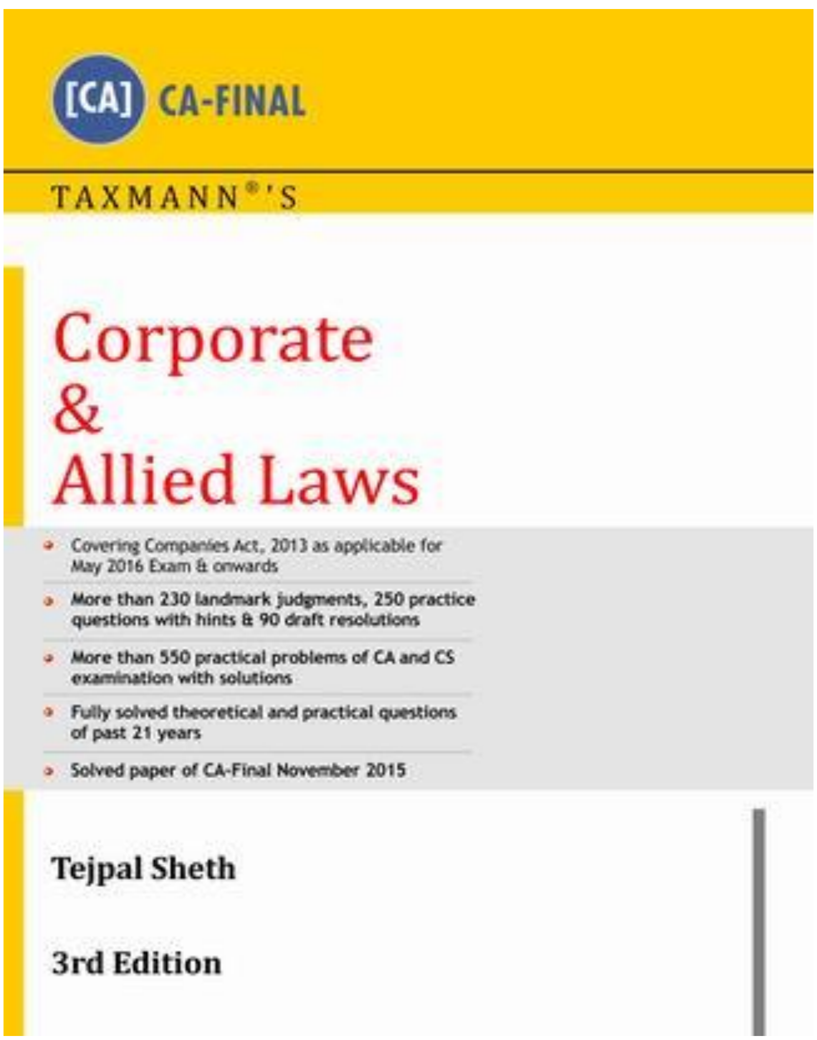

CHAPTER 1

ACCOUNTS & AUDIT

1. BOOKS OF ACCOUNT REQUIRED TO BE KEPT – SECTIONS 2(13) & 128 OF COMPANIES ACT, 2013

- Company should maintain at its **registered office** proper books of account, other relevant books and papers and financial statement for every financial year with respect to:
  - all sums of **money received and expended** by the company and the matters in respect of which **receipts and expenditure** take place.
  - all **sales and purchases of goods and services** by the company.
  - the **assets and liabilities** of the company.
- In the case of company which belongs to any class of companies specified under Section 148 of Companies Act, 2013 required to maintain **cost records.**

2. PLACE OF MAINTAINING BOOKS – SECTION 128 OF COMPANIES ACT, 2013

- Books of account shall be maintained and kept at **registered office.**
- All or any books of account may be kept at other place in India if Board of directors passes resolution and gives notice to ROC within **7 days.**
- Notice to ROC shall specify name of books to be kept at other place and complete address.
- If company wants to maintain a **separate set of books at branch**, the Board has to pass a resolution and within **7 days** of such decision intimate the ROC, location of such declared branch office.
- If separate books of account are maintained at branch in India or outside India, it would be deemed to be compliance of Section 128, if summarized returns are sent at regular intervals to the registered office or to a place where accounts are maintained as per decision of the Board.
- If books of account are maintained **outside India**, summarized returns shall be sent to the **registered office at quarterly intervals – Rule 4 of Companies (Accounts) Rules, 2014**
- Notice of address at which books of account are to be maintained is given in Form No. **AOC-5**.

3. PROPER BOOKS OF ACCOUNT – SECTION 128 OF COMPANIES ACT, 2013

- Company shall maintain proper books of account. Proper books of account means books of account which:
  - Exhibit **true and fair view** of state of affair of company.

- Should **explain the transaction** entered into by company.
- Is maintained on **accrual basis.**
- Is kept according to **double entry system**.
- Books of account should be maintained in **indelible ink if it is maintained in physical form.**

Books of account in electronic form – Rule 3 of Companies (Accounts) Rules, 2014

- Books of account may be kept in electronic form.
- Following conditions shall be satisfied to maintain books of account and other books in electronic form:
  - It should remain **accessible in India** for subsequent reference.
  - It should be retained completely in the format in which they were originally generated, sent or received.
  - Information in electronic record (document) should be capable of being **displayed in legible form**.
  - Proper system for storage, retrieval, display or printout of electronic records should be maintained by company as per audit committee or by board where audit committee is not constituted.
  - Information received from branch should not be altered. It should be kept in original form in which it was received from branch.
  - Back up of books of account and other books should be maintained in electronic mode at any place but it should be kept in server physically located in India on periodic basis.
  - Company is required to intimate **ROC on annual basis** at the time of filing financial statement:
    - Name of service provider.
    - IP address of service provider.
    - Location of service provider.
    - Address or location where books are maintained on cloud.

4. PERSON RESPONSIBLE FOR KEEPING BOOKS OF ACCOUNT – SECTION 128 OF COMPANIES ACT, 2013

- The following persons shall be held responsible for maintaining proper books of account:
  - **Managing director; or**
  - **Whole time director** in charge of finance function; or
  - **Chief financial officer;** or
  - If any other person is entrusted with compliance with provisions of Section 128 by Board of Directors then he is liable.

Punishment for default

- Person who is made responsible for maintaining books of account fails, he is punishable with :
  - imprisonment for a term **upto 1 year or**
  - **with fine from Rs. 50,000 to Rs. 5,00,000 or**
  - **with both**.

5. PERIOD FOR WHICH BOOKS OF ACCOUNT TO BE PRESERVED – SECTION 128 OF COMPANIES ACT, 2013

- Books of account relating to the period of not less than **8 financial years** shall be preserved in **good condition** along with the relevant vouchers.

- Where a company has not been in existence for 8 years, the books of account and related vouchers should be preserved in good order right from the first accounting year of the company.
- This period of 8 years can be **longer, if the company is under investigation** and Central Government direct company to maintain its books of account for period more than 8 years.

> **Important Note:**
>
> Vouchers relevant to any entry in such books of account also to be preserved for 8 years.

- Following persons are responsible for maintenance of books of account:
  - Managing director; or
  - Whole time director in charge of finance; or
  - Chief financial officer; or
  - If any other person is entrusted with compliance with provisions of Section 128 by Board of Directors then he is liable.

6. INSPECTION OF CERTAIN FINANCIAL INFORMATION BY DIRECTOR - SECTION 128 OF COMPANIES ACT, 2013

Inspection of books of account and other books and papers maintained in India

- Section 128 provides that books of account and other books and papers maintained by the company **within India** shall be open for inspection at registered office of company or other place in India by any director **during business hours.**
- **Summarised returns of the books of account** of the company kept and maintained outside India shall be sent to registered office at **quarterly intervals.** It should be kept at registered office and kept open to **directors for inspection.**
- Director is entitled to ask for information of books either **personally or through an agent.**

> **Important Note:**
>
> Expression 'other books and papers' must be constructed **ejusdem generis** as referring to other books and papers of the same kind as the books of account. It does not include every kind of paper in company.

Inspection of financial information outside India

- If any **other financial information** is maintained outside the country, director can furnish request to company setting out full details of financial information sought and period at for which such information is sought in **writing**. Company should provide financial information **within 15 days.**
- Financial information maintained outside India should be demanded by director himself and not by his power of attorney holder or agent or representative.

Inspection of books of subsidiary

- Inspection in respect of **any subsidiary** of company should be done only by any **person authorized in this behalf by resolution of board of directors.**
- Where an inspection is made, the **officer and employees of company should give all assistance** in connection with inspection.

7. FINANCIAL STATEMENT – SECTION 129 OF COMPANIES ACT, 2013

- **Section 129** along with **Schedule III** to the Companies Act, 2013 deals with the preparation and presentation of financial statement.

Important Note: Financial Statement

As per Section 2(*40*), financial statement includes:

1. Balance sheet
2. Profit and loss account or in the case of company not for profit, income and expenditure statement
3. Cash flow statement
4. Statement of changes in equity, if applicable
5. Any explanatory note annexed to above documents

However for One Person Company, small company and dormant company financial statement do not include cash flow statement.

- ➢ The balance sheet should be in the form set out in **Part I of Schedule III**, and Profit and loss account shall be as per **Part II of Schedule III of Companies Act, 2013**. As per Schedule III, vertical form of Balance Sheet & Profit-Loss Account is compulsory.
- ➢ Financial statement should comply with accounting standards. If it **does not comply with the accounting standards**, following disclosure should be made:
  - ❑ the **deviation** from the accounting standards.
  - ❑ the **reasons** for such deviation.
  - ❑ the **financial effect,** if any, arising due to such deviation.
- ➢ **An insurance company, banking company, an electric company** and any other company for which special act governing it if specified form of balance sheet, such companies are not required to disclose information as per Companies Act, 2013.
- ➢ **Central Government may exempt** any class of companies by notification from the provisions of this section or rules on following conditions:
  - ❑ Exemption may be given in **public interest.**
  - ❑ Exemption may be granted **with or without condition.**
  - ❑ Exemption may be granted on **its own or on application by class of companies.**

Important Note:

As per MCA Circular No. 08/2014 dated 4th April, 2014, the financial statements (and documents required to be attached thereto), auditors report and Board report in respect of financial years that commenced earlier than 1st April, 2014 shall be governed by the relevant provisions/schedules/rules of the Companies Act, 1956 and that in respect of financial years commencing on or after 1st April, 2014, the provisions of the new Act shall apply. This means that the financial statements etc. for the year ending 31st March 2014 shall be prepared as per Companies Act, 1956 and for the year ending 31st March 2015 and thereafter shall be prepared as per the Companies Act, 2013.

Section 129 is not applicable to the extent of application of AS-17 to the Government Company engaged in defence production.

8. CONSOLIDATED FINANCIAL STATEMENTS – SECTION 129 OF COMPANIES ACT, 2013

- ➢ Consolidation of financial statements is made mandatory for all companies where a **company has one or more subsidiaries whether Indian or foreign.**
- ➢ The mandatory consolidation applies to all companies whether such company is:
  - ❑ listed or unlisted.
  - ❑ private or public.
- ➢ For the purposes of consolidation of financial statements, the expression **subsidiary includes associate company and joint venture.**

- **'Associate company'**, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
- **'Significant influence'** means **control of at least 20% of total share capital, or of business decisions** under an agreement.
- **'Control'**, shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

> **Important Note:**
>
> The provisions of this Act are applicable to the preparation, adoption and audit of financial statements of holding company shall similarly apply to consolidated financial statement also.

> **Important Note : Subsidiary company - Section 2(*87*)**
>
> Subsidiary company means a company in which other company (i.e. holding company):
>
> - Control composition of Board of Directors; or
> - Exercises or controls more than one half of total share capital.

9. EXTENSION OR MODIFICATION OF FINANCIAL YEAR – SECTION 2(*41*) OF COMPANIES ACT, 2013

- The definition of Financial Year under Companies Act 2013 has been **aligned with the Tax laws.**
- "Financial year", in relation to any company or body corporate, means the period ending on the **31st day of March every year.** Now every company is required to follow uniform financial year.
- Existing company and body corporate on the commencement of 2013 Act, is required to align its financial year as per provision of Section 2(*41*) within a period of 2 years from commencement of 2013 Act. [Section 2(*41*) is made effective from 1st April 2014]
- Where a company or body corporate has been incorporated **on or after the 1st January of 2014**, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up.

> **Example:**
>
> If company or body corporate is incorporated on 31-12-2014, its first financial year shall be the period from 31-12-2014 to 31-3-2015.
>
> If company or body corporate is incorporated on 1-1-2015, its first financial year will be 1-1-2015 to 31-3-2016.

- A company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different Financial Year for consolidation of its accounts outside India, the **National Company Law Tribunal (NCLT)** may allow any period as its financial year, whether or not that period is a year.

Procedure for seeking extension

- **Board meeting** should be conveyed and resolution to extend the financial year of the subsidiary company should be passed.
- Application is made to **NCLT.**

> **Important Note:**
>
> A subsidiary in India of a foreign company may, with the approval of NCLT follow a different period as its FY.

3. **Krishna Kumar Khamka Vs. ROC – West Bengal (1986)**

   In case of default in lay off balance sheet before AGM, director can't be held liable for a default which took place long before they become director or officers of company or after they ceased to be director by resignation.

4. **DCW Vs. State of Saurashtra (1957)**

   C.A. who is in whole time employment of company can't be appointed as its auditor.

5. **Newton Vs. Brimingham Small Arms (1906)**

   Auditor must have free access to the information which is necessary and material for their report.

6. **Newton Vs. Brimingham Small Arms (1906)**

   Article of association of company can't preclude auditor team from availing himself of all information which is material to enable him to make his report and to fulfil his statutory duties.

7. **Fox and Son Vs. Morrish Grant & Co. (1918)**

   Auditor must check company's own cash account with its bank pass book and cheque counterfoils and with statement of its account obtained from its bank.

8. **ICAI Vs. Rajaram (1960)**

   C.A. should himself verify the assets of company of which he has been appointed auditor, and should not rely on the verification done by special examiners appointed by company itself according to the articles.

9. **Re Allen Craig & Co. (London) Ltd (1934)**

   It is not the auditor's duty to see that the directors call a meeting and that his report is sent or placed in the hands of shareholders.

10. **Dy. Secretary, Ministry of Finance v. S.N. Das Gupta (1956)**

    Auditor must check cash in hand and cash at bank as on balance sheet date.

11. **ICAI Vs. Jnanendranath Saikia (1955)**

    Deliberate omission on part of the company to appoint an Auditor in its AGM is not a casual vacancy.

Past Examination Questions

Question 1

The financial statement of AS Limited have been signed by two directors A and B. The board comprises of a third director C, who is also the managing director. The company has also employed a full time secretary. Examine whether the authentication of the financial statements is in accordance with law. (CA May, 2000 Modified)

Or

The Board of Directors of Vishwakarma Electronics Limited consists of Mr. Ghanshyam, Mr. Hyder (Directors) and Mr. Indersen (Managing Director). The company has also employed a full time Secretary.

The financial statement of the company were signed by Mr. Ghanshyam and Mr. Hyder. Examine whether the authentication of financial statements of the company was in accordance with the provisions of the Companies Act, 2013? (CA November 2011 Modified)

Or

Examine the validity of the following with reference to the provisions of the Companies Act, 2013:

The financial statement of TXN Ltd. for the year ended 31st March, 2014 was signed by one of its Directors and the Secretary. (CA June 2009 Modified)

Answer

The financial statement (i.e. balance sheet, profit and loss accounting and cash flow statement) must be signed on behalf of the Board of directors by chairperson of company, if he is authorized in this behalf.

If chair person is not authorized, it should be signed by :

- two directors including MD when there is one, and
- chief executive officer (CEO) if he is director,
- chief financial officer and company secretary where they are appointed. - Section 134 of Companies Act, 2013.

In the instant case, the profit and loss account and balance sheet have been signed by Mr. A and Mr. B, the directors. In view of Section 134 of the Companies Act, 2013, Mr. C, managing director should be one of the two signing directors. Since the company has also employed a secretary, he should also sign the profit and loss account and balance sheet in addition to the managing director C, and one of the directors, either A or B.

Question 2

The auditor made certain adverse comments on the audited financial statements of a government company. Explain with reference to the relevant provisions of the Companies Act, 2013 whether it is possible for the government company to revise the audited but unadopted financial statements in the light of the adverse comments made by the auditor of India and also whether it is necessary for the board of directors to give explanations in the board's report in respect of such adverse comments.

(CA May, 2000 Modified)

Answer

The original financial statements may be revised to remove reservations of auditor. Such revised statements should be resubmitted to the auditors before placing them at the annual general meeting. Original set of financial statements should be returned to auditor. Auditor should also make an adequate disclosure about revision of financial statements.

As per Section 134 of Companies Act, 2013 board of directors is required to give full explanation and comments on every reservation, qualification or adverse remark by auditor in Board's report.

In the given case, company has not complied with provision of Section 134. Company is liable for fine which is not less than Rs. 50,000 but not exceed than Rs. 25 Lakhs. Every officer in default is liable for imprisonment for term which may extend to 3 years or with fine which is not less than Rs. 50,000 but not exceed than Rs. 5 Lakhs, or with both.

Question 3

X Ltd. has a subsidiary company called Y Ltd. The financial year of the holding company is 31st March, whereas that of the subsidiary company ends on 30th June every year. The management of the holding company decides that the financial year of the subsidiary Company for the year 1.7.2013 to 30.6.2014 should be extended upto 31.3.2015, so that the financial years of the holding and subsidiary companies end on 31st March every year. Advise the management about the steps to be taken under the Companies Act 2013 to achieve the purpose. ***(CA May, 2001 Modified)***

Or

S Ltd. is a subsidiary company of H Ltd. The financial year of H Ltd is from 1st April to 31st March, whereas the financial year of S Ltd. is 1st July to 30th June every year. This is now causing difficulties particularly in view of the requirement of reporting and circulating the consolidated annual accounts as required by Accounting Standard AS-21. The Board of Directors of H Ltd. decides that the accounting year of S Ltd. for the year 1st July, 2013 to 30th June, 2014 be extended from present 12 months to 21 months, i.e. 1st July, 2013 to 31st March, 2015, so that the financial years of the holding company and the subsidiary company end on the same date.

State the provisions of the Companies Act, 2013 in this respect and mention the steps to be taken in this regard. ***(CA November, 2003, 2005 Modified)***

Or

Sunrise Limited is a subsidiary company of Hotline Ltd. The financial year of Sunrise Limited is 1st July to 30th June, whereas the financial year of Hotline Limited is from 1st April to 31st March every year. To maintain uniformity and consolidation of annual accounts the board of directors of Hotline Limited decided that the accounting year of Sunrise Limited for the year 1st July, 2013 to 30th June, 2014 be extended from present 12 months to 21 months i.e. ***1st July 2013 to 31st March 2014. Mention in the light of the provisions of the Companies Act, 2013, the steps to be taken by the Hotline Limited in this regard.*** ***(CA June, 2009 Modified)***

Or

Ambitions Engineering Consultants Ltd., whose financial year ends on 31st March, has acquired Struggling Techies Ltd. making it a subsidiary company. The financial year of the subsidiary company ends on 30th June. The management of the holding company wants to change the financial year of

the subsidiary company, if possible, so as to coincide with the financial year of the holding company. State the relevant provisions of the Companies Act, 2013 regarding the financial year and the maximum period upto which the accounts can be prepared in a Financial Year and the approvals, if any, required to be taken to accomplish this task (CA May 2010 Modified)

Answer

The definition of Financial Year under Companies Act 2013 has been aligned with the Tax laws. "Financial year", in relation to any company or body corporate, means the period ending on the 31st day of March every year. Now every company is required to follow uniform financial year. Financial year for every company start from 1st day of April.

Existing companies on the commencement of 2013 Act, is required to align its financial year as per provision of Section 2(*41*) within a period of 2 years from commencement of 2013 Act. [Section 2(*41*) is made effective w.e.f. 1st April 2014]

A company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different Financial Year for consolidation of its accounts outside India, the National Company Law Tribunal (NCLT) may allow any period as its financial year, whether or not that period is a year.

In view of above provision, X Ltd cannot apply to NCLT for extension or modification of financial year of its subsidiary because its subsidiary is Indian company. The financial year of holding company start on 1st April but its subsidiary company on July. Subsidiary company should take necessary steps to align its financial year with holding company within period of 2 years from date of commencement of 2013 Act.

Question 4

The Financial statement of a listed company have not been prepared in accordance with some of the applicable accounting standards. Examine the responsibility of the directors and auditors in this regard under the Companies Act, 2013. (CA May, 2003 Modified)

Or

XYZ Limited did not prepare its financial statement for financial year in conformity with some of the mandatory Accounting Standards. You are required to state with reference to the provisions of the Companies Act, 2013, the responsibilities of directors and statutory auditor of the company in this regard. (CA May 2007 Modified)

Answer

As per Section 129(5) of Companies Act, 2013, if the financial statements are not prepared as per accounting standards, the company shall disclose in financial statements the following:

- the deviation from the accounting standards
- the reasons for such deviation
- the financial effect, if any, of such deviation.

As per Section129 of Companies Act, 2013 Managing Director, whole time director in charge of finance, Chief financial officer or any other person charged by board is duty bound to comply requirement of AS. In absence of these persons, all directors are liable for non-comply with AS.

Every auditor should comply with applicable accounting standards. Further, the Board's report shall include a Directors' Responsibility Statement, indicating therein that on the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures.

The auditor shall state in his report that the annual accounts comply with accounting standards referred to in Section 133 of Companies Act, 2013.

Question 5

XYZ Ltd. while preparing the financial statement for the financial year ended 31st March, 2014 did not comply with the Accounting Standards. State the consequences that follow in case of Non-compliance. (CA November 2011 Modified)

Answer

Please refer the answer of question No. 4 to understand section 129 of Companies Act, 2013 on compliance of accounting standards and requirement of disclosure of AS.

Managing director, the whole time director in charge of finance, Chief financial officer or any other person who has been charge with responsibility to comply provisions of Section 129 of Companies Act, 2013, makes default and do not make proper disclosure, he can be punished for :

- sentenced to imprisonment upto 1 year or