

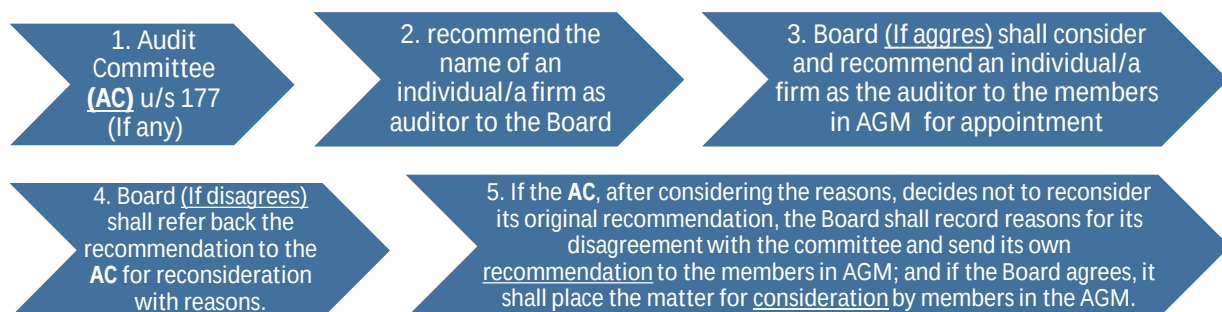
AUDIT OF THE COMPANY

1. Appointment of auditors [Section 139]

I: Appointment of auditor [Section 139(1)]:

- a. Every company shall, at the first annual general meeting, appoint an individual/a firm as an auditor of the company.
- b. The auditor so appointed shall hold office from the conclusion of 1st AGM till the conclusion of 6th AGM.
- c. Manner and procedure of selection and appointment of auditors as per **Rule 3 of the Companies (Audit and Auditors) Rules, 2014** prescribes:
 - (i) **Board or Audit Committee** (if required to constitute):
 - Shall consider qualifications and experience of the individual or the firm proposed
 - Shall consider any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the ICAI or any competent authority or any Court.
 - May call for such other information from the proposed auditor as it may deem fit.

(ii) Procedure:



- d. The company shall place the matter relating to such appointment for ratification by members at every AGM. According to **the Companies (Audit and Auditors) Rules, 2014**, the appointment shall

be subject to ratification in every annual general meeting **till the 6th meeting** by way of passing of an ordinary resolution.

If the appointment is not ratified by the members, the BOD shall appoint another individual/a firm as its auditor(s) after following the procedure laid under the Act.

- e. Written consent of the auditor before such appointment is made (*and*) a certificate* from him/it that the appointment shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

***Certificate by Auditor: Contents** as per the Companies (Audit and Auditors) Rules, 2014, that–

- ✓ the individual/the firm is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules/regulations made thereunder;
- ✓ the proposed appointment is as per the term provided under the Act;
- ✓ the proposed appointment is within the limits laid down by/under the authority of the Act;
- ✓ the list of proceedings against the auditor/audit firm/any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct;
- ✓ whether the auditor satisfies the criteria provided in section 141

- f. The company shall inform the auditor concerned of his/its appointment and also file a notice (in the Form ADT-1) of such appointment with the Registrar **within 15 days** of the meeting in which the auditor is appointed.

II: Terms and Rotation of Auditor [Section 139(2)]:

- a. This section provides that listed companies (*and*) other prescribed* class/classes of companies (except one person companies and small companies) shall not appoint/re-appoint-
- i. an individual as auditor for more than one term of five consecutive years; and
 - ii. an audit firm as auditor for more than two terms of five consecutive years.
- b. *Prescribed companies under **The Companies (Audit and Auditors) Rules, 2014**
- i. all unlisted public companies having paid up share capital (PSC) of **Rs.10 crore or more**;
 - ii. all private limited companies having PSC of **Rs.20 crore or more**;
 - iii. all companies having PSC of below threshold limit mentioned in (i) & (ii) above, but having public borrowings from financial institutions/banks/public deposits of **Rs.50 crores or more**.

c. Cooling off Period [5 years]:

- i. An individual auditor who has completed his term (i.e. 1 term of 5 consecutive years) shall not be eligible for re-appointment as auditor in the same company **for 5 years** from the completion of his term;
 - ii. An audit firm which has completed its term(s) (i.e. 2 terms of 5 consecutive years) shall not be eligible for re- appointment as auditor in the same company **for 5 years** from the completion of such term.
- d. An audit firm having a common partner/partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall not be appointed as auditor of the same company for a period of five years.
- e. **Transitional period:** Every company, existing on/before the commencement of this Act, shall comply with the requirements of this these provisions **within 3 years** from the date of commencement of this provision.
- f. The right of the company to remove an auditor [s.140(1)] or the right of the auditor to resign from such office of the company [s.140(2/3)] shall not be affected by such provisions
- g. Members of a company may resolve to provide that—
- ✓ the auditing partner and his team shall be rotated at such intervals;
 - ✓ the audit shall be conducted by more than one auditor.

Note: Here, the word “firm” shall include a LLP incorporated under the LLP Act, 2008.

III: Appointment of Auditors:

(A) First Auditors:

- a. For Government Company [139(7)]:
 - Includes: i) Government Companies, ii) other companies owned/controlled by CG/SG/jointly by CG and SG
 - Appointment shall be made by CAG within **60 days** of registration of company.
 - If CAG fails to appoint, BOD shall appoint within next **30 days**.
 - If BOD fails to appoint, Members of company shall appoint at EGM within next **60 days**.
- b. For other companies [139(6)]
 - Appointment shall be made by BOD within **30 days** of registration of company.
 - If BOD fails to appoint, Members of company shall appoint at EGM within next **90 days**.

(B) Subsequent Auditors:

a. For Government Company [139(5)]:

- Appointment by CAG within **180 days** from the commencement of financial year.
- Auditor shall hold office till conclusion on of the next AGM.

b. For other companies [139(1)]: already discussed in para 'I' above.

IV: Filling up casual vacancy [Section 139(8)]:

a. **Meaning:** Any vacancy caused by the auditor ceasing to act as such after accepting a valid appointment. *E.g. vacancy due to death, disqualification, resignation etc.*

If there is no valid appointment, then there cannot be a casual vacancy

b. **Manner of filling:**

- In case of companies in which CAG is auditor, it shall be filled by CAG **within 30 days**. If CAG fails, then shall be filled by BOD within **next 30 days**.
- In other case, vacancy shall be filled by BOD **within 30 days**.

Note: Vacancy by resignation of auditor is casual vacancy but same shall be approved by members, within 3 months of recommendation by BOD, at meeting even if it is filled by BOD.

V: Re-appointment of retiring auditor [section 139(9), (10) and (11)]:

a. At any AGM, a retiring auditor may be re-appointed , 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 reappointed; 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.

b. Where at any AGM, no auditor is appointed/re-appointed, the existing auditor shall continue to be the auditor of the company.

2. Removal, resignation of auditor and giving of special notice [Section 140]

I: Removal of auditor before the expiry of his term [Section 140(1)]:

a. Resolution of removal of auditor shall be passed by the Board.

- b. The application shall be made to the CG for approval, **within 30 days** of the resolution passed by the Board, by making an application in Form ADT-2 and shall be accompanied with the prescribed fees.
- c. The auditor may be removed from his office before the expiry of his term only by a special resolution within 60 days of receipt of approval of CG
- d. Before removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

II: Resignation by Auditor [Section 140(2) & (3)]

- a. If the Auditor has resigned from the company, **he** shall **file within 30 days** from the date of resignation, a statement in the form ADT-3 with the i) company and ii) the Registrar.
- b. In case of government companies, the auditor shall also file such statement with the CAG of India also.
- c. The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation, in the statement.
- d. In case of non-compliance, he or it shall be punishable with **fine** which shall not be less than **Rs.50,000** but which may **extend to Rs.5 Lacs**.

III: Appointing Auditor other than the Retiring Auditor [Section 140(4)]

- a. If the retiring auditor has not completed a consecutive tenure of 5 years/10 years, **special notice shall be required** for a resolution at an AGM appointing other person as auditor (or) providing expressly that a retiring auditor shall not be re-appointed.
- b. On receipt of such a notice, the company shall forthwith send a copy thereof to the retiring auditor.
- c. Retiring auditor has right to make representation against his removal and he may request to circulate to the members of the company also, on such request the company shall—
 - i. in any notice of the resolution, state the fact of the representation having been made; and
 - ii. send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before/after the receipt of the representation by the company,
 - iii. If a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may require that the representation shall be read out at the meeting.
- d. If a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

3. Eligibility, qualifications and disqualifications of auditors [Section 141]

I: Qualifications of an auditor [Section 141(1) & (2)]:

- a. Eligible to be appointed as auditor only if he is a CA within the meaning of the Chartered Accountants Act, 1949.
- b. A firm whereof majority of partners practising in India are qualified for appointment as aforesaid.
- c. Where a firm (including a LLP) is appointed as an auditor of a company, only the partners who are CA shall be authorised to act and sign on behalf of the firm.

II: Disqualifications of auditors [Section 141(3)]:

The following persons shall *not be qualified* for appointment as auditor of a company-

1. A body corporate (other than a LLP)
2. an officer/employee of the company;
3. a person who is a partner, or who is in the employment, of an officer/employee of the company;
4. a person who, or his relative* or partner—
 - i. is holding any security of or interest in the ¹*company*/²*its subsidiary*/³*of its holding*/⁴*of its associate company*/⁵*a subsidiary of such holding company*
(* Relative may hold security or interest in the company of face value not exceeding Rs.1,00,000 as prescribed under the rules. If the relative acquires any security or interest above Rs.1 Lac, the corrective action to maintain the limits shall be taken by the auditor within sixty days of such acquisition or interest.)
 - ii. is indebted to the ¹*company*/²*its subsidiary*/³*of its holding*/⁴*of its associate company*/⁵*a subsidiary of such holding company*, **in excess of Rs.5 Lacs**; or
 - iii. has given a guarantee (or) provided any security in connection with the indebtedness of any third person to ¹*company*/²*its subsidiary*/³*of its holding*/⁴*of its associate company*/⁵*a subsidiary of such holding company*, **in excess of Rs.1 Lac**.
5. a person/a firm who, whether directly/indirectly, has business relationship with the ¹*company*/²*its subsidiary*/³*of its holding*/⁴*of its associate company*/⁵*a subsidiary of such holding company*. except –
 - commercial transactions which are in the nature of professional services permitted to be rendered by an auditor/audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
 - commercial transactions which are in the ordinary course of business of the company at arm's length price.

6. a person whose relative is a director (or) is in the employment of the company as a director (or) KMP (key managerial personnel);
7. a person who is in full time employment elsewhere (or) a person/partner of a firm holding appointment as its auditor, if such person/partner is at the date of such (re)appointment holding appointment as auditor of **more than 20 companies** (this limit of 20 is per person);
8. a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction;
9. any person whose subsidiary / associate company / any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

III: Vacation of office by an auditor [Section 141(4)]:

If an auditor of a company incurs any of the disqualifications, he shall be deemed to have vacated his office. Such vacation shall be deemed to be a casual vacancy in the office of the auditor.

4. Remuneration of auditors [Section 142]

- i. The remuneration of the auditors shall be fixed by the company in GM or in such manner as the company in GM may determine.
- ii. In the case of first auditor, remuneration may be fixed by the Board.
- iii. The remuneration mentioned aforesaid shall, **include** the expenses incurred by the auditor in connection with the audit of the company and any facility extended to him. But the remuneration **does not include** any remuneration paid to him for any other service rendered by him at the request of the company.

5. Powers and duties of auditors and auditing standards [Section 143]¹

I: Powers of Auditors [Section 143(1)]:

- a. **Access to books of accounts:** Every auditor of a company shall have a right of access at all times to the books of accounts and vouchers of the company, whether kept at the registered office of the company or at any other place.

¹ This section shall mutatis mutandis apply to cost auditor [S.148] and secretarial auditor [S.204]

- b. **Entitled to have necessary information and explanation:** He shall be entitled to require from the officers of the company such information and explanations as the auditor may consider necessary for the performance of his duties as auditor.
- c. **Matters of inquiry:** The auditor may also inquire into the following matters, namely:—
1. Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms are prejudicial to the interests of the company/members;
 2. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
 3. Where the company not being an investment company 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 purchase price;
 4. Whether loans and advances made by the company have been shown as deposits;
 5. Whether personal expenses have been charged to revenue account;
 6. Where it is stated in the books 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 books and the BS is correct, regular and not misleading:
- d. **Access to record of all its subsidiaries:** The auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its FS with that of its subsidiaries.

II: Duties of auditors [Section 143(2), (3) and (4)]

- a. **Duty to report:** The auditor shall make a report to the members of the company on:
- ✓ On the accounts examined by him; and
 - ✓ On every FS which are required by or under this Act to be laid before the company in GM;
- b. While making the report shall take into account the provisions of the Act, the accounting and auditing standards and other matters which are required to be included in the audit report.
- c. The auditor shall express his opinion of the accounts and FS examined by him w.r.t. give a true and fair view of i) the state of the company's affairs as at the end of its financial year, ii) profit/loss iii) cash flow for the year and iv) such other matters as may be prescribed.
- d. The auditors' **report shall also state [report on principal assertion] [May 2015]—**
(Where any of the following matters is answered in the negative, the report shall state the reason for the same.)
1. 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;

2. whether proper books of account as required by law have been kept by the company so far as appears from his examination of those books;
 3. proper returns and reports adequate for the purposes of his audit have been received from branches;
 4. whether the BS and P&L account dealt with in the report are in agreement with the books of account and returns;
 5. whether the FS comply with the ASs;
 6. the observations/comments on financial transactions or matters which have any adverse effect on the functioning of the company;
 7. whether any director is disqualified from being appointed u/s 164(2);
 8. any qualification/reservation/adverse remark relating to the maintenance of accounts and other matters;
 9. whether adequate IFCS (internal financial controls system) has in place (and) the operating effectiveness of such controls;
 10. such other matters as prescribed:
 - ✓ whether the company has disclosed the impact of pending litigations its financial statement;
 - ✓ whether the company has made provision, as required by law or accounting standards, on long term contracts (including derivative contracts);
 - ✓ whether there has been any delay in transferring amounts to the IEPF (Investor Education and Protection Fund).
- e. **Compliance with SAs:** Every auditor shall comply with the standards on auditing (SAs), which may be prescribed by CG, as recommended by ICAI, in consultation with and after examination of the recommendations made by NFRA (National Financial Reporting Authority).

III: Reporting of frauds by auditors [Section 143(12)]:

- a. **Procedure (as mentioned in the Companies (Audit and Auditors) Rules, 2014):** If an auditor of a company has reason to believe that an offence involving fraud is being or has been committed against the company by officers/employees of the company, he shall immediately report the matter to the CG immediately but **not later than 60 days of his knowledge**.
 1. Auditor shall forward his report to the Board/the Audit Committee, immediately after he comes to knowledge of the fraud, seeking their reply/observations **within 45 days**;
 2. on receipt of such reply/observations the auditor shall forward his report with the reply/observations alongwith his comments to CG **within 15 days** of receipt of such reply/observations;
 3. In case auditor fails to get any reply/observations within 45 days, he shall forward his report to CG alongwith a note containing the details that report was earlier forwarded to the Board/Audit Committee for which he failed to receive any reply within time.

4. The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with A.D. or by Speed post followed by an e-mail in confirmation of the same.
 5. The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number
 6. Signed by the auditor with his seal and shall indicate his Membership Number.
 7. The report shall be in the form of a statement as specified in Form ADT-4.
- b. **Penalty:** If any auditor, cost auditor or secretarial auditor do not comply with these provisions, he shall be punishable with **fine** which shall **not be less than Rs.1 Lacs** but which may **extend to Rs.25 Lacs**.

6. Audit of Government Companies [Section 143(5), (6) & (7)]²

- a. In the case of a Government company, the CAG of India shall appoint the auditor and-
 1. Direct auditor the manner in which the accounts are required to be audited and;
 2. The auditor so appointed shall submit a copy of the audit report to CAG of India.
- b. The audit report include the following:
 1. the directions, if any, issued by CAG of India,
 2. the action taken thereon and
 3. its impact on the accounts and financial statement of the company.
- c. CAG of India shall **within 60 days** from the date of receipt of the audit report **have a right to,—**
 1. Conduct a supplementary audit of the FS of the company-
 - i. by such person/persons as he may authorise in this behalf;
 - ii. for the purposes of such audit, CAG may authorise such persons to obtain such information
 - iii. as CAG of India may direct; and
 2. Comment upon or supplement such audit report.
 3. Any comments given/supplement shall be sent by the company to every person entitled to copies of audited financial statements (and) also be placed before the AGM of the company.
- d. **Test Audit:** For Government Company, CAG of India may cause test audit to be conducted of the accounts of such company. The provisions of section 19A of CAG's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of test audit.

² This section shall mutatis mutandis apply to cost auditor [S.148] and secretarial auditor [S.204]

7. Audit of accounts of branch office of company [Section 143(8)]³

- a. **Branch office in India:** The accounts of that office shall be audited either by:
- the company's auditor appointed u/s 139, or
 - by any other person qualified for appointment as an auditor of the company u/s 139.
- b. **Branch office 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.
- c. The duties and powers of the company's auditor shall be as contained in section 143 (1) to (4).
- d. **Report of Branch Auditor:**
- 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.

8. Auditor not to render certain services [Section 144]

I: Prohibited services: An auditor shall provide to the company only such services as are approved by the Board of Directors/the audit committee. But such services shall not include any of the following services namely:—

- ✓ Accounting/book keeping services;
- ✓ Internal audit;
- ✓ Design and implementation of any financial information system;
- ✓ Actuarial services;
- ✓ Investment advisory services;
- ✓ Investment banking services;
- ✓ Rendering of outsourced financial services;
- ✓ Management services; and
- ✓ Any other kind of services as may be prescribed.

II: Transition period: If an auditor/audit firm has been performing any non-audit services on/before the commencement of the Act, shall comply with the provisions of this section before the closure of the 1st financial year after the date of such commencement.

³ This section shall mutatis mutandis apply to cost auditor [S.148] and secretarial auditor [S.204]

9. Auditors to sign audit reports, etc. [Section 145]

- a. 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
- b. The qualifications/observations/comments on financial transactions or matters shall be-
 - read before the company in general meeting and
 - open to inspection by any member of the company.

10. Auditors to attend general meeting [Section 146]

- a. All notices and other communications relating to any GM shall be forwarded to the auditor.
- b. The auditor shall attend any GM either by himself or through his authorised representative, who shall also be qualified to be an auditor, unless exempted by the company.
- c. The auditor shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

11. Punishment for contravention [Section 147]

I: Penalty on company [Section 147(1)]:

If any of the provisions of sections 139 to 146 is contravened, the company shall be punishable with **fine** which shall **not be less than Rs.25,000** but which may **extend to Rs.5 Lacs**.

II: Penalty on officers [Section 147(1)]:

If any of the provisions of sections 139 to 146 is contravened, every officer of the company who is in default shall be punishable with

- (1) **Imprisonment** for a term which may **extend to 1 year** or
- (2) With **fine** which shall **not be less than Rs.10,000** but which may **extend to Rs.1 Lacs**; or
- (3) **Both** with imprisonment and fine.

III: Penalty on auditor [Section 147(2) & (3)]:

- a. If an auditor of a company contravenes any of the provisions of section 139, 143, 144 or 145, the auditor shall be punishable with **fine** which shall **not be less than Rs.25,000** but which may **extend to Rs.5 Lacs**.
- b. 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
 - i. **imprisonment** for a term which may extend to **1 year** and
 - ii. **fine** which shall **not be less than Rs.1 Lac** but which may **extend to Rs.25 Lacs**.
- c. Also he shall be liable to—
 - i. refund the remuneration received by him to the company; and
 - ii. pay for damages to the company, statutory bodies/authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.