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COMPANY AUDIT – I
[LESSON – 7]

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Section 224 to 233 of the Companies Act, 1956 deal with provisions relating to audit of companies.

Section	
224	Appointment and remuneration of auditors.
224A	Auditor not to be appointed except with the approval of the company by special resolution in certain cases.
225	Provisions as to resolutions for appointing or removing auditor.
226	Qualification and disqualification of an auditor.
227	Powers and duties of auditor.
227 (2) (3)	Duty to report
227 (1A)	Duty to Enquire (Audit enquiries)
227 (4A)	Duty to make statement on additional matters specified by the Central Govt.
228	Audit of accounts of branch office of company.
229	Signature of audit report etc.
230	Reading and inspection of auditor's report.
231	Right of auditor to attend general meeting.
232	Penalty for non-compliance with section 225 to 231.
233	Penalty for non-compliance by auditor with section 227 and 229.
233A	Power of Central Government to direct special audit in certain cases.
233B	Audit of cost accounts in certain cases.

Qualification of an Auditor [(Section 226(1)(2)]

As per section 226 following persons are qualified to be auditor of a company:

1. **Section 226(1) :** A Chartered Accountant holding "Certificate of Practice" within the meaning of chartered accountant Act, 1949; provided that a firm where of all the partners practicing in India are qualified for appointment as aforesaid.
2. **Section 226(2) :** The holder for a certificate in erstwhile part B states entitling him to act as an auditor of the companies (It was only a short term provision and is not relevant now).

Disqualification for Auditor [u/s 226 (3) (4) and (5)] :

Under Section 226(3) : the following persons are not qualified for appointment a 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 who is in the employment of an officer or employee of the company;

(d) a person who is indebted to the company for more than Rs. 10,000 or who has given any guarantee or provided any security in connection with the any third person to the company for more than Rs. 10,000;

(e) a person holding any security having voting right of that company.

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

Under Section 226(5) : Provides if an auditor after his appointment, becomes subject to any disqualification u/s 226(3) and u/s 226(4), he shall be deemed to have automatically vacated his office.

Points to be noted :

1. A firm would be disqualified to be appointed as an auditor even if one partner is disqualified u/s 226(3)(4)(5).
2. If, a being a relative of person having substantial interest in the company or in any business, expresses any opinion an financial statements of the company, or of the business, he should disclose his interest while making the report. If this disclosure is not made it would amount to misconduct under the C.A. Act, 1949.
3. A person shall be deemed to be a relative of another, if and any if:
   (a) they are members of a HUF; or
   (b) they are husband and wife; or
   (c) the one is related to the other in the manner indicated in schedule 1A of the Companies Act *e.g.* Father, mother, brother, sister, son (including step son, mother, father) *etc.*
4. A person is qualified 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 Central Govt. permission may have to be obtained u/s 314 of the Act.
5. Purchase of goods/services credit from company exceeding Rs.10,000 will be regarded as indebtness, even if company allows every one period of credit upto 1.5 months.

7.2 Appointment of Auditor

Appointment by Shareholders in General Meeting : Section 224(1) empowers the shareholders to appoint auditor at each A.G.M. This section makes it obligatory that every company registered under the companies Act to appoint its auditor. As per section 224(1) of the companies Act, Every company shall, at each AGM appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next AGM and shall with in seven days of the appointment, give intimation thereof to every auditor so appointed. The auditor so appointed shall with in 30 days of the receipt from the company of the intimation inform the Registrar of Companies in writing that he has accepted or rejected the appointment.

Appointment of the First Auditor : u/s224(5) the first auditor of a company can be appointed by the Board of Directors (BOD) within 1 month of th1e date of registration of the company to hold office till the conclusion of the first AGM. If the BOD fails to appoint the first auditor, the company in general meeting is empowered to make the appointment. **(date of registration means date of incorporation)**

If first auditors is not appointed by the directors within one month of registration, the company in general meeting may appoint the first auditor.

The auditor of a company is normally appointed by the shareholder by passing a resolution at the AGM.

Things to be noted :

- First auditor are generally appointed by BOD within one month of the date of registration.
- First auditor so appointed shall hold office until the conclusion of the first AGM.
- The auditor so appointed by the BOD may be removed by the company <u>at a general meeting without the approval of the Central Government.</u>
- An auditor cannot be appointed as first auditor simply because his name has been stated in the Articles of Association.
- The first auditor are themselves not required to inform the Registrar of Companies about their acceptance or refusal of such an appointment.
- The need to send written information to the Registrar by the auditor is applicable only to the appointment of the auditor in the AGM an not at EGM.
- The first auditor need not be sent intimation by the company of their appointment.

Re-appointment of Auditor :
<u>Section 224(2)</u> states that the retiring auditor cannot be deemed to be re-appointed automatically at the AGM. A retiring auditor shall stand re-appointed as auditor of the company subject to the following conditions:

(i) The auditor proposed must possesses the qualifications u/s 226;

(ii) The auditor should not suffer from disqualification u/s 226(3) and 226(4);

(iii) In 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 re-appointed.

  (b) no resolution has been passed at the AGM providing expressly that retiring auditor shall not be re-appointed.

  (c) no notice of the resolution to appoint same other person or persons in place of the retiring auditor has been passed.

(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 with the limits specified in section 224(1B).

Filling of a Casual Vacancy : Section 224(6) states that a casual vacancy in the office of the auditor can be filled by the Board of Director, provided such vacancy <u>has not been caused by the resignation of the auditor.</u> In case of a casual vacancy arising an account of resignation, only the company in general meeting can fill the vacancy by appointing another auditor.

Casual vacancy has not been defined in the Act. But it may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firms of auditor etc.

The provision to require the filing of casual vacancy caused by resignation of the auditor by the general meeting is in accordance with the principle of auditor independence. Any abuse of authority or financial impropriety by the management, that might have contributed to the resignation will be known.

Appointment by the Central Government : Section 224(3) where at an AGM, no auditor are appointed or re-appointed the Central Government may appoint a person to fill the vacancy. Company will inform Central Government within seven days after AGM that no appointment of auditors could be made. In case of any default to give such notice to the Central Government, the company and its every officer in default shall be punishable with the fine which may extend to Rs. 5000. 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.

Appointment of Auditor by Special Resolution (Section 224A) : Section 224A provides that appointment and re-appointment of auditors in certain cases only by special resolution. However, in case of a company in which not less than 25% of subscribed share Capital (Equity Share Capital + Pref. Share Capital) is held whether singly or in any combination by :

(i) a public financial institution or a Govt. Company or the Central Govt. or any State Govt.; or

(ii) any financial or other institution established by any provincial or state Act in which a state govt. holds not less than 51% of the subscribed share capital; or

(iii) a nationalised bank or an insurance company carrying on general insurance business; or

(iv) any combination of above shall appoint or re-appoint an auditor in the AGM only by passing a special resolution.

If no special resolution is passed for appointing an auditor for the above company, then it shall be deemed that no auditor or auditors had been appointed and power of Central Govt. u/s 224(3) will become operative.

Government has clarified u/s 224A that the relevant date for holding 25% of the subscribed share capital is the date of AGM and not the date of issue of notice for AGM.

Appointment of Auditor of a Government Company : Section 617 of the Act defines Government Company "as any company in which not less than 51% of the paid up share capital is held by the Central Government or by any state Government or partly by the Central Government and partly by one or more state Government and including a company which is a subsidiary of a Government Company.

According to Section 619, the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India.

As per Section 619, a company in which not less than 51% of the paid up share capital held by one or more of the following or any combination thereof :

(a) the Central Government and one or more Govt. Companies;

(b) any State Govt. or Governments and one or more Government Companies;

(c) the Central Government, one or more State Government Companies;

(d) the Central Government and one or more corporation owned or controlled by the Central Government;

(e) the Central Government, one or more State Govt. and one or more Corporation owned or controlled by the Central Government.

(f) One or more corporation owned or controlled by the Central Government or the State Government'

(g) more than 1 Govt. Company.

The auditor of the above such company shall be appointed by the C&AG.

7.28 **Auditor Appointed at an AGM failing to accept the appointment :** The appointment of an auditor is complete only on the acceptance of the offer by the auditor. The non acceptance of appointment by the auditor does not result in any casual vacancy. Section 224(3) of the Companies Act, 1956, empowers the Central Government to fill up a vacancy in case no auditors are appointed or re-appointed at an AGM. It is also opined that the appointment of an Auditor having been made by shareholders, sub-section (3) of 226 cannot be invoked. The auditor could only be appointed by shareholders at general meeting. Also Board of Directors are not authorised to fill up the vacancy in case the existing auditors appointed at the AGM refuse to accept the appointment.

7.29 **Appointment to fill up a vacancy due to 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 general meeting, 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 the circumstances which led upto his resignation.

In the case of appointment of an auditor to act jointly with an existing auditor, the procedure would be similar to that where the existing auditor is being removed.