CA Final Amendments – May 2015- Advanced Auditing and Professional Ethics

Amendments in Corporate Governance

A monitoring cell set up by SEBI, will assess compliance by companies with the requirements of clause 49 and report non-compliances to SEBI within 60 days from the end of each quarter. This shows the strong intent of SEBI to not only bring in regulations, but also put in place a monitoring mechanism.

Applicability of Clause 49

- Applicable to all listed companies
- Not mandatory to
    - Companies having paid up equity share capital not exceeding ` 10 crore and Net Worth not exceeding ` 25 crore, as on the last day of the previous financial year;
    - It may be noted that where the provisions of Clause 49 becomes applicable to a company at a later date, such company shall comply with the requirements of Clause 49 within six months from the date on which the provisions became applicable to the company.
    - Companies whose equity share capital is listed exclusively on the SME and SME-Institutional Trading Platforms.

Role of Audit committee

- Includes *Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:*
    - *(a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013*

Audit Committee – Companies Act 2013 Vs Clause 49

- Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
    - (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013

Audit Committee as per Sec 177 of Companies Act 2013 required if one of the following conditions met

- Listed Company
- Public companies with a paid up capital >= Rs.10 Cr
- Public companies having turnover >= Rs.100 Cr
- Public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits >= Rs. 50 Cr

  The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of section
  Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

Audit Committee Composition

- The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.
- It may be noted that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

Woman Director

- **Provisions regarding appointment of woman director as provided in Clause 49 (II)(A)(1) shall be applicable with effect from April 01, 2015**

Counting for minimum number of Independent directors etc

- rounding off any fraction to the next integer

Additional Conditions for Independent Director

- means a non-executive director
- Not less than 21 years of age
- other than a nominee director of the company
- who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience

- who is or was not a promoter of the company or its holding, subsidiary or associate company and who is not related to promoters or directors in the company, its holding, subsidiary or associate company
- apart from receiving director's remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year
- none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year,
- who, neither himself nor any of his relatives
    - (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
    - ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm
- iii) holds together with his relatives two per cent or more of the total voting power of the company; or
- (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company
- (v) is a material supplier, service provider or customer or a lessor or lessee of the company
- Independent director shall not be entitled to any stock options.

Replacement of Independent Director

- An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.
- Provided that where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

First board meeting *Section 173*

- Every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation and thereafter hold a minimum number of four meetings of its Board of Directors every year in such a manner that not more than one hundred and twenty days shall intervene between two consecutive meetings of the Board.

Clause 49 and Section 173

- Clause 49 and Section 173 stipulate that the Board meeting shall be held at least four times a year.
- The further requirement of Clause 49 is that the maximum time gap between any two meetings should not exceed four months.
- The requirement under the Companies Act, 2013 is that the Board meeting would be held at least once in every one hundred and twenty days.

Code of Conduct

- The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.

Subsidiary Companies

- At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non listed Indian subsidiary company.
- The company shall formulate a policy for determining 'material' subsidiaries and such policy shall be disclosed on the company's website and a web link thereto shall be provided in the Annual Report.
- For the purpose of this clause, a subsidiary shall be considered as material if
    - the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or
    - if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.
- No company shall dispose of shares in its material subsidiary which would
    - reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or
    - cease the exercise of control over the subsidiary

  without passing a special resolution in its General Meeting except

    - in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal.

- Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal.

Public issue proceeds

- When money is raised through an issue (public issues, rights issues, preferential issues etc.), the company shall disclose the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results to the Audit Committee.
- Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the audit committee.
- Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company.
- Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay.
- The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Summary of Disclosures in Corporate Governance report

- Related Party Transactions
- Disclosure of Accounting Treatment
- Remuneration of Directors
- Management
- Shareholders
- Disclosure of Resignation of Directors
- Disclosure of Formal Letter of Appointment
- Disclosures in Annual Report
- Proceeds from Public Issues, Right Issues, Preferential Issues etc.

Accounting Standard Compliance

- The company should implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and should also ensure that the annual audit is conducted by an independent, competent and qualified auditor

Nomination and Remuneration Committee

- The company through its Board of Directors shall constitute the nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.
- Provided that the chairperson of the company (whether executive or nonexecutive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee
- The role of such committee shall, inter-alia, include the following:
- (i) Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;
- (ii) Formulation of criteria for evaluation of Independent Directors and the Board;
- (iii) Devising a policy on Board diversity;
- (iv) Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.
- The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders' queries. However, it would be up to the Chairman to decide who should answer the queries.

Consolidated Financial Statements

- According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Further, section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements.
- The Consolidated financial statements shall also be approved by the board of directors before they are signed on behalf of the board, along with its own financial statements and shall also be laid before the annual general meeting of the company along with the laying of its own financial statement.

- The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1.
- According to Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act [refer Appendix given at the end of this Chapter].
- As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.
- Thus, the companies having subsidiaries, which have previously never prepared the consolidated financial statements, must prepare their consolidated financial statements in adherence with this mandatory requirement. This will provide the holding companies' stakeholders more transparency about the companies' businesses.

Name of the entity	***Net Assets, i.e., total assets minus total liabilities***		***Share in profit or loss***	
	As % of consolidated net assets	***Amount***	***As % of consolidated profit or loss***	***Amount***
Subsidiaries **Indian** 1, 2, 3 **Foreign** 1,2,3				
Minority Interests in all subsidiaries Associates (Investment as per the equity method) Indian Foreign				

Joint Ventures (as per proportionate consolidation/investment as per the equity method) Indian Foreign				

Banking Companies

Provisioning

Standard Assets

- (1) direct advances to agricultural and Small and Micro Enterprises (SMEs) sectors at 0.25 per cent;
- (2) advances to Commercial Real Estate (CRE) Sector at 1.00 per cent;
- (3) Advances to Commercial Real Estate – Residential Housing Sector (CRE - RH) at 0.75 per cent;
- (4) Housing loans extended at teaser rates – 2.00%. The provisioning on these assets would revert to 0.40 per cent after 1 year from the date on which the rates are reset at higher rates if the accounts remain 'standard';
- (5) Restructured accounts classified as standard advances will attract a higher provision (as prescribed from time to time) in the first two years from the date of restructuring. In cases of moratorium on payment of interest/principal after restructuring, such advances will attract the prescribed higher provision for the period covering moratorium and two years thereafter.
- Restructured accounts classified as non-performing advances, when upgraded to standard category will attract a higher provision (as prescribed from time to time) in the first year from the date of upgradation.
- The above-mentioned higher provision on restructured standard advances (2.75 per cent as prescribed vide circular dated November 26, 2012) would increase to 5 per cent in respect of new restructured standard accounts (flow) with effect from June 1, 2013 and increase in a phased manner for the stock of restructured standard accounts as on May 31, 2013 as under
- 3.50 per cent - with effect from March 31, 2014 (spread over the four quarters of 2013-14)
- 4.25 per cent - with effect from March 31, 2015 (spread over the four quarters of 2014-15)
- 5.00 per cent - - with effect from March 31, 2016 (spread over the four quarters of 2015-16)
- ***(6) All other loans and advances not included above - 0.40%***

- It is clarified that the Medium Enterprises will attract 0.40% standard asset provisioning. The definition of the terms Micro Enterprises, Small Enterprises, and Medium Enterprises shall be in terms of Master Circular on Lending to Micro, Small & Medium Enterprises (MSME) Sector

NPA Provisioning

- Substandard assets
  - Secured exposure 15%
  - Unsecured exposure 25% (security value <=10% Loan)
  - Unsecured exposure for infra loans backed by ESCROW 20%
  - Doubtful
  - Unsecured Portion – 100%
  - Secured Portion
    - D1 (upto 1 yr) – 25%
    - D2 (>1, <=3 yr) – 40%
    - D3-100%
- Loss Assets 100%

Company Audit

Contents

Qualifications of auditor

The provisions relating to eligibility, qualifications and disqualifications of an auditor are governed by section 141 of the Companies Act, 2013 .The main provisions are stated below:

1. Individuals – A person shall be eligible for appointment as auditor, only if he is a Chartered Accountant, holding Certificate of Practice.

2. Firm (Including LLP) – Majority of its partners should be Chartered Accountants, holding Certificate of Practice. Where a firm is appointed as the auditor, only the partners who are Chartered Accountants shall be authorized to act and sign on behalf of the firm.

NOTE – LLPs can operate with non-CA partners in line with international standards.

Case Study

Preksha, a member of the ICAI, does not hold a Certificate of practice. Is her appointment as an auditor valid?

Answer

Qualifications of an Auditor: *A person shall be qualified for appointment as an auditor of a company, only if one is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, only a Chartered Accountant holding the certificate of practice can* *engage in public practice. Preksha does not hold a certificate of practice and hence cannot be appointed as an auditor of a company.*

Disqualifications

Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014 (hereinafter referred as CAAR), the following persons shall not be eligible for appointment as an auditor of a company, namely:-

1. Body Corporate (Except LLP)
2. An officer or employee of the Company.
3. A partner or employee of the officer or employee of the Company.
4. A person who, or his relative, or partner
    a. Holding any security of/ interest in the company/ its subsidiary/ its holding/associate or any fellow subsidiary.
        i. The relative may hold security or interest in the company of face value not exceeding Rs.100000.
        ii. If the relative acquires security or interest of face value exceeding Rs.100000,
        iii. Further, in the event of acquiring security or interest by a relative above the threshold limit of Rs.100000, it should come back to the prescribed limits within 60 days of such acquisition of interest, failing which the auditor will be deemed to have vacated the office.
    b. Indebted to the Company/ its subsidiary/ holding/ associate/ fellow subsidiary in excess of Rs. 500000. (i.e. the limit is applicable to the person, or his relative or partner)
    c. Has given guarantee or provided any security in connection with indebtedness if third party to the Company/ its subsidiary/ its holding/ associate/ fellow subsidiary for more than Rs. 100000.
5. a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed

    a. The term "directly or indirectly" above includes a relative.
    b. Business relationship doesn't include –
        i. Professional services of a CA firm.
        ii. Transactions in ordinary course of business as a customer. E.g. Telecom, Hospitals, Hotels, Airlines etc.
6. A person whose relative is –
    a. A Director; or
    b. Is in the employment of the Company as a Director or a key managerial personnel.
7. A person who
    a. Has been convicted by court of an offense involving fraud; and
    b. A period of ten years has not elapsed since the date of conviction.
8. A person who is in full time employment elsewhere; or a person who is holding appointmnet as auditor for more than twenty companies.
9. Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

NOTE – If any of these disqualifications are attracted after appointment, then the auditor shall be deemed to have vacated the office.

Case Study

Comment on the following:

Mr. Amar, a Chartered Accountant, bought a car financed at Rs. 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be to even after taking the loan.

Answer

According to section 141 (3)(d) (ii) of the Companies Act, 2013, a person is not eligible for appointment as auditor of any company, If he is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh.

In the given case Mr. Amar is disqualified to act as an auditor under section141 (3)(d) (ii)) as he is indebted to M/s Chaudhary Finance Ltd. for more than 5'00'000 Rs. Also according to Section141 (3)(d) (ii) he cannot act as an auditor of any subsidiary of Chaudhary Finance Ltd. i.e. he is also disqualified to work in Charan Ltd. & Das Ltd. Therefore he has to vacate his office in Das Ltd. Even though it is a subsidiary of Chaudhary Finance Ltd.

Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd must have to appoint any other CA as an auditor of the company.

Case study

An auditor purchased goods worth Rs. 501,500 on credit from a company being audited by him. The company allowed him one month's credit, which it normally allowed to all known customers.

Answer

Purchase of goods on credit by the auditor: *Section 141(3)(d)(ii) of the Companies Act, 2013 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding five lakh rupees. Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees five lakh, he is disqualified for appointment as an auditor of the company. It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.*

Case Study

a) *Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2013-2014. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.*

Answer

a) *Auditor holding securities of a company : As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.*

   Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a *casual vacancy in the office of the auditor.*

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Threfore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partner Mr. Hanuman is holding equity shares of its subsidiary.

Case Study

As an auditor, comment on the following situations/statements:

One of the directors of Hitech Ltd. is attracted by the disqualification under Section 164(2) of the Companies Act, 2013.

Answer

a) ***Disqualification of a Director under section 164(2) of the Companies Act, 2013: Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as directors under section 164(2) of the Companies Act, 2013. The auditor has to ensure that written representation have been obtained by the Board from each director that one is not hit by Section 164(2).***

   Since in this case, one of the director is attracted by disqualification under section 164(2) of the Act, the auditor shall state in his report as per section 143 about the disqualification of the particular director.

Case Study

'B' owes Rs. 5,01,000 to 'C' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses?

Answer

Indebtedness to the Company: As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, for an amount exceeding Rs. 500000/- then he is not qualified for appointment as an auditor of a company. Accordingly, B's appointment is not valid and he is disqualified as the amount of debt exceeds Rs. 500000. Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not valid because in such a case also the auditor shall be indebted to the company. The auditor is entitled to recover fees on a progressive basis only.

Case Study

Mr. Fat, auditor of Thin Ltd., has his office and residence in the building owned by Thin Ltd. Mr. Fat has been given 10% concession in rent by the company as compared to other tenants.

Answer

As per SA 200, "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing", In the case of an audit engagement it is in the public interest and, therefore, required by the Code of Ethics, that the auditor be independent of the entity subject to the audit. The Code describes independence as comprising both independence of mind and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's *ability to act with integrity, to be objective and to maintain an attitude of professional skepticism. In the instant case, Mr. Fat has his office and residence in the building owned by Thin Ltd. who are subject to audit by Mr. Fat. Giving 10% concession in rent may be due to some other reasons other than holding auditor ship of Thin Ltd. It may be due to being very old tenant or due to office and residence in the same building or Mr. Fat might have carried out major renovation and so on. Thus in the instant case unless and until there is direct proof, giving 10% concession in rent does not affect independence of the auditor in expressing his opinion on the audit of Thin Ltd.*

Appoinment of auditors (Under Section139(1) of the Companies Act, 2013)

1. Every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
2. Competent authority for appointment are –
   a. If constitution of Audit Committee is needed for company, then Audit Committee;
   b. Else, Board of Directors.
3. The Competent Authority, if Audit Committee, shall recommend auditor to the Board for consideration.
4. If the Board doesn't agree with the recommendation, it shall refer back to Audit Committee for reconsideration, with reasons. If the Board agrees with the recommendation, it shall recommend appointment of such auditors to members in AGM.
5. In case of disagreement between the Audit Committee and the Board of Directors
   a. If the Audit Committee agrees with the Board's reasons for reconsideration, then it shall place the Board's recommendation before members in AGM.
   b. If the Audit Committee disagrees with the Board's reason for reconsideration, the Board shall record reasons for disagreement and send this fact to the members for their consideration in AGM.
6. Prior to the appointment, a certificate shall be obtained from the Auditor stating that the
   a. Auditor is qualified for appointment;
   b. Auditor is not disqualified for appointment;
   c. Proposed appointment is as per the Act, and within the limits prescribed.
   d. Disclosure of any cases of professional misconduct pending against the proposed auditor or his firm, or his partner.
7. Form ADT-1 shall be filed with the ROC by the company, within 15 days of meeting in which the auditor is appointed or re-appointed. Also, the concerned auditor shall be informed.
8. **Ratification of appointment**: the appointment shall be subject to ratification in every AGM till the 6th meeting by way of passing of **an ordinary resolution.**

If not ratified, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act.

Term of Auditor

Applicability:

Applicability of section 139(2), "Rotation of Auditors" is applicable to the following "class of companies"

1. All unlisted Public companies with paid up capital >=Rs.10 Cr
2. All Private companies with paid up capital >=Rs.20 Cr
3. All companies having PUC below limits mentioned above, but having public deposits or

borrowings from financial institutions and banks of >= Rs. 50 Crs

As per Section 139(2) , No listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint/re-appoint

1. an individual as auditor for more than one term of five consecutive years; and

2. an audit firm as auditor for more than two terms of five consecutive years.

Provided that:

1. an individual auditor who has completed his term under clause (a) shall not be eligible for reappointment as auditor in the same company for five years from the completion of his term;

2. an audit firm which has completed its term under clause (b), shall not be eligible for reappointment as auditor in the same company for five years from the completion of such term.

Firms with common partners – If firm that has just completed its term and proposed firm has common partners, then such proposed firm would be ineligible to be appointed as auditors.

Example –

- *M/s Krishna & Associates is an audit firm having 2 partners namely Mr. Krishna and Mr. Shyam. Mr. Shyam is also a partner of another audit firm named M/s Kukreja & Associates.*
- *M/s Krishna & Associates was appointed as the auditors in the company Golden Smith Ltd. for two consecutive periods i.e. from year 2014 to year 2024.*
- *Now, if Golden Smith Ltd. wants to appoint Ms Kukreja & Associates as its audit firm, it can not do so because Mr. Shyam was the common partner between both the Audit firms.*
- *This prohibition is only for 5 years i.e. upto year 2029. After 5 years Golden Smith Ltd. may appoint M/s Kukreja & Associates as its auditors.*

Transitional Provisions –

1. Every company, existing on or before the commencement of this Act which is required to comply with the provisions of this sub-section shall comply with the requirements of this sub-section within 3 years from the date of commencement of this Act.
2. Period for which office as auditor is held prior to commencement of this act should also be considered for rotation and cooling period.
3. The incoming auditor or audit firm should not be in same network of audit firms as the outgoing auditor.
4. The term "same network" includes the firms operating or functioning under the same brand name, trade name or common control.

If a signing partner resigns from the firm which is appointed as auditor of a company and joins another firm, then such other firm is ineligible for appointment as auditor for 5 yrs i.e cooling period rule applies.

Illustration explaining rotation of an individual auditor

Number of consecutive years for which an individual audito has been functioning as auditor in the same company [in the first AGM held after	Maximum number of consecutive years for which he may be appointed in the same company (including transitional period)	Aggregate period which the auditor would complete in the same company in view of column I and II

the commencement of provisions of section 139(2)]		
I	II	III
5 Years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Illustration explaining rotation of an audit firm

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)	Aggregate period which the firm would complete in the same company in view of column I and II
I	II	III
10 Years (or more than 1 0 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 year	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 year	7 years	10 years
2 years	8 years	10 years
1 years	9 years	10 years

Case Study

No Annual General Meeting (AGM) was held for the year ended 31st March, 2014, in XYZ Ltd., Ninu is the auditor for the previous 3 years, whether she is continuing to hold office for current year or not.

Answer

Tenure of Appointment: Section139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting. But in this regard it is to be noted that the company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.

In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded. Therefore, Ninu shall continue to hold office till the conclusion of the annual general meeting.

Resolution by members

- In the firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by the members,

  OR

- The audit shall be conducted by more than one auditor.

This resolution is optional.

Joint Auditors' reappointment

2 or more firms / individuals are to be appointed in such a way that both or all the joint auditors do not complete their term in the same year.

Appointment of First Auditor for other than a Government Company

The first auditor of a company, other than a Government Company, shall be appointed:

- by the Board of directors within 30 days of the date of registration of the company; OR,
- Members of the company and the company in general meeting may appoint the first auditor within 90 days at an extra ordinary general meeting.

Such auditor shall hold office till the conclusion of the first annual general meeting

Appointment of First Auditor in case of a Government Company

- The first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company; OR,
- the Board of Directors of the company shall appoint such auditor within the next 30 days; OR,
- The members of the company shall appoint such auditor within the 60 days at an extraordinary general meeting.

Such auditor shall hold office till the conclusion of the first annual general meeting.

Case Study

As an auditor, comment on the following situations/statements:

The first auditors of Health and Wealth Ltd., a Government company, was appointed by the Board of Directors.

Answer

Appointment of the First Auditor by the Board of Directors: Section 139(6) of the Companies Act, 2013 (the Act) lays down that "the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company". Thus, the first auditor of a company can be appointed by the Board of Directors within 30 days from the date of registration of the company. However, in the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013. Hence in the case of M/s Health and Wealth Ltd., being a government company, the first auditors shall be appointed by the Comptroller and Auditor General of India.

Thus, the appointment of first auditors made by the Board of Directors of M/s Health and Wealth Ltd., is null and void.

Case Study

Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director.

Answer

Appointment of First Auditor of Company: Section 139(6) of the Companies Act, 2013 (the Act) lays down that "the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company". In the instant case, the appointment of Shri Ganapati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor first auditor of the company within one month of registration of the company. In view of the above, the Managing Director of PQR Ltd should be advised not to appoint the first auditor of the company.

Appointment of Auditor (other than first auditor) in case of a Government Company (U/S 139(5))

- The Comptroller and Auditor-General of India shall appoint auditors within a period of **180 days** from the commencement of the financial year in the case of:
  - a Government company; or
  - any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments,
- **The auditor appointed shall hold office till the conclusion of the annual general meeting**.

Case Study

Nickson Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nickson Ltd. appointed Mr. P as statutory auditor for the year.

Answer

According to Section 139 (7) of the Companies Act, 2013, a Government company is defined "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 Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company as thus defined". The auditors of a government company shall be appointed or re- appointed by the Comptroller and Auditor General of India.

In the given case Ajanta Ltd is a government company as its 20% shares have been held by Central Govt, 25% by U.P. State Government and 10% by M.P. State Govt. Total 55% shares have been held by Central and State governments. Therefore, it is a Government company.

Nickson Ltd. is a subsidiary company of Ajanta Ltd. Hence Nickson Ltd. covers in the definition of a government company. Hence the Auditor of Nicksons Ltd. can be appointed only by C & AG.

Therefore, appointment of 'P' is invalid and 'P' should not give acceptance to the Directors of Nicksons Ltd.

Filling of a casual vacancy (Under section 139(8))

- The Board of Directors may fill casual vacancy in the office of an auditor within 30 days.
- If such casual vacancy is as a result of resignation of an auditor, such appointment shall also be approved by the company at a General Meeting convened within three months of the recommendation of he Board.
- In the case of companies subject to audit by auditor appointed by C&AG, casual vacancy to be filled by the C&AG within 30 days. Failure of C&AG to do so, will be taken up by the Board of Directors within next 30 days.
- **Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.**
- **Casual Vacancy by resignation –**
    - As per section 140 (2) the auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form ADT–3 (as per Rule 8 of CAAR) with the company and the Registrar.
    - In case of a Government company, the auditor shall also file such statement with the Comptroller and Auditor- General of India, indicating the reasons and other facts as may be relevant with regard to his resignation.
    - In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees as per section 140 (3).

Case Study

'At the AGM of ICI Ltd., Mr. X was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to give up practice and join industry. State, how the new auditor will be appointed by ICI Ltd and the conditions to be complied for.

Answer

Appointment of New Auditor in case of Resignation: Section 139(8) of the Companies Act, 2013 deal with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g., death, disqualification, resignation, etc. In the instance case, Mr. X has been validly appointed and thereafter he had resigned.

The law provides that in case a casual vacancy has been created by the resignation of the auditor (as in this case), the Board cannot fill in that vacancy itself, such appointment shall also be approved by the company at general meeting convened within three months of the recommendation of the board and then he shall hold office till the conclusion of the nest annual general meeting..

In this case the casual vacancy has been created on account of resignation. Therefore, Board of Directors will have to fill the vacancy within thirty days and such appointment shall be approved by the company at the general meeting within three months of the recommendations of the board. . The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting.

The provisions of the Companies Act, 2013 applicable for the appointment of an auditor in place of a retiring auditor would equally applicable in the instant case are given below:

i. *Section 140(4)(i): Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor.*

ii. *Section 115: Special notice is to be given by such number of members holding not less than one percent of total voting power or holding shares on which such an aggregate sum of not exceeding five lakh rupees has been paid upto the date of the notice. The notice shall be sent by the members to the company at least seven days before the date of the meeting*

iii. *Section 140(4)(ii): On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.*

iv. *Section 140(4)(iii): Representation if any, received from the retiring auditor should be sent to the members of the company.*

v. *Section 139: Before any appointment or reappointment of auditors is made at an annual general meeting, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Section 141(3)(g).*

vi. *The incoming auditor should also satisfy himself that the notice provided for under Sections 139 and 140 has been effectively served on the outgoing auditor.*

Case Study

Comment on the following:

a) *Due to the resignation of the existing auditor(s), the Board of directors of X Ltd appointed Mr. Hari as the auditor. Is the appointment of Hari as auditor valid?*

Answer

a) *Board's Powers to Appoint an Auditor: As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-*

i. *In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days.*
If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;

ii. *In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days:*
It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within he said period the Board of Directors shall fill the vacancy within next thirty days.
Therefore, the vacancy can be filled by the Board of Directors within thirty days but such appointment should be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting

Case Study

M/s Young & Co., a Chartered Accountant firm, and Statutory Auditors of Old Ltd., is dissolved on 1.4.2014 due to differences of opinion among the partners. The Board of Directors of Old Ltd. in its meeting on 6.4.2014 appointed another firm M/s Sharp & Co. as their new auditors for one year.

Answer

a) *Section 139(8) of the Companies Act, 2013 lays down that the Board of Directors may fill any casual vacancy in the office of an auditor provided that where such vacancy is caused by the resignation of an auditor, the vacancy shall be filled in general meeting.*
The expression "casual vacancy" has not been defined in that Act. Talking its natural meaning it may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the

firm etc. Furthermore Section 139(8) stipulates that any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

In the instant case the action of the board of directors in appointing M/s Sharp & Co. to fill up the casual vacancy due to dissolution of M/s Young & Co., is correct.

However, the board of directors are not correct in giving them appointment for one year. M/s Sharp & Co. can hold office until the conclusion of next AGM only.

Reappointment of retiring Auditor

1. At any annual general meeting, a retiring auditor may be re-appointed at an AGM, if—
   i. he is not disqualified for re-appointment;
   ii. he has not given the company a notice in writing of his unwillingness to be re-appointed; and
   iii. a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
2. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
3. **Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.**
4. In addition to listed companies, following classes of companies shall constitute an Audit Committee -
   a. Public companies with a paid up capital >= Rs.10 Cr
   b. Public companies having turnover >= Rs.100 Cr
   c. Public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits >= Rs. 50 Cr

Question

Under what circumstances the retiring Auditor cannot be reappointed?

Answer

In the following circumstances, the retiring auditor cannot be reappointed:

1. A specific resolution has not been passed to reappoint the retiring auditor.
2. The auditor proposed to be reappointed does not possess the qualification prescribed under section 141 of the Companies Act, 2013.
3. The proposed auditor suffers from the disqualifications under section 141(3), 141(4) and 144 of the Companies Act, 2013.
4. He has given to the company notice in writing of his unwillingness to be reappointed.
5. A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed.
6. A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 141(3)(g) of the Companies Act, 2013.

Removal of Auditor before expiry of term

- The auditor may be removed from his office before the expiry of his term by
  - a special resolution of the company, and
  - After obtaining the previous approval of the Central Government (fee paid application form ADT 2)
- The application shall be made to the Central Government within 30 days of the resolution passed by

the Board.

- The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

- The auditor shall have an opportunity of being heard.

Case Study

Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term?

Answer

Permission of Central Government for removal of auditor under section 140(1) of the Companies Act, 2013: Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence. Further, in case of conflict of interest the shareholders may remove the auditors in their own interest.

Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval.

On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention.

In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term.

Resignation by Auditor

- If the Auditor has resigned from the company, he shall file within a period of 30 days from the date of resignation, a statement in Form ADT 3.
  - In case of government companies, the auditor shall file such statement
    - with the Comptroller and Auditor-General of India
    - Company and
    - ROC.
  - In other cases,
    - with the company and
    - ROC

- The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation, in the statement.

- Penalty on non-compliance shall not be less than Rs 50,000 but which may extend to Rs 5 Lacs.

Appointment of Auditor other than the retiring Auditor

- If the retiring auditor has not completed a consecutive tenure of 5 years or 10 years, as the case may be, **special notice** shall be required for
    - a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or
    - Providing expressly that a retiring auditor shall not be re-appointed.
- On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- Outgoing auditor has the right to give representation,—

- in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
- send a copy of the representation to every member of the company 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, it shall be read out at the meeting.
- However, if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

Auditor's remuneration

- The remuneration of the auditors of a company shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.
- In the case of first auditor, remuneration may be fixed by the Board.
- The remuneration shall include the fee payable, expenses incurred in connection with the audit and any facility extended to him, but not remuneration paid to him for any other service rendered at the request of the company.

Ceiling on number of Audits

- For a person who is in full time employment elsewhere or a person or a partner of a firm, holding appointment as its auditor, the number of audits held at any point of time shouldn't exceed 20.
- In the case of a firm of auditors, the ceiling limit of 20 shall be applicable for every partner of the firm who is not in full time employment elsewhere. This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits.
- Where a chartered accountant is a partner in a number of auditing firms, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Case Study

Give your comments and observations on the following:

a) *KBC & Co. a firm of Chartered Accountants has three partners, K, B & C; K is also in whole time employment elsewhere. The firm is offered the audit of ABC Ltd. and is already holding audit of 40 companies.*

b) *At an Annual General Meeting of a listed company, Mr. R a retiring auditor after completing the tenure of five consecutive years of his service claims that he has been reappointed automatically, as the intended resolution of which a notice had been given to appoint Mr. P, could not be proceeded with, due to Mr. P's death.*

Answer

a) *Ceiling on Number of Company Audits: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies.*

   In the firm of KBC & 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. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, and in the given case company is already holding forty audits, therefore, KBC & Co. can't accept the offer for audit of ABC Ltd.

b) *Term of Auditor: Section 139(2) of the Companies Act, 2013 deals with the term of an Auditor which provides that listed companies and other prescribed class or classes of companies (except one person* *companies and small companies) shall not appoint or reappoint an individual as auditor for more than one term of five consecutive years.*

In the given case, notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with and consequently casual vacancy in the office has been created."

Therefore as per Section 139(8) of the Companies Act, 2013, casual vacancy to be filled by the Board of Directors within thirty days. Thus, the claim of Mr. R would not hold good.

Case Study

PBS & Associates, a firm of Chartered Accountants, has three partners P, B and S. The firm is already having audit of 45 companies. The firm is offered 20 company audits. Decide and advise whether PBS & Associates will exceed the ceiling prescribed under Section 141(3)(g) of the Companies Act, 2013 by accepting the above audit assignments?

Answer

Ceiling on number of audits: Before appointment is given to any auditor, the company must obtain a certificate from him to the effect 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 141(3)(g) of the Act which prescribes that a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty 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.

If Mr. P, B and S do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by M/s PBS & Associates is 60. But, the firm is already having audit of 45 companies. So the firm an accept the audit of 15 companies only, which is well within the limit, specified by Section 141(3)(g) of the Companies Act, 2013.

Powers of Auditors

1. Right of access to books of accounts and vouchers.
2. Right to obtain information and explanation from officers.
3. Right to receive notices and to attend general meeting.
4. Right to report to the members of the company on the accounts examined by him.
5. 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.
6. The auditor shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

Case Study

What will be position of the Auditor in the following cases:

a) *A, a chartered accountant has been appointed as auditor of Laxman Ltd. In the Annual General Meeting of the company held in September, 2013, which assignment he accepted. Subsequently in January, 2014 he joined B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner.*

b) *Y, is the auditor of X Pvt. Ltd. In which there are four shareholders only, who are also the Directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Y to* *accept a reduced fee and for that he has been offered not to carry out such full audit as he has done in the past. Y accepted the suggestions of the directors.*

c) *While conducting the audit of a limited company for the year ended 31st March, 2014, the auditor wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor.*

Answer

a) *Disqualifications of an Auditor: Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor. In the present case, A, an auditor of M/s Laxman Ltd., joined as partner with B, who is Manager Finance of M/s Laxman Limited, has attracted clause (3) (c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of M/s Laxman Limited.*

b) *Restricting Scope of Audit: Y may agree to temporary reduction in audit fees, if he so wishes, in view of the suggestions made by the directors (perhaps in accordance with the decision of the company taken in general meeting). But his duties as a company auditor are laid down by law and no restriction of any kind can restrict the scope of his work either by the director or even by the entire body shareholders.*

There is no concept of full or part audit under Section 143 of the Companies Act, 2013. Further, remuneration is a matter of arrangement between the auditor and the shareholders. Section 142 specifies the remuneration of an auditor, shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

His duties may not necessarily commensurate with his remuneration. Y,therefore, should not accept the suggestions of the directors regarding the scope of the work to be done. Even if Y accepts the suggestions of the directors regarding the scope of work to be done, it would not reduce his responsibility as an auditor under the law. Under the circumstances, Y is violating the provisions of the Companies Act, 2013.

c) *Right of Access to Minute Books: Section 143 of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit.*

In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company.

It is, therefore, essential for the auditor to refer to the Minute Books. In the absence of the Minute Books, the auditor may not be able to vouch/verify certain transactions of the company.

In case the directors have refused to produce the Minute Books, the auditor may consider extending the audit procedure as also consider qualifying his report in any appropriate manner.

Case Study

Mr. Budha, Statutory Auditors of Secret Ltd. was not permitted by the Board of Directors to attend general meeting of the company on the ground that his right to attend general meetings is restricted only to those meetings at which the accounts audited by him are to be presented and discussed.

Answer

According to Section 146 of the Companies Act, 2013 the auditors of a company are under an obligation to attend any general meeting of the company and not only those meetings at which the accounts audited by them are to be presented and discussed.

In the instant case, the board of directors of Secret Ltd., have no right to restrict Mr. Buddha from attending the general meeting and Mr. Buddha has every right to attend such meeting as conferred by Section 146.

Thus, the action of the board of directors is contrary to the provisions of law and curtails the right of the auditor.

Case Study

At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?

Answer

Restrictions on Powers of Statutory Auditors: Section 143 of the Companies Act, 2013 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence, any such resolution even if passed by entire body of shareholders is ultra vires and therefore void.

Duties of auditor

Duty to Report: As per sub section 3 of section 143 of the Companies Act, 2013, the auditor's report shall also state –

a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
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
c) returns adequate for the purposes of his audit have been received from branches not visited by him; whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
e) whether, in his opinion, the financial statements comply with the accounting standards;
f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
g) whether any direct is disqualified from being appointed as a director under sub- section (2) of the section 164;
h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
j) such other matters as may be prescribed.

Further, Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditors report. The auditor's report shall also include their views and comments on the following matters, namely:-

i. whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
ii. whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
   a. whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

2. Duty to report on fraud – Report to Central Government in sealed cover with RPAD in form ADT 4 within 60 days of his knowledge of fraud after following this procedure
   a. Send a report in this regard to BOD / AC and seek reply <=45 days
   b. Upon receipt of such reply, send report of auditor along with replies to CG <=15 days of receipt of reply
   c. If no reply is received in 45 days' time, send a report to CG indicating this fact.
   d. Penalty for failure to follow this procedure is >=1L, <=25L
3. Duty to report on any other matter specified by Central Government.
4. Duty to state the reason for qualification or negative report.
5. Duties and powers in relation to Brach audit and the Branch Auditor.
6. The auditor shall attend the AGM either by himself or through his authorized representative. Thus, **it is compulsory for him to attend the meeting unless otherwise exempted by the company.**

<u>SEC 227 (1A) as per Companies Act 1956– AUDITORS' DUTY AS TO INQUIRE / IMPLIED ASSUMPTIONS OF AN AUDIT [This is applicable for May 2015 exam]</u>

Sec 227(1A)(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."

- This clause applies to loans and advances <u>**GIVEN** by the company during the financial year</u> under audit, <u>whether they are outstanding on the date of the Balance Sheet or not.</u>
- Distinction is intended to be made between "loans and advances" and "deposits".
- "Security" for this purpose would include any movable or immovable property, whether belonging to the borrower or not, of which either physical possession or over which a legally effective charge is given to lender.
- Applies to all loans and advances made on the **basis of security / charge, whether movable or immovable, whether or not belonging to the borrower**.
- Company's right to enforce such right shall be examined in detail.

Type of Security	Documents to be verified
Shares and debentures	Duly transferred in the name of the Company
Government securities, and other securities, documents of title which are transferable by endorsement and delivery, e.g. Bills of Lading, and Railway Receipts	Duly endorsed

Immovable property	Registered mortgage deed Or Equitable mortgage (as appropriate)
Life Insurance Policy	Assignment in favor of lender, duly registered with the Insurance company
Pledge	Appropriate record of goods held
Hypothecation of goods	Deed of hypothecation

- Where the loan or advance is made to a company, any charge on the assets of such a company should have been registered under Section 125 of the Act in order to constitute an effective security.
- If the loan has been given for business considerations, e.g., loans to staff for purchase of cars, houses, etc. loans to suppliers of raw materials or other goods, there may be justification for interest being charged at a rate lower than the market rate, or even, in appropriate circumstances, no interest being charged at all.
- However, when a loan is given only with a view to earning interest, the interest charged would be at the commercial rate.
- In the case of partly secured loans or advances, it would be advisable to show them separately in the Balance Sheet as "partly secured", indicating the extent to which they are secured.
- Particular attention should be paid to loans or advances to concerns in which the directors of the company or their associates are interested.
- The reference to "members" should therefore be construed as a reference to the members of a company as a class, in their capacity as members.
- The question whether the loan or advance is "properly secured" would have to be considered at the end of each accounting year. However, the question whether a loan is "prejudicial to the interests of the company or its members" would have to be considered only at the time when the loan is given, or renewed.

227(1A) (b): "Whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company."

- Intended to cover transactions of the company for which the only evidence, or the principal evidence, is the entry regarding the transactions in the books of account.
- In such cases, the auditor should inquire whether such transactions have in fact taken place and, if so, whether they are prejudicial to the interests of the company.

227(1A)(c): "Where the company is not an investment company within the meaning of Section 372 or a banking 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".

- Inquire in all cases where shares, debentures or other securities have been sold at a price less than their cost.
- If, as a result of his inquiries, the auditor is satisfied that the sale is bona fide and the price realized is reasonable, having regard to the circumstances of the cases, he has no further duty to report on the matter.
- Applies to a company whose principal business is dealing in shares, stocks, debentures or other securities.
- Bonus Shares:
    - The question of treatment of bonus shares would also arise.

  - When bonus shares are received, the number of shares in the portfolio would be increased by the bonus shares while the cost of the total portfolio would remain the same as before.
  - The result would be that the average cost per unit of the total holding would come down proportionately.
- The usual accounting practice for apportioning the cost of a part of the total holding on the sale thereof is to take it at its average cost.

227(1A)(d): '"Whether loans and advances made by the company have been shown as deposits".

- It should be noted that the inquiry to be made is whether loans and advances have been shown as deposits, and not vice versa.

227(1A)(e): "Whether personal expenses have been charged to revenue account." {May 1997, May 2001, May 2003- CA Final}

- The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor.
- Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon.

227(1A)(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 so 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."

  - "Papers" would presumably refer to the Return of Allotment filed by the company under Section 75 of the Act.

Where the consideration for the issue of shares is an adjustment against a bona fide debt payable in money on demand by the company, the shares are deemed to have been subscribed in cash (Shares issued to settle loan payable) – In such cases, no comment is required by the auditor in the auditor's report.

Case Study

Give your comments on the following:

Mr. X, a Director of M/s KP Private Ltd., is also a Director of another company viz., M/s GP Private Ltd., which has not filed the financial statements and annual return for last three years 2010-11 to 2012-13. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the Companies Act, 2013, and auditor should not mention disqualification remark in his audit report.

Answer

a) *Disqualification of a Director under section 164(2) of the Companies Act, 2013: Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director under section 164(2) of the Companies Act, 2013. As per provisions of Section 164(2), if a director is already holding a directorship of a company which has not filed the financial statements or annual returns for any continuous period of three financial years shall not be* *eligible to be reappointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.*

In this case, Mr X is a director of M/s KP Private Ltd. as well as of M/s GP Private Ltd., And, M/s GP Private Ltd., has not filed the financial statements and annual return for last three years. Hence the provisions of section 164(2) are applicable to him and as such he is disqualified from directorship of both the companies. Therefore, the auditor shall report about the disqualification under section 143(3)(g) of the Companies Act, 2013.

Case Study

An auditor became aware of a matter regarding a company, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion.

Answer

Section 146 of the Companies Act, 2013 empowers the auditors of a company to attend any general meeting of the company; to receive all the notices and other communications relating to the general meeting, unless otherwise exempted by the company, and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Where the auditor has reason to believe that the directors concealed deliberately a serious fact from the shareholders which came to his note after issuance of the audit report, he should exercise this right. Normally speaking, an auditor considers subsequent events only upto the date of issuance of the audit report.

The discovery of a fact after issuance of the financial statements that existed at the date of the audit report which would have caused the revision of the audit report, requires the auditor to bring this to the notice of shareholders.

Likewise, it may be advisable for the auditor to attend the meeting with a view to bringing to the notice of the shareholders any matter which came 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 attached to the accounts.

Case Study

As an auditor, comment on the following situations/statements:

a) *The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1) of Section 143 of the Companies Act, 2013, as he was satisfied that no comment is required.*
b) *The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the auditors report to them.*

Answer

a) *Comment on Matters Contained under Section 143(1) of the Companies Act, 2013: Section 143(1) of the Act deals with duties of an auditors requiring auditor to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor include relating to loans and advances, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, etc. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor of Trilok Ltd. is correct in non-reporting on the matters specified in Section 143(1).*

b) *Dispatch of Auditor's Report to Shareholders: Section 143 of the Companies Act, 2013 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. In Re Allen Graig and Company (London) Ltd., 1934 it was held that duty of the auditor after having signed the report to be annexed to a balance sheet is confirmed only to forwarding his report to the secretary of the company. It will be for the secretary or the director to convene a general meeting and send the balance sheet and report to the members (or other person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.*

Case Study

As an auditor, comment on the following situations/statements:

a) A Ltd. has its Registered Office at New Delhi. During the current accounting year, it has shifted its Corporate Head Office to Indore though it has retained the Registered Office at New Delhi. The Managing Director of the Company wants to shift its books of account to Indore from New Delhi, as he feels that there is no legal bar in doing so.

b) The Board of Directors of a company have filed a complaint with the Institute of Chartered Accountants of India against their statutory auditors for their failing to attend the Annual General Meeting of the Shareholders in which audited accounts were considered.

Answer

a) Shifting of Books of Account: As per section 128(1) of The Companies Act 2013, every company shall keep at its registered office proper books of accounts. It is permissible, however, for all or any of the books of accounts to be kept at such place in India as the Board of Directors may decide but, when a decision in this regard is taken, the company must file within seven days of such decision with the Registrar of Companies a notice in writing giving full address of the other place.

Conclusion: In view of the above provisions, A Ltd should maintain its books of account at its registered office at New Delhi. The Managing Director is not allowed to shift its books of account to Indore unless decision in this behalf is taken by the Board of Directors and a notice is also given to the Registrar of Companies within the specified time. The auditor may accordingly, inform the Managing Director that his contention is not in accordance with the legal provisions.

b) Auditor's Attendance at Annual General Meeting: Section 143 of the Companies Act, 2013 confers right on the auditor to attend the general meeting.

The said section provides that all notices and other communications relating to any general meeting of a company also to be forwarded to the auditor. Further, it has been provided that the auditor shall be, unless otherwise exempted, entitled to attend any general meeting and to be heard at such general meeting which he attends on any part of the business which concerns him as an auditor.

Therefore, the section does not cast any duty on the auditor to attend the annualgeneral meeting. The law only confers right on the auditor to receive notices and also attend the meeting if he so desires. Therefore, the complaint filed by the Board of Directors is based on mis-conception of the law.

<u>Case Study</u>

M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised nonprofit organisation feels that the standards on auditing need not to be applied as Goodwill Education Foundation is a non-profit making concern.

Answer

a) *Compliance with Standards on Auditing : As per sub section 9 of section 143 of the Companies Act, 2013, every auditor shall comply with the auditing standards. Further as per sub section 10 of section 143 of the Act, the Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority:*

Provided that until any auditing standards are notified, any standard, or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

Further, the Preface to Standards on Auditing gives the scope of the Standards on Auditing. As per the Preface, the SAs will apply whenever an independent audit is carried out; that is, in the independent examination of financial statements/information of any entity; whether profit oriented or not and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.

Also while discharging their attest function; it is the duty of the Chartered Accountant to ensure that SAs are followed in the audit of financial information covered by their audit reports.

In the given case, even though the client is a non-profit oriented entity the SAs shall apply and the auditor shall be guilty of professional misconduct for failing to discharge his duty in case of non-compliance with SAs.

Prohibited Services for auditors

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be. But such services shall not include any of the following services (whether such services are rendered *directly or indirectly* to the company or its holding company or subsidiary company), namely

a. accounting and book keeping services;
b. internal audit;
c. design and implementation of any financial information system;
d. actuarial services;
e. investment advisory services;
f. investment banking services;
g. rendering of outsourced financial services;
h. management services [this excludes services permitted by ICAI as per Professional ethics]; and
i. Any other kind of services as may be prescribed [Eg. Prohibited services by CA in practice as per ICAI like Portfolio management, Underwriting and Stock broking are under this category]

Note – If an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of the Companies Act, 2013, shall comply with the provisions of this section (i.e. section 144) before the closure of the first financial year after the date of such commencement

Case Study

Give your comments on the following:

a) Mr. Aditya, a practising chartered accountant is appointed as a "Tax Consultant" of ABC Ltd., in which his father Mr. Singhvi is the Managing Director.

b) *You, the Auditor of A Ltd., have been considered for ratification by the members in the 4th general meeting as the sole auditor, where you were one of the joint auditors for the immediately preceding three years and the said joint auditors are not re-appointed.*

Answer

a) *Appointment of a Practising CA as 'Tax Consultant': A chartered accountant appointed as an auditor of a company, should ensure the independence in respect of his appointment as an auditor, else it would amount to "misconduct" under the Chartered Accountants Act, 1949 read with Guidance Note on Independence of Auditors.*

   In this case, Mr. Aditya is a "Tax Consultant" and not a "Statutory Auditor" or "Tax Auditor" of ABC Ltd., hence he is not subject to the above requirements.

b) *Appointment of Sole Auditor: When one of the joint auditors of the previous years is considered for ratification by the members as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors. As per sub- section 4 of section 140 of the Companies Act, 2013, special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139 of the said Act. Accordingly, provisions of the Companies Act, 2013 to be complied with are as under:*

   1. *Ascertain that special notice u/s 140(2) of the Companies Act, 2013 was received by the company from such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice not earlier than three months but at least 14 days before the AGM date as per Section 115 of the Companies Act, 2013 read with rule 23(1) and 23(2)of the Companies (Management and Administration) Rules, 2014*
   2. *Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per Section 115 of the Companies Act, 2013 read with rule 23(3) of the Companies (Management and Administration) Rules, 2014.*
   3. *Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.*
   4. *The notice is also sent to the retiring auditor as per Section 140(4)(ii) of the Companies Act, 2013.*
   5. *Verify whether any representation, received from the retiring auditor was sent to the members of the company.*
   6. *Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.*

Basic Elements of the Auditor's report

a. Title
b. Addressee
c. Introductory paragraph specifying
   i. Entity under audit
   ii. Audit of FS
   iii. Title of each statement comprising the Financial Statement.
   iv. Significant accounting policies.
   v. Date or period covered by each Financial Statement.
d. Management's responsibility for the Financial Statements.

e. Auditors' responsibility.
f. Auditor's opinion.
g. Signature of the Auditor.
h. Date of the Auditor's report.

Audit Reports

1. Unmodified 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.

2. Modified Report –

The auditor shall modify the opinion in the auditor's report when:

(i) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(ii) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Types of Modified Reports –

a. **Qualified Opinion** - The auditor shall express a qualified opinion when:
   i. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
   ii. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

b. **Disclaimer of Opinion -** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
c. **Adverse Opinion -** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to 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.

Matters that do not affect the Auditor's Opinion:

1. **Emphasis of Matters Paragraph -** It is given when the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.
2. **Other Matters Paragraph** - It may be given when the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or

the auditor's report and this is not prohibited by law or regulation. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph.

When does an auditor issue unqualified opinion and what does it indicate?

Answer

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

i. The financial statements have been prepared using the generally accepted accounting principles and being constantly followed.
ii. The financial statements comply with relevant statutory requirements and regulations.

All material matters relevant to proper presentation of the financial information, subject to statutory requirement, if applicable, have been adequately disclosed.

When does an auditor issue disclaimer of opinion and what does it indicate?

(a) Disclaimer of Opinion: As per SA 500 "Audit Evidence", the auditor must collect sufficient and appropriate audit evidence, on the basis of which he draws his conclusion to form an opinion, on the financial statements. But, if the auditor fails to obtain sufficient information to form an overall opinion on the matter contained in the financial statements, he issues a disclaimer of opinion. The reasons due to which the auditor is not able to collect the audit evidence are:

i. Scope of audit is restricted;
ii. The auditor may not have access to the books of accounts, e.g.:-
    a. Books of A/c's of the company seized by IT authorities.
    b. Sometimes, inventory verifications at locations outside the city bound the scope of duties of the auditor.

In such a case, the auditor must state in his audit report that- "He is unable to express an opinion because he has not been able to obtain sufficient and appropriate audit evidence to form an opinion".

Case Study

Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, working as Manager of Shrivastav and Co., a Chartered Accountant firm, signed the audit report of Om Ltd. on behalf of Shrivastav & Co.

Answer

Signature on Audit Report: Section 145 of the Companies Act, 2013 requires that the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141 i.e. where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

Therefore, Mr. Rajendra, a fellow member of the Institute and a manager of M/s Shrivastav & Co., Chartered Accountants, cannot sign on behalf of the firm in view of the specific requirements of the Companies Act, 2013. If any auditor's report or any document of the company is signed or authenticated otherwise than in conformity with the requirements of Section 145, the auditor concerned and the person, if any, other than *the auditor who signs the report or signs or authenticates the document shall, if the default is willful, be punishable with a fine.*

Case Study

The auditor of a limited company has given a clean report on the financial statement on the basis of Xerox copies of the books of accounts, Vouchers and other records which were taken away by the Income-tax Department in search under section 132 of the I.T. Act, 1961.

Answer

Reliability of Audit Evidence: *The degree of reliance which can be placed by the auditor on the documentary audit evidence available in the present case will be considerably increased if the xerox copies of account books and vouchers are certified to be true copies by the Income Tax Department. If the tax authorities refuse to certify the same, the auditor should get the certificate to this effect from the management of the company. The auditor should use procedure like confirmation of balances from third parties, inspection of tangible assets, etc. and obtain evidence which corroborates the documentary evidence available. In any case, the auditor has to satisfy himself that he has obtained sufficient and appropriate audit evidence to support the figures contained in the financial statements and formulate his opinion accordingly. Under such circumstances, the auditor should have appropriately modified his report and bring this fact to the attention of shareholders. In case he was satisfied, a simple paragraph of information was enough but in case the auditor failed to establish the reliability of evidence available, he would be required to a disclaimer of opinion.*

Joint Audit
Advantages

- Advantage of mutual consultation
- Lower workload
- Better quality of performance
- Improved service to the client
- Displacement of the auditor of the company taken over in a take - over often obviated,
- In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- Lower staff development costs.
- Lower costs to carry out the work.

Disadvantages

- The fees being shared.
- Psychological problem where firms of different standing are associated in the joint audit.
- General superiority complexes of some auditors.
- Problems of co-ordination of the work.
- Areas of work of common concern being neglected.
- Uncertainty about the liability for the work done.

Joint Auditors’ Responsibilities (SA 299)

- To divide the work among themselves.
- Each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him.

All the Joint Auditors shall be jointly and severally responsible –

- In respect of the audit work which is not divided among the joint auditors and is carried out by all of them.
- in respect of decisions taken by all the joint auditors
- In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors
- For examining that the FS of the entity comply with the disclosure requirements of the relevant statute.

Case Study

E and S were appointed as Joint Auditors of X and Y Ltd. What will be their professional responsibility in a case where the company has cleverly concealed certain transactions that escaped the notice of both the Auditors.

Answer

Responsibilities of Joint Auditors: *In conducting a joint audit, the auditor(s) should bear in mind the possibility of existence of any fraud or error or any other irregularities in the accounts under audit. The principles laid down in SA 200, SA 240 and SA 299 need to be read together for arriving at any conclusion. The principle of joint audit involves that each auditor is entitled to assume that other joint auditor has carried out his part of work properly. However, in this case, if it can be assumed that the joint auditors E and S have exercised reasonable care and skill in auditing the accounts of X & Y Ltd. and yet the concealment of transaction has taken place, both joint auditors cannot be held responsible for professional negligence. However, if such concealment could have been discovered by the exercise of reasonable care and skill, the auditors would be responsible for professional negligence. Therefore, it has to be seen that while dividing the work, the joint auditors have not left any area unattended and exercised reasonable care and skill while doing their work.*

Dividends

Verification of Dividends: Examine the company's Memorandum and Articles of Association to ascertain the dividend rights of different classes of shares.

1. Confirm that the profits appropriated for payment of dividend are distributable having regard to the provisions contained in Section 123 If the company proposes to pay the dividend out of past profit in reserves, see that either this is in accordance with the rules framed by the Central Government in this behalf or the consent of the Government has been obtained.
2. Inspect the shareholders' Minute Book to verify the amount of dividend declared and confirm that the amount recommended by the directors.
3. If a separate bank account was opened for payment of dividends, check the transfer of the total amount of dividends payable from the Dividends Accounts.
4. Check the particulars of members as are entered in the Dividend Register or Dividend List by reference to the Register of Members, test check the calculation of the gross amount of dividend payable to each shareholder on the basis of the number of the shares held and the amount of CDT, if applicable. Verify the casts and crosscast of the different columns.

5. Check the amount of dividend paid with the dividend warrants surrendered. Reconcile the amount of dividend warrants outstanding with the balance in the Dividend Bank Account.
6. Examine the dividend warrants in respect of previous years, presented during the year for payment and verify that by their payment, any provision contained in the Articles in the matter of period of time during which amount of unclaimed dividend can be paid had not been contravened.
7. According to section 123, as it is compulsory for a company to transfer the total amount of dividend which remains unpaid or unclaimed, within thirty days of the declaration of the dividend to a special bank account entitled "Unpaid Dividend Account of .... Company Limited/Company (Pvt.) Limited". Such an account is to be opened only in a scheduled bank. The transfer must be made within 7 days from the date of expiry of thirty days. The expression "dividend which remains unpaid" means any dividend the warrant in respect thereof has not been encashed or which has otherwise not been paid or claimed.
8. In case any money transferred to the unpaid dividend amount of a company remain unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred to Investor Education and Protection Fund established under section 125 of the Act.
9. Ensure the compliance, in case dividend is paid in case of inadequate profits.

9.2 Interim Dividends: A company may distribute part of its profits during the two annual general meetings. That means, a company may declare dividends before the close of the accounting year and finalisation of accounts. Board may from time to time pay to the members such interim dividend as appeared to be justified by the company. However, the definition of "dividend" includes the interim dividend

A. The Board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.
B. The amount of dividend including interim dividend so deposited under sub-section (1A) shall be used for payment of interim dividend.
C. The provisions contained in sections 123, 124, 125, 126 and 127 shall, as far as may be, also apply to any interim dividend.

Therefore, conditions and procedures laid down in section 123, 124*, 125*, 126 and 127 would have to be complied with while declaring interim dividends.

Right to dividend, Right Shares and Bonus Shares to be held in abeyance pending registration of transfers of shares - Section 126 of the Companies Act, 2013 requires that where any instrument of transfer of shares has been delivered to any company for registration and a transfer of such shares has not been registered by the company, the company shall transfer the dividend in relation to such shares to the special account referred to in section 124*. Further the company shall also keep in abeyance and offer to right shares and any issue of fully paid up bonus shares in respect of such shares which have not been registered by the company. However, the company may transfer the dividend in case it has been authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer.

Penalty for failure to distribute dividend within the prescribed period, i.e., thirty day, has been made quite stiff by prescribing imprisonment for two year. Rupees one thousand everyday for which the default continues as also liability to pay simple interest at the rate of 18% p.a.

[Transfer to reserves provisions are deleted]

Audit of Branch Office Accounts

1. The accounts of the Branch office may be audited by the Company auditor himself or by any auditor competent under the Act, or the auditor qualified to do the audit under the relevant provisions of the country in which it is situated where the branch is situated outside India.
2. The Branch Auditor shall submit the report to the Company Auditor who shall deal with it accordingly.
3. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to perform further audit procedures.
4. SA 600 on "Using the work of another auditor" may be applied.

<u>Case Study</u>

M/s. Seeman & Co. had been the company auditor for Amudhan Company Limited for the year 2013-14. The company had three branches located at Chennai, Delhi and Mumbai. The audits of branches-Chennai, Delhi were looked after by the company auditors themselves. The audit of Mumbai branch had been done by another auditor M/s Vasan & Co., a local auditor situated at Mumbai. The branch auditor had completed the audit and had given his report too. After this, but before finalization, the company auditor wanted to visit the Mumbai branch and have access to the inventory records maintained at the branch. The management objects to this on the grounds of the company auditor is transgressing the scope of audit areas agreed. Comment.

Answer

<u>Right of Access of Company Auditor for Branch Records:</u> The audit of the branch of a company is dealt with in Section 143(3) of the Companies Act, 2013. According to this section, the audits of the branches can be done by the company auditor himself or by another auditor. Even where, the branch accounts are audited, the company auditor has right to visit the branch if he deems it necessary to do so for the performance of his duties as auditor.

He has also right of access at all times to the books and accounts and vouchers of the company maintained at the branch office. He can appropriately deal with the repot of the branch auditor in framing his main repot. He will disclose how he had dealt with the branch audit report.

In this case, the audits of two branches were done by the company auditor and one branch was done by a separate branch auditor.

Applying the above provisions, to the instant case, management's objection that the company auditor is transgressing the scope of audit areas agreed, is absolutely, wrong. The right of company auditor in visiting and accessing the records of branch can not be forfeited. Even where the branch accounts are audited by another local auditor, the company auditor has right to visit the branch and can have access to the books and vouchers of the company maintained at the branch office.

<u>Case Study</u>

During the year 2013-14, it was decided for the first time that the accounts of the branch office of AAS Company Limited be audited by qualified Chartered Accountants other than the company auditor. Accordingly, the Board had appointed branch auditors for the ensuing year. One of the shareholders complained to the Central Government that the appointments was not valid as the Board of Directors do not have power to appoint auditors, be they Company Auditor or Branch Auditors?

Answer

Appointment of Branch Auditor: The Companies Act, 2013 leaves it to the company to designate or not to designate any establishment of the company as 'branch office'. Under the Companies Act, 2013, only establishment "described as such by the company" shall be treated as a 'branch office'.

Further, as per Section 143(8) of the Companies Act, 2013, where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The shareholders in general meeting, instead of appointing branch auditor, may authorize the board of directors to appoint branch auditors.

In the present case, the board has appointed branch auditors without obtaining authorization from the shareholders in general meeting. The board had appointed the auditor where it did not have authority to do so. As such, the appointment is invalid.The shareholder's complaint is right.

The branch auditor should ascertain before accepting the audit whether his appointment is valid.

Cost Audit(Section 148)

- Cost audit can be conducted only by a Cost Accountant in practice ONLY. CAs not permitted.
- The report of the cost audit shall be submitted by the cost accountant in practice to the Board of Directors, not to Central Govt.
- Under the New Act, the penalties have been increased .The company, every officer and cost auditor shall be punishable in the manner as provided in Sec 147.
- The New Act has specifically provided that the cost audit shall comply with the cost auditing standards.

Cost Audit: Cost Audit is covered by Section 148 of the Companies Act, 2013. The audit conducted under this section shall be in addition to the audit conducted under section 143 of the Companies Act, 2013.

As per the section 148 the Central Government may by order specify audit of items of cost in respect of certain companies.

Further, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.

It is provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

The audit shall be conducted by a Cost Accountant in Practice who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed.

Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards ("cost auditing standards" mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government).

As per rule 14 of the Companies (Audit and Auditors) Rules, 2014

(a) in the case of companies which are required to constitute an audit committee-

i. the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountant in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
ii. the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant inpractice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter X of the Companies Act, 2013 shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

It is provided that the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

Internal Audit

- The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

a) every listed company;

b) every unlisted public company having-

i. paid up share capital of fifty crore rupees or more during the preceding financial year; or

ii. turnover of two hundred crore rupees or more during the preceding financial year; or

iii. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or

iv. outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year;

c) Every private company having-
   i. turnover of two hundred crore rupees or more during the preceding financial year; or
   ii. Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

- For an existing company covered under any of the above criteria shall, it shall then comply with the requirements of section 138 and this rule within six months of 1st April, 2014
- Internal auditor may or may not be an employee
- He may be a CA in practice or not
- he Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit

Case Study

JKT Ltd. having Rs. 40 lacs paid up capital, Rs. 9.50 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs. 49 crores, Rs. 145 crores and Rs. 260 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory. Comment.

Answer

Applicability of Provisions of Internal Audit : As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014 every private company shall be required to appoint an internal auditor or a firm of internal auditors, having-

i. turnover of two hundred crore rupees or more during the preceding financial year; or
ii. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

In the instant case, JKT Ltd. is having turnover of Rs. 260 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the Company has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit.

Punishment for Non Compliance

- **Penalty on company [Section 147(1)]:**
  - If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with
  - Fine>= Rs 25,000 but which may extend to Rs 5 Lacs.
- **Penalty on officers [Section 147(1)]:**
  - If any of the provisions of sections 139 to 146 (both inclusive) is contravened, every officer of the company who is in default shall be punishable with,
    - imprisonment for a term which may extend to 1 year or
    - With fine >=10,000 but which may extend to Rs 1 Lacs; or
    - Both with imprisonment and fine.
- If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine >= Rs 25,000 but which may extend

to Rs 5 Lacs.

- If an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with
  - imprisonment for a term which may extend to 1 year and
  - Fine >= Rs 1 Lac but which may extend to Rs 25 Lacs.
- Further, where an auditor has been convicted as above, he shall be liable to
  - refund the remuneration received by him to the company; and
  - Pay for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

Liability of Audit Firm

- Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in the Companies Act, 2013, or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

Auditor's Lien

In terms of the general principles of law, 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 nonpayment of fees, for work done on the books and documents.

The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

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. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
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.

Under section 128 of the Companies Act, 2013, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of ac count by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

Further, as per SA 230 "Audit Documentation", "working papers are the property of the auditor". The auditor may at his discretion make portions of or extracts from his working papers available to his clients.

Thus, documents prepared by the professional accountant solely for the purpose of carrying out his duties as auditor (whether under statutory provisions or otherwise) belong to the professional accountant.

In the case of Chantrey Martin and Co. v. Martin, it was held that the following documents were the property of the auditor: working papers and schedules relating to the audit, draft accounts of the company, and the draft tax computation prepared by an employee of the auditor.

It is also clear that the accountant's correspondence with his client (letters written by the client to the accountant and copies of the letters written by the accountant to the client belong to the accountant. In the case of Chantrey Martin and Co. v. Martin, it was also held that the correspondence between the accountant and the taxation authorities with regard to the client's accounts and tax computations was the property of the client since the accountant merely acted as agent of the client.

However, where the accountant communicates with third parties not as an agent, but as a professional man, e.g., as an auditor, the correspondence with third parties would seem to belong to the accountant. According to the statement, where an auditor obtains documents confirming the bank balance or confirming the custody of securities of the client or other similar documents, it is probable that the courts would hold that these documents belong to the auditor.

Distinction between Audit Reports and Certificates

Particulars	Report	Certificate
Meaning	is an expression of opinion	is a written confirmation of the accuracy of the facts stated therein
	It means expressing an opinion on the financial statements. The term report implies that the auditor has examined relevant records in accordance with generally accepted auditing standards and that he is expressing an opinion whether or not the financial statements represent a true and fair view of the state of affairs and of the working results of an enterprise	When an auditor certifies a financial statement, it implies that the contents of that statement can be measured and that the auditor has vouched for the exactness of the data. The term certificate is, therefore, used where the auditor verifies certain exact facts
	Since an auditor cannot guarantee that the figures in the balance sheet and profit and loss account are absolutely precise, he cannot certify them. This is primarily because the accounts itself are product of observance of several accounting policies, the selection of which may vary from one professional to another and, thus, he can only have an overall view of the accounts through normal audit procedures. Therefore, the term certificate cannot be used in connection with these, statements. Thus, when a reporting auditor issues a certificate, he is responsible for the factual	An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain precise figures and is in a position to vouch safe their accuracy as per the examination of documents and books of account.

	accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.	

Miscellaneous cases
Case Study

As an Auditor, comment on the following:

a) *Company has debited Rs. 1,75,000 to Delivery Van Account received from a customer against credit sales of Rs. 1,50,000 to him who is now is not able to pay the amount. The Delivery Van has not been registered in the name of the company with R.T.O. till date of Finalisation of accounts.*
b) *XYZ Ltd. Co. gave a donation of Rs. 50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2014. The average net profits of the company for the last three years were 15 lakhs. Comment.*
c) *AAS Limited had provided for doubtful debts to the extent of Rs. 23 lakhs during the year 2012-13. The amount had since been collected in the year 2013-14. Another debt of Rs. 25 lakhs had been identified to be doubtful during the year 2013-14. The Company made an additional provision of Rs. 2 lakhs during the year. The Profit and Loss account for the year ended 31.3.2014 disclosed in Debit side-provision for doubtful Debts Rs. 2 lakhs.*
d) *Alagar Limited is a company engaged in the business of chassis building and bus transportation services. It accounts all expenses and income in Profit and Loss account under various heads explaining clearly the nature of the operations. The auditor of the company requires that the Profit and Loss account should depict the Profit or Loss from the businesses of assembly as well as of operation of bus services separately.*

Answer

a) ***AS 10 "Accounting For Fixed Assets":*** *As per AS 10 "Accounting for Fixed Assets" When a fixed asset is acquired in exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. For these purposes fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident.*

   The delivery van has been acquired in exchange for another assets i.e. receivables. The fair value of delivery van is Rs. 1,75,000 and that of receivable were Rs. 1,50,000. Here fair market value of the asset given up is more clearly evident. Therefore the delivery van should be valued at Rs. 1,50,000. Also the delivery van should be recognized as an asset of the company even though it is not yet registered in the name of the company. This is because legal title is not necessary for an asset to exist. What is necessary is control over the asset as per the framework for preparation and presentation of financial statements. Applying substance over form, we find since price has been settled, and the company has control of assets, hence it should be reflected as an asset along with a note to the effect that the registration in the name of the company is pending.

b) ***Donation to Charitable Institutions : Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the***

aggregate of which, in any financial year, exceed five per cent. of its average net profits for the three immediately preceding financial years.

Facts of the case: In the instant case, the company has given donation of Rs. 50,000/- each to the two charitable organisations which amounts to 1,00,000. Assuming that the charitable organisations are not related to the business of the company, the average profits of the last 3 years is Rs. 15 lakhs and the 5% of this works out to Rs. 75,000. Hence the maximum of donation could be Rs. 75,000 only. For excess of Rs. 25,000 the company is required to take prior permission in general meeting which is not been taken. t

Conclusion: By paying donations of Rs. 1,00,000 which is more than Rs. 75,000, the Board has contravened the provisions of Section 181 of the Companies Act, 2013. Hence the auditor should qualify his audit report accordingly.

c) ***Disclosure of certain ordinary activities under AS 5:*** *As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies "when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.*

During the relevant year, the company had collected the amount of Rs. 23 lakhs for which provision had already been made earlier in the accounts. The said provision should be reversed to that extent during the relevant year. The company estimates a doubtful debt to the extent of Rs. 25 lakhs in the current year which must be provided for during the relevant year. Circumstances which may give rise to the separate disclosure of items of income and expense in accordance with paragraph 12 of AS 5 include reversals of provisions. The company had netted off the reversal and additional provision and had shown the net debit of Rs. 2 lakhs in P&L account. This practice does not seem to be good as per AS 5. Company may show the net debit in P&L account but should disclose the facts of write back and additional provision made during the year by way of note. The Company's accounting treatment is wrong and it may warrant audit qualifications.

Segmental reporting: *As per AS 17, the company accounts must be presented according to the primary classification based on nature of income and expenses and therefore segment results are to be disclosed accordingly. The result of segment should be disclosed in terms of segment revenue and segment expense. In the instant case, the company has two business segments namely assembly and transportation. These two segments should be properly identified. In this case, company should add note to show segment result after computation. It is not necessary that segment-wise details of each and every expenditure and revenue should be specified.*

Question 21

Give your assertions for the following items appearing in balance sheet of a Limited Company:

		Amount in Rs.
(i) Cash in hand		10,000
(ii) Investments		1,00,000
(iii) Secured Loans		10,00,000
(iv) Machinery:		
Opening cost	13,00,000	
Less: depreciation		
Current depreciation	1,30,000	11,70,000

Answer

i. **Cash in Hand Rs. 10,000**

This is the item of current assets, exhibited on the asset side of balance sheet It implies:

1. that the firm concerned has Rs. 10,000 in hand in valid notes and coins on the balance sheet date.
2. that the cash was free and available for expenditure to the firm.
3. that the books of accounts show a cash balance of identical amount at the end of the day on which the balance sheet is drawn up.

ii. **Investments Rs. 1,00,000**

This is also the item to be exhibited on the asset side of balance sheet as per Schedule III to the Companies Act, 2013, as prescribed by Company Law. This description is not giving us a complete picture of investment. We, as an auditor, must know:

1. Nature of Investment, type of Investment; whether it is short term or long term investment or trade investment or non-trade investment.
2. Rate of interest receivable.
3. Face value or market value of investments as on balance sheet date.

iii. **Secured Loan Rs. 10,00,000**

It Implies that the company has secured loan from some parties, worth Rs. 10,00,000. The description does not give us a complete picture. We, as an auditor, must know:

1. the name of the lender,
2. the nature of security provided; and
3. the rate at which interest is payable.

iv. **Machinery Rs. 11,70,000.**

1. The Company owns the Plant and Machinery whose WDV as on date of balance sheet is Rs. 11,70,000. Gross block is Rs. 13,00,000.
2. The Machinery physically exists.
3. The asset is being utilized in the business of the company productively.
4. Charge of depreciation on this asset is Rs. 1,30,000 relates to the year in respect of which the accounts are drawn up.
5. The amount of depreciation, has been calculated on recognized basis and the calculation is correct.

Case Study

As an auditor comment on the following:

a) On 31.3.2014 inventory taking by Identity Ltd. revealed an inventory of Rs. 50 crores at its godown. Due to a fire on 1st April, 2014, inventory worth Rs. 30 crores was destroyed. The salvage value and insurance claim were estimated at Rs. 25 crores before the commencement of audit. No provision was made in the books of company for the year ended 31.3.2014 for Rs. 5 crores.

b) T Ltd. gave a guarantee to the court for payment of VAT dues of Rs. 15 lakhs for its subsidiary Company Y Ltd. According to the company, since the guarantee was given on behalf of its subsidiary Company, no disclosure was required.

c) Uranus Ltd. has purchased and installed new machinery during the year in expectation of increased sales. However, no production was made by using the new machine. The directors contend that as the machinery was not used, no depreciation needs to be provided.

d) Mr. D is a director of X Ltd. and Y Ltd. On 30th June, 2013, Mr. D resigned from directorship of Y Ltd. X Ltd. sold goods to Y Ltd., during the entire year at the same price and conditions as to any other customer. X Ltd. discloses only the sales for the first quarter ending 30th June, 2013 as related party transactions.

Answer

a) SA 560 "Subsequent Events" requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor's report. However, the exact manner and treatment would depend upon whether the event falls in the category of adjusting event or non-adjusting event. The event took place after the close of the accounting year and does not relate to conditions existing at the balance sheet date.

Thus, it will have no effect on items appearing at the balance sheet date because as per AS – 4 "Contingencies and Events Occurring after Balance Sheet Date" have to be adjusted that provide evidence of conditions existing as at the balance sheet date. AS - 4 requires disclosure of the non-adjusting event, in the report of the approving authority only and no further action needs to be taken by the auditor.

As the company has correctly accounted by not providing provision, the auditor is required to ensure the proper disclosure of abovementioned event.

b) **Disclosure of guarantee given by a company on behalf of its holding Company:** T Ltd, in its books of accounts is required to record a contingent liability of Rs. 15 lakhs for the guarantee given by it for payment of VAT dues of its subsidiary company to the court. If, the subsidiary fails to meet its obligation, T Ltd would be required to pay Rs. 15 lakhs to the authorities concerned.

AS 29 also states that the existence and amount of guarantees undertaken by an enterprise are generally disclosed in financial statements by way of a note, even though the possibility that the loss will occur, is remote. Thus the amount of any guarantee given by the company on behalf of its subsidiary is required to be stated and where practicable the general nature of such contingent liability if material, be specified. Accordingly, the views expressed by the company cannot be accepted.

c) As per AS 6 on "Depreciation Accounting", depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising out of use, effluxion of time or obsolescence through technology and market changes. Thus, depreciation has to be charged even in case of these assets which are not used at all during the year but by mere effluxion of time provided such assets qualify as depreciable assets. When the machinery was installed and made ready for production, it means it was intended to be used for the purpose of business. If there is an intention to use an asset, though it may not have actually been used, it is a 'constructive' or 'passive' use and eligible for depreciation. Thus, depreciation in respect of this machinery ought to have provided in the accounts for the year under audit.

Thus, the auditor may suitably qualify the report stating that depreciation has not been provided.

d) As per SA 550 'Related Parties', in examining the identified related party transactions, the auditor should obtain sufficient appropriate audit evidence as to whether these transactions have been properly recorded and disclosed.

As per paragraph 23 of AS 18 'Related Party Disclosures', transactions of X Ltd for the first quarter with Y Ltd upto 30th June, 2013 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did exist need not to be disclosed as related party transactions. As X Ltd has correctly identified and disclosed the related party transactions, the auditor need not take any further action.

Case Study

M.N.P. Company Ltd. purchased a machinery for Rs. 1.00 crore. The State Government granted the company a subsidy of Rs. 40 lakhs to meet partial cost of machinery. The company credited the subsidy received from the State Government to its Profit and Loss Account for the year ended March 31, 2014. Comment.

Answer

Accounting treatment for Government Grants: As per AS 12 "Accounting for Government Grants", accounting treatment of any grants or subsidy depends on nature of grants or receipts. Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets.

Following are two methods of presentation of grants related to specific fixed assets in financial statements as acceptable alternatives;

i. Under the first alternative the grant is shown in the balance sheet as a deduction from the gross value of the assets concerned. The grant is recognized in profit and loss accounts over the useful life of the depreciable life of asset by way of a reduced depreciation charge.

ii. Under second alternative, it is treated as a deferred income which should be recognized in profit and loss account over useful life of asset in proportion in which depreciation will be charged on the assets concerned. Deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet with a suitable description i.e. Deferred Government Grant.

Conclusion: In the instant case, MNP Company Ltd received a subsidy from government worth Rs. 40 lakhs towards meeting partial cost of machinery. The company credited the same to its profit & loss account.

Accounting treatment of grant received towards partial cost of machinery is not correct. The auditor should advise company to correct the above accounting treatments of grant; otherwise it is the duty of the auditor to qualify his report bringing out the quantification impact clearly.

Case Study

Comment on the following:

a) X Ltd. has its Registered Office at Mumbai. During the current accounting year it shifted its Corporate Office to Delhi. The Managing Director of the Company wants to shift company's books of account to Delhi because he holds the view that there is no legal bar in doing so.

b) A partnership firm revalued its fixed assets like land and building. The firm adequately disclosed the revalued amounts in the Balance Sheet.

Do you, as an auditor, approve the disclosure given by the partnership firm?

c) R.K. & Company are the auditors of PQR Company Ltd. The Managing Director of the Company demands copies of the working papers from the auditors. Are the auditors bound to oblige the Managing Director?

Answer

a) Shifting of Books of Account: As per section 128(1) of The Companies Act 2013, every company shall keep at its registered office proper books of accounts. It is permissible, however, for all or any of the books of accounts to be kept at such place in India as the Board of Directors may decide but, when a decision in this regard is taken, the company must file within seven days of such decision with the Registrar of Companies a notice in writing giving full address of the other place.

Conclusion: In view of the above provisions, X Ltd should maintain its books of account at its registered office at Mumbai. The Managing Director is not allowed to shift its books of account to Delhi unless decision in this behalf is taken by the Board of Directors and a notice is also given to the Registrar of Companies.

b) **Disclosure of revalued fixed assets of a partnership firm:** As per AS 10 "Accounting for fixed assets", revalued amounts substituted for historical costs of fixed assets, method adopted to compute the revalued amounts, nature of indices used, year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts should be disclosed in the financial statements. In the instant case, the partnership firm revalued its fixed assets like building and land and adequately disclosed the revalued amounts in the Balance sheet. The firm did not disclose the method adopted by it for arriving at the revalued figures.

Conclusion: The firm had disclosed the revalued amounts in the balance sheet but the method and nature of indices used etc. are not disclosed. Thus, this act of the firm is in contravention with the AS 10 for "Accounting for Fixed Assets'.

Hence, the auditor cannot approve the disclosure given by the partnership firm and shall have to qualify the report.

c) Ownership and custody of working papers: As per SA-230 "Audit Documentation", the working papers are the property of the auditor, the auditor may, at his discretion make portion of or extracts from his working papers available to the client.

In the instant case the managing director of the company has demanded copies of the working papers from the auditor. He has no right to obtain copies of the working papers from the auditor because they are the property of the auditor. However the auditor may at his discretion make portions of or extracts from the working paper to the managing director of PQR & Company Ltd.

Conclusion: The auditor is not bound to oblige the managing director by supplying copies of the audit working papers.

Cost Audit

- Cost audit can be conducted only by a Cost Accountant in practice ONLY. CAs not permitted
- The report of the cost audit shall be submitted by the cost accountant in practice to the Board of Directors, not to Central Govt.
- Under the New Act, the penalties have been increased .The company, every officer and cost auditor shall be punishable in the manner as provided in Sec 147.
- The New Act has specifically provided that the cost audit shall comply with the cost auditing standards.
- It is an audit process for verifying the cost of manufacture or production of any article, on the basis

of accounts as regards utilisation of material or labour or other items of costs, maintained by the company.

- Cost Audit is covered by Section 148 of the Companies Act, 2013. The audit conducted under this section shall be in addition to the audit conducted under section 143.
- As per the section 148, the Central Government may by order specify audit of items of cost in respect of certain companies.
- Further, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.
- Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

Applicability

- (A) Companies engaged in the production of following goods in strategic sectors, such as machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items; turbo jets and turbo propellers; arms and ammunitions
- (B) Companies engaged in an industry regulated by a Sectoral Regulator or a Ministry or Department of Central Government, such as aeronautical services of air traffic management, aircraft operations; telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997.
- (C) Companies operating in areas involving public interest, such as mineral products including cement; ores; Construction Industry; companies engaged in health services viz. functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories.
- (D) Companies (including foreign companies other than those having only liaison offices) engaged in the production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent).

Rule 5

- every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, is required to maintain cost records in Form CRA-1. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Rule 6

- companies prescribed under the said Rules to appoint an Auditor within one hundred and eighty days of the commencement of every financial year.

- Every referred company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.
- The cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

Reporting

- The cost auditor shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in Form CRA-3. He shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

Duty to report fraud

- The provisions of sub-section (12) of section 143 of the Companies Act, 2013 and the relevant rules on duty to report on fraud shall apply ***to a cost auditor during performance of his functions under section 148 of the Act and these rules.***

Cost Audit doesn't apply to

- **The requirement for cost audit under these rules shall not be applicable to a company which is covered under rule 3, and,**
- **(i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue; or**
- **(ii) which is operating from a special economic zone.**

Who can be cost auditor?

- The audit shall be conducted by a Cost Accountant in Practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed.
- ***The auditor conducting the cost audit shall comply with the cost auditing standards***
- Provisions regarding Audit committee taking initiative, Qualifications and Disqualification provisions apply even to Cost Auditor

Report Submission

- A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

- If, after considering the cost audit report referred to under this section and the, information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Audit of PSUs

- Statutory auditors of Government Company are appointed or re-appointed <u>by the Comptroller and Auditor General of India</u>.
- The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor- General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

Supplementary audit under section

- 143(6)(a) of the Companies Act, 2013 - The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct.
- (c) Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013 - Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.
- (d) Test audit under section 143(7) of the Companies Act, 2013 - Without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

Items to be covered in Cost Audit

- ***Input Material(s) or Service(s):***
- ***Salaries and Wages:***
- ***Utilities***
- ***Service Department Expenses***

- ***Repairs and Maintenance***
- ***Fixed Assets, Depreciation and Lease Charges***
- ***Overheads***
- ***Royalty and Technical Know-How Fee***
- ***Research and Development Expenses***
- ***Quality Control***
- ***Work-In-Progress and Finished Stock***
- ***Captive Consumption***
- ***By-Products***
- ***Joint Products/Services***
- ***Packing Expenses***
- ***Interest and Other Borrowing Costs***
- ***Expenses or Incentives on Exports***
- ***Pollution Control: expenditure***
- ***Production Records***
- ***Sales Records***
- ***Any Other Item of Cost***
- ***Adjustment of Cost Variances***
- ***Cost Statements***
- ***Reconciliation of Cost and Financial Accounts***
- ***Statistical Records like machine hours, labor efficiency, key financial and costing ratios***
- ***Physical verification***
- ***Related Party Transactions***

Multi State Cooperative Society Audit

- Cash book
- Sales book
- Purchases book
- Cost records

Qualification for Auditor

- Only CA with COP

Disqualification for Auditor

- (a) A body corporate.
- (b) An officer or employee of the Multi-State co-operative society.
- (c) A person who is a member or who is in the employment, of an officer or employee of the Multi-State co-operative society.
- (d) A person who is indebted to the Multi-State co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an amount exceeding one thousand rupees.

Deemed vacation of office

- If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

Appointment of first auditors

- First auditor or auditors of a Multi-State co- operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting.
- If the board fails to exercise its powers under this sub- section, the Multi-State co-operative society in the general meeting may appoint the first auditor or auditors.

Appointment of Subsequent Auditors

- The subsequent auditor or auditors are appointed by Multi-State co-operative society, at each annual general meeting, the auditor or auditors so appointed hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

Powers of Auditors

- Right to access books of account
- Right to obtain information and explanation

Duties to Inquire

- (a) Whether loans and advances made by the Multi-State co-operative society 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 Multi-State co-operative society or its members,
- (b) Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,
- (c) Whether personal expenses have been charged to revenue account, and
- (d) Where it is Stated in the books and papers of the Multi-State co-operative society 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 as correct regular and not misleading.

Central Govt’s power to direct Special Audit when

- Affairs Not Managed in Accordance With Prudent Commercial Practices
- Managed as it would Cause Injury to Interest of Trade or Industry or Business
- Financial Position is such as would endanger its Insolvency

Special Auditor

- Appointed by CG
- Chartered Accountant
- Statutory Auditor or Another auditor
- Appointed only when CG holds >=51% of the PUC in MSCS
- Powers of Special Auditor same as company Auditor
- Report to Central Government
- If Govt doesn't take action in 4 months from the date of such report, then it should copy / extracts therefrom to read before members
- Fees determined by CG, paid by MSCS

NBFC

Investments in MGC

- investments made towards Government securities, quoted or otherwise, government guaranteed securities and bonds not exceeding the MGC's capital may be treated as "Held to Maturity (HTM)" for the purpose of valuation and accounted for accordingly
- Investment classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity
- The book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period
- However, if any security out of this HTM category is traded before maturity, the entire lot will be treated as securities held for trade and will have to be marked to market.
- while calculating the capital adequacy of the MGC, the mortgage guarantees provided by the MGCs may be treated as Contingent Liabilities and the credit conversion factor applicable to these Contingent Liabilities will be 50 percent as against the present applicable credit conversion factor of 100 percent.

Registration with RBI

- Section 45-IA inserted by the RBI Act, w.e.f. 9th January, 1997, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds (NOF) of ` 2 Crore
- **Although the requirement of minimum NOF at present stands at ` 200 lakh, the minimum NOF for companies that were already in existence before April 21, 1999 was retained at ` 25**

lakh. However, for strengthening the financial sector and technology adoption, and in view of the increasing complexities of services offered by NBFCs, it shall be mandatory for all NBFCs to raise minimum NOF to ` 1 crore by March, 2016, and to further double it to ` 2 crore by 2017

Audit report

- Audit report is governed by Sec 143 of Companies Act 2013

Professional Ethics

Companies not to engage in accountancy

- Section 25 provides that:
- No company, whether incorporated in India or elsewhere, shall practise as chartered accountants.
- ***it is clarified that the "company" shall include any limited liability partnership which has company as its partner for the purpose of this section***

Clause 9 of Part I of First Schedule

- **Accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956, in respect of such appointment have been duly complied with *(now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013)*.**
- The Companies Act, 2013 provides for the requirements which an auditor appointed in respect of a company should satisfy himself about, before he accepts the appointment.
- The relevant provisions are contained in Sections 139, 140, 141 and 142 of the said Act. Section 139 contains several provisions in the matter of appointment of auditors in different circumstances and situations; and Section 140 lays down the procedure which must be followed when a company desires to change its auditors, or when an auditor resigns from the company; whereas Section 141 provides the eligibility, qualifications and disqualifications of auditors; and Section 142 contains the provisions related to the remuneration of the auditor.
- In order that the validity of the appointment of an auditor is not challenged or objected to by shareholders or the retiring auditors at a later date, it has been made obligatory on the incoming auditor to ascertain from the company that the appropriate procedure in the matter of appointment has been faithfully followed.
- As regards the mode of sending the notice of the resolution to the members of the company as provided in Sections 224 and 225 ***(now Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013)***, it should noted that there is no provision that the notice should necessarily be sent by registered post. The notice can be sent by the company in accordance with the provisions contained in Section 53 ***(now Section 20 of the Companies Act, 2013)***.
- For the purpose of better understanding to the students, the relevant provisions of Section 20 of the Companies Act, 2013 are briefly summarised hereunder:
- (i) A document may be served on a company or an officer thereof sending it through registered post; or speed post; or courier service; or by leaving it at its registered office; or by means of electronic transmission.

- (ii) If the member or the person concerned has given specific direction to the Company that the notice should be sent to him through a particular mode, and has deposited with the Company the sum sufficient to defray the expenses for this purpose, the notice should be sent in such specified manner.

- (iii) For above purposes, the courier means a document sent through a courier which provides proof of delivery.

- With the introduction of Companies Act, 2013, Clause 9 of Part I of the First Schedule to the Chartered Accountants Act, 1949 also needs to be modified in view of the new Companies Act, 2013. Till the time the Chartered Accountants Act, 1949 along with the "Code of Ethics" gets amended in accordance with Companies Act, 2013, students may study and use section 139, 140 and 142 read with section 141 of the Companies Act, 2013 while applying the above clause.

Clause 1 of Part 1 of Second Schedule

- A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he-

- **Clause (1) Discloses Information acquired in the course of his professional engagement to any person other than his client so engaging him without the consent of his client or otherwise than as required by any law for the time being in force.**

- **as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.**

Clause 4 of Part 1 of Second Schedule

- **Expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.**

- Relative shall have meaning as per Section 2(77) of Companies Act 2013

- New Form ADT-1 is required to be filed with the Registrar as per the provisions and rules made under Companies Act, 2013 in place of 23-B

Additional case Studies for revision of Companies Act

Case Study

- Mr. X, a Director of M/s KP Private Ltd., is also a Director of another company viz., M/s GP Private Ltd., which has not filed the financial statements and annual return for last three years 2010-11 to 2012-13. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the Companies Act, 2013, and auditor should not mention disqualification remark in his audit report.

Answer

- Disqualification of a Director under section 164(2) of the Companies Act, 2013: Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director under section 164(2) of the Companies Act, 2013. As per provisions of Section 164(2), if a director is already holding a directorship of a company which has not filed the financial statements or annual returns for any continuous period of three financial years shall not be eligible to be reappointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

- In this case, Mr X is a director of M/s KP Private Ltd. as well as of M/s GP Private Ltd., And, M/s GP Private Ltd., has not filed the financial statements and annual return for last three years. Hence the provisions of section 164(2) are applicable to him and as such he is disqualified from directorship of both the companies. Therefore, the auditor shall report about the disqualification under section 143(3)(g) of the Companies Act, 2013.

Case Study

- An auditor became aware of a matter regarding a company, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion.

Answer

- Section 146 of the Companies Act, 2013 empowers the auditors of a company to attend any general meeting of the company; to receive all the notices and other communications relating to the general meeting, unless otherwise exempted by the company, and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.
- Where the auditor has reason to believe that the directors concealed deliberately a serious fact from the shareholders which came to his note after issuance of the audit report, he should exercise this right. Normally speaking, an auditor considers subsequent events only upto the date of issuance of the audit report.
- The discovery of a fact after issuance of the financial statements that existed at the date of the audit report which would have caused the revision of the audit report, requires the auditor to bring this to the notice of shareholders.
- Likewise, it may be advisable for the auditor to attend the meeting with a view to bringing to the notice of the shareholders any matter which came 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 attached to the accounts.

Case Study

- The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1) of Section 143 of the Companies Act, 2013, as he was satisfied that no comment is required.

Answer

- Comment on Matters Contained under Section 143(1) of the Companies Act, 2013: Section 143(1) of the Act deals with duties of an auditors requiring auditor to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor include relating to loans and advances, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, etc.
- Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein.

- If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor of Trilok Ltd. is correct in non-reporting on the matters specified in Section 143(1).

Case Study

- The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the auditors report to them.

Answer

- Dispatch of Auditor's Report to Shareholders: Section 143 of the Companies Act, 2013 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company.

- The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. In Re Allen Graig and Company (London) Ltd., 1934 it was held that duty of the auditor after having signed the report to be annexed to a balance sheet is confirmed only to forwarding his report to the secretary of the company. It will be for the secretary or the director to convene a general meeting and send the balance sheet and report to the members (or other person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders

Case Study

- A Ltd. has its Registered Office at New Delhi. During the current accounting year, it has shifted its Corporate Head Office to Indore though it has retained the Registered Office at New Delhi. The Managing Director of the Company wants to shift its books of account to Indore from New Delhi, as he feels that there is no legal bar in doing so.

Answer

- Shifting of Books of Account: As per section 128(1) of The Companies Act 2013, every company shall keep at its registered office proper books of accounts. It is permissible, however, for all or any of the books of accounts to be kept at such place in India as the Board of Directors may decide but, when a decision in this regard is taken, the company must file within seven days of such decision with the Registrar of Companies a notice in writing giving full address of the other place.

- Conclusion: In view of the above provisions, A Ltd should maintain its books of account at its registered office at New Delhi. The Managing Director is not allowed to shift its books of account to Indore unless decision in this behalf is taken by the Board of Directors and a notice is also given to the Registrar of Companies within the specified time.

- The auditor may accordingly, inform the Managing Director that his contention is not in accordance with the legal provisions.

Case Study

- The Board of Directors of a company have filed a complaint with the Institute of Chartered Accountants of India against their statutory auditors for their failing to attend the Annual General Meeting of the Shareholders in which audited accounts were considered

Answer

- Auditor's Attendance at Annual General Meeting: Section 143 of the Companies Act, 2013 confers right on the auditor to attend the general meeting.
- The said section provides that all notices and other communications relating to any general meeting of a company also to be forwarded to the auditor. Further, it has been provided that the auditor shall be, unless otherwise exempted, entitled to attend any general meeting and to be heard at such general meeting which he attends on any part of the business which concerns him as an auditor.
- Therefore, the section does not cast any duty on the auditor to attend the annual general meeting. The law only confers right on the auditor to receive notices and also attend the meeting if he so desires. Therefore, the complaint filed by the Board of Directors is based on mis-conception of the law.

Case Study

- M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised nonprofit organisation feels that the standards on auditing need not to be applied as Goodwill Education Foundation is a non-profit making concern.

Answer

- Compliance with Standards on Auditing : As per sub section 9 of section 143 of the Companies Act, 2013, every auditor shall comply with the auditing standards. Further as per sub section 10 of section 143 of the Act, the Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority:
- Provided that until any auditing standards are notified, any standard, or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.
- Further, the Preface to Standards on Auditing gives the scope of the Standards on Auditing. As per the Preface, the SAs will apply whenever an independent audit is carried out; that is, in the independent examination of financial statements/information of any entity; whether profit oriented or not and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.
- Also while discharging their attest function; it is the duty of the Chartered Accountant to ensure that SAs are followed in the audit of financial information covered by their audit reports.
- In the given case, even though the client is a non-profit oriented entity the SAs shall apply and the auditor shall be guilty of professional misconduct for failing to discharge his duty in case of non-compliance with SAs.

Case Study

- M/s Renault & Co., Chartered Accountants, appointed as a statutory auditor of R Ltd. for the financial year 2013-14. The company is also in need of some actuarial services. Consequently, the Board of Directors of the company offered the same to M/s Sona & Co., an associate to M/s Renault & Co., which has been duly accepted by the firm. Comment.

Answer

- **Services Not To Be Rendered By Auditor:** This provision is newly inserted by section 144 of the Companies Act, 2013. Section 144 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely
- (i) accounting and book keeping services;
- (ii) internal audit;
- (iii) design and implementation of any financial information system;
- (iv) actuarial services;
- (v) investment advisory services;
- (vi) investment banking services;
- (vii) rendering of outsourced financial services;
- (viii) management services; and
- (ix) any other kind of services as may be prescribed.
- Further section 141(3)(i) of the Companies Act, 2013 also disqualify a person for appointment as an auditor of a company whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.
- Additionally, in accordance with section 141(4) of the Act, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.
- In the given case, M/s Renault & Co., Chartered Accountants, was appointed as an auditor of R Ltd. Further, the company offered actuarial services to M/s Sona & Co., an associate to M/s Renault & Co., which has also been duly accepted by the firm. Therefore, M/s Renault & Co. is disqualified to hold office as an auditor of R Ltd. under section 141(3)(i), as its associate is involved in providing such services, to R Ltd., as mentioned in section 144 of the Companies Act, 2013.
- Subsequently, M/s Renault & Co. shall have to vacate the office of auditor of R Ltd. accordingly.

Case Study

- Navy and Cavy Associates, a Chartered Accountant firm, has been appointed as Statutory Auditor of Poor Ltd. for the financial year 2013-2014. Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, is indebted for ` 6,00,000 to Wealthy Ltd., a subsidiary company of Poor Ltd. Comment.

Answer

- **Indebtness to the Subsidiary Company:** As per sub-section (3)(d)(ii) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ` 5 lakhs.

- Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor

- In the present case, Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd., a subsidiary company of Poor Ltd., for ` 6 lakhs.

- Therefore, the firm, Navy and Cavy Associates would be disqualified to be appointed as statutory auditor of Poor Ltd. as per section 141(3)(d)(ii), which is the holding company of Wealthy Ltd., because Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd. for an amount exceeding the minimum approved limit.

Case Study

- Orange Ltd. is an unlisted public company. Its balance sheet shows paid up share capital of ` 5 crore and public deposits of ` 100 crore. The company appointed M/s Santra & Co., a chartered accountant firm, as the statutory auditor in its annual general meeting held at the end of September, 2014 for 11 years. You are required to state the provisions related to- rotation of auditor and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions.

Answer

- **Rotation of Auditor & Cooling Off Period Provisions:** The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under:

Class of Companies for Rotation of Auditor

↓

including Listed Companies

+

excluding OPC (One Person Company) and Small Companies

- **All unlisted public companies having paid up share capital ≥ ` 10 crore**

- **All private limited companies having paid up share capital ≥ ` 20 crore**

- **All companies having paid up share capital of below threshold limit mentioned, but having public borrowings from financial institutions, banks or public deposits ≥ ` 50 crore**

- As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

- (a) an individual as auditor for more than one term of 5 consecutive years; and

- (b) an audit firm as auditor for more than two terms of 5 consecutive years.

- In the given case, Orange Ltd. is an unlisted public company having paid up share capital of ` 5 crore and public deposits of ` 100 crore. The company has appointed M/s Santra & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2014 for 11 years.

- The provisions relating to rotation of auditor will be applicable as the public deposits exceeds ` 50 crore. Therefore, Orange Ltd. can appoint M/s Santra & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Santra & Co. shall hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2019 and thereafter can be re- appointed as auditor for one more term of five years i.e. upto year 2024. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s Santra & Co. made by Orange Ltd. for 11 years is void.

- **Cooling off period:** As per the proviso to section 139(2) of the Companies Act, 2013-

- (1) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of his term;

- (2) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such term.

- Therefore, M/s Santra & Co. shall not be re-appointed as Auditor in Orange Ltd. for further term of 5 years i.e. upto year 2029.

Case Study

- Mr. Pratiq, a practicing Chartered Accountant, has been appointed as an auditor of Opus Ltd. He is holding securities of the company having face value of ` 89,000 only.

- (i) You are required to state, whether Mr. Pratiq is qualified to be appointed as an auditor of Opus Ltd.

- (ii) Would your answer be different, if instead of Mr. Pratiq; Mr. Quresh, the step- father of Mr. Pratiq, is holding the securities?

Answer

- **Disqualification due to Holding of Securities:** According to section 141(3)(d)(i) of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors)Rules 2014, an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

- However, as per the proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of ` 1,00,000.

- Further, the term "relative" has been defined under the Companies Act, 2013 which means anyone who is related to another as members of a Hindu Undivided Family; husband and wife; Father (including step- father), Mother (including step-mother), Son (including step- son), Son's wife, Daughter, Daughter's husband, Brother (including step- brother), Sister (including step- sister).

- In the present situation,

  - (i) Mr. Pratiq is holding securities in Opus Ltd., which is not allowed as per the provisions of section 141(3)(d)(i) of the Act. Therefore, Mr. Pratiq will be disqualified to be appointed as an auditor of Opus Ltd.

- (ii) Mr. Quresh, the step-father of Mr. Pratiq, is holding the securities in Opus Ltd.

  - It may be noted that step-father is included in the definition of the term "relative" as per the Companies Act, 2013. Further, proviso to section 141(3)(d)(i) of the Act allows a relative of the auditor to hold securities in the company of face value not exceeding of ` 1,00,000.

  - Here, Mr. Quresh is holding securities for face value of ` 89,000 which is below the limit as prescribed under the said proviso.

  - Therefore, Mr. Pratiq will not be disqualified to be appointed as an auditor of Opus Ltd.

Case Study

- Zank Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the current account and as per the requirements of funds, the flexi deposits are encashed and transferred to current accounts. As of 31st March, 2014 certain cheques issued to vendors are not presented for payment resulting in the credit balance in the books of the company. The management wants to present the book overdraft under current liabilities and flexi deposits under cash & bank balances.

Answer

- The composite bank balance including the balance in flexi deposit accounts are positive, even though physical set-off has not been made as on the balance sheet date.

- Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set-off from the flexi deposit accounts.

- The disclosure of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct.

Case Study

- Mr. SB, a practicing Chartered Accountant, was appointed by CON Ltd. as Statutory Auditor. While doing the audit of CON Ltd., Mr. SB observed that certain loans and advances were made without proper securities; certain trade receivables and trade payables were adjusted *inter se*; and personal expenses were charged to revenue.

Answer

- **Enquiring into Certain Matters:** Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein.

- Clause (a) of Section 143(1) requires the auditor to enquire: "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 prejudicial to the interests of the company or its members"

- If the auditor finds that the loans and advances have not been properly secured, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of part I of Schedule III to the Companies Act. Further the auditor needs to enquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report.

- If trade receivables and trade payables are adjusted *inter se*, this amounts to merely book entries. The auditor, as per clause (b) of section 143(1), should enquire "whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company". This proposition has got to be enquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards.

- Regarding Personal Expenses, Clause (e) of section 143(1) requires the auditor to enquire "Whether personal expenses have been charged to revenue account". The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also.

- In the instant case, Mr. SB, the statutory auditor of CON Ltd., needs to enquire in the light of above provisions. If, as a result of the enquiries, he is satisfied then there is no further duty to report on these matters and if not, then he may report accordingly.

Case Study

- Gracious Ltd. has made a contribution of ` 7.8 lacs during the financial year ended 31.3.14 to Samaj Seva Party, a political party, for running a teaching institute situated in the rural area, where most of the workers of the company reside. It is admitted that the benefit of the institute is mostly for the children of the workers of the company. The average net profit of the company during the three immediately preceding financial years was ` 100 lakhs.

Answer

- **Restrictions Regarding Political Contribution:** Section 182 of the Companies Act, 2013 deals with prohibitions and restrictions regarding political contributions. According to this section, a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party. In other cases, aggregate contribution in any financial year should not exceed 71/2 % of average net profit during the three immediately preceding financial years.

- In the given case, Gracious Ltd. has made a contribution of ` 7.8 lacs to Samaj Seva Party, a political party. The average net profit of the company during the three immediately preceding financial years is ` 100 lakhs and the 71/2 % of this works out to ` 7.5 lacs.

- As the company has contributed ` 7.8 lacs, there is a violation of the provisions of Section 182 of the Companies Act, 2013 although the children of its workers are benefited. Therefore, the auditor would have to qualify his report accordingly.

Case Study

- Mr. Man is a whole-time director of Manthan Ltd. who has a very good relation with the Director (Operations) of the company. Consequently, he entered into a purchase contract for supply of goods of ` 5,00,000 with the company without obtaining prior consent of the Board. What is the responsibility of the auditor in relation to the Companies Act, 2013?

Answer

- **Responsibility of Auditor in Relation to the Companies Act, 2013:** As per Section 188 of the Companies Act, 2013, no company shall enter into any contract or arrangement with a related party to sale, purchase or supply of any goods or materials, except with the consent of the Board of Directors given by a resolution at a Board Meeting. Further, it is provided that no contract or arrangement, in the case of a company having specified paid-up share capital, or transactions exceeding prescribed sum, shall be entered into except with the prior approval of the company by a special resolution.

- The contracts or arrangements mentioned above are those for which the register(s) are maintained under section 189 of the Companies Act, 2013 .The scope of the auditor's inquiry under this clause is restricted to such transactions referred to in sections 184 and 188 of the Act.

- The auditor should, while reporting, in the first instance, determine whether the aggregate value of all the transactions entered into with any of the companies/firms/parties covered in the register maintained under section 189 of the Act exceed the value of rupees five lakhs in the year. If so, the auditor has to examine whether each of the transactions entered into with such a company/firm/party have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. Further, the auditor while reporting should clearly bring out the reasons as to why no adverse comment was considered necessary.

- The contracts referred to in section 188 are for sale, purchase or supply of any goods, materials or services and contract of underwriting the subscription of any securities or derivatives of the company between a Company and its director or, its relative, a firm in which the director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director. The auditor will have to obtain the list of such parties which are covered by section 188 mentioned above.

- Hence, the auditor should ensure that all the above mentioned provisions have been compiled with.

Case Study

- PK Ltd. has taken a term loan from a nationalized bank in 2012 for ` 350 lakhs repayable in 7 equal yearly instalments (including interest) of ` 50 lakhs beginning from 31st March, 2013 onwards. It had repaid the instalments due in 2013 & 2014, but defaulted in repayment of principal as well as interest for the current financial year 2015. Discuss the reporting responsibilities of the auditor of PK Ltd. in accordance with the Companies Act, 2013.

Answer

- **Reporting Requirement as per Schedule III to the Companies Act, 2013:** As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of term loans and other loans is required to be disclosed in the notes to accounts. It also requires specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in each case.

- In the given case, PK Ltd. has taken a loan from a nationalized bank three years back in 2012. It was regular in payment of instalments (including interest) for last two years but defaulted for the current financial year 2015. Therefore, it needs to be reported in the notes to accounts.

- The draft report for above matter is as under:

  - *"PK Ltd. has taken a loan during the year 2012, from a nationalized bank amounting to ` 350 lakhs @ X% p.a. which is repayable by yearly installment of ` 50 lakhs for 7 years.*

  - *The company has defaulted in repayment of dues including interest to a nationalized bank during the financial year 2014-15 amounting to ` 50 lakhs which remained outstanding as at March 31, 2015."*

Case Study

- A Chartered Accountant in practice has been appointed as an auditor of a company which raised finance from the capital market on the basis of a prospectus issued a few years back. The main object for raising the finance was specified to be setting up a project on information technology.

- The company advanced the sum so raised to various firms and private companies in which the directors of the company were a partner or a director respectively. These parties had no standing whatsoever with information technology. In the Balance Sheet, these advances appeared as a current asset under the head "Short-term Loans and Advances – unsecured, considered good". There was no mention to the notes to accounts about nature and purpose of such advances; and the auditor has issued routine audit report without any qualifications. On the very next day to the issuance of audit report, the directors and their related parties gone disappeared. The company, in which the auditor was conducting audit, has just vanished.

- You are required to state whether the auditor will be held guilty for professional misconduct? Is there any liability subsists under any law?

Answer

- **Liability for Misconduct:** Schedule III to the Companies Act, 2013 requires specific disclosure of loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member. Thus, the company has failed to comply with the requirements of Schedule III vitiating true and fair view.

- Further, the Companies Act, 2013 specifically deals with transactions in which particular directors are interested. Section 188 specifies that Board's consent is required for certain contracts to be entered into with related parties. Section 184 requires disclosure of interest by director and also lays down the procedure to be followed in this regard. Section 189 of the Companies Act, 2013 requires that every company shall keep one or more registers in which particulars of all contracts or arrangements, to which Section 184 or Section 188 applies, shall be entered separately.

- Thus, it is quite natural that all these particulars should have been recorded in such registers since the company advanced monies to various parties "related" to directors.
- In the given case, the company has advanced the sum to the parties that are related to the Directors of the company and showed the same under the head "Short-term Loans and Advances – unsecured, considered good" rather than specific disclosure under the notes to accounts. The auditor of the company also issued clean audit report without any qualifications. It appears that the auditor did not perform his duties properly.
- Therefore, as per the explanation provided above, the auditor has specific obligation to report under the Companies Act, 2013. Thus, he is liable under the Companies Act, 2013 and may be penalized under section 147 since he has performed his duties in a negligent manner. Further, the auditor would also be held guilty for professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Case Study

- You are required to elucidate the functions of the Audit Committee as per section 177 of the Companies Act, 2013.

Answer

- **Functions of the Audit Committee as per Section 177 of the Companies**
- The Audit Committee performs various important functions like investigating the matters referred by board, discuss about internal control system etc. Section 177 of the Companies Act, 2013 deals with the terms of reference as well as functions of the audit committee which are as under:
- (A) As per Section 177(4), every Audit Committee shall act according to the terms of reference specified in writing by the Board which includes—
  - (1) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
  - (2) review and monitor the auditor's independence and performance, and effectiveness of audit process;
  - (3) examination of the financial statement and the auditors' report thereon;
  - (4) approval or any subsequent modification of transactions of the company with related parties;
  - (5) scrutiny of inter-corporate loans and investments;
  - (6) valuation of undertakings or assets of the company, wherever it is necessary;
  - (7) evaluation of internal financial controls and risk management systems;
  - (8) monitoring the end use of funds raised through public offers and related matters.
- (B) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial

statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

- (C) The Audit Committee shall have authority to investigate into any matter in relation to the items specified referred above to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

- (D) Every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed.

Case Study

- Disgust Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slowdown in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee.

Answer

- **Holding of Meeting and Review Requirements as per Clause 49 of the (SEBI) Listing Agreement:** One of the requirement as stipulated under clause 49 **[Clause 49 (III) (B)]** (on which Section 177 of the Companies Act, 2013 relating to audit committee, is silent) is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings.

- The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

- In this case, Disgust Limited is a company incorporated in India and have 6 members in it's Audit Committee. Contention of audit committee members to meet only once due to recessionary conditions in India, at the year end is not in line with the clause 49 of the (SEBI) Listing Agreement .

- Besides, there is a mandatory review requirement as per Clause 49 (III) (E), according to which the Audit Committee shall mandatorily review the following information:

- (1) Management discussion and analysis of financial condition and results of operations;

- (2) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

- (3) Management letters / letters of internal control weaknesses issued by the statutory auditors;

- (4) Internal audit reports relating to internal control weaknesses; and

- (5) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

- In the instant situation, though, the Audit Committee has reviewed monthly information system, but, failed to comply with the above requirements mentioned at point no. 1 to 5 of Clause 49 (III) (E) of Listing Agreement.

Case Study

- H Ltd. owns 55% voting power in S Ltd. It however holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. H Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

Answer

- **Consolidation of Financial Statement:** AS 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when:
- (i) Control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future; or
- (ii) Subsidiary operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent.
- Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares held as 'stock-in-trade' are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".
- However, as per Section 129(3) of the Companies Act, 2013 read with Rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.
- In this case, H Ltd's intention is to dispose off the shares in the near future as shares are being held as 'stock in trade' and it is quite clear that the control is temporary, however for the compliance of provisions related to consolidation of financial statements given under the Section 129(3) of the Companies Act, 2013 read with Companies (Accounts) Rules, 2014, H Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the Act.

Tax Audit

- the specified number of tax audit assignments that an auditor, as an individual or as a partner of a firm, can accept is 60 numbers. The ceiling limit was increased from 45 to 60 numbers in February, 2014 effective for the audits conducted during the financial year 2014-15 and onwards. ICAI has notified that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments u/s 44AB.

Report Vs Certification .. Auditors' work

- While test checks may suffice in the conduct of a statutory audit for the expression of the auditor's opinion as to whether the accounts depict a 'true and fair' view, the tax auditor may be required to apply reasonable tests on the total information to be prepared by the assessee in respect of certain items in the prescribed form, e.g., in verification of payments for purchases/expenses exceeding ` 20,000/- in cash.

- While the entity may have to prepare the details for the entire year, the tax auditor may have to ensure that no items have been omitted in the information furnished and a reasonable test check would reveal whether or not the information furnished is correct.

- The extent of check undertaken would have to be indicated by the tax auditor in his working papers and audit notes. The tax auditor would be well advised to so design his tax audit programme as would reveal the extent of checking and to ensure adequate documentation in support of the information being certified. [Tax Audit comparison is in a different file]