



# AUDIT AND AUDITORS

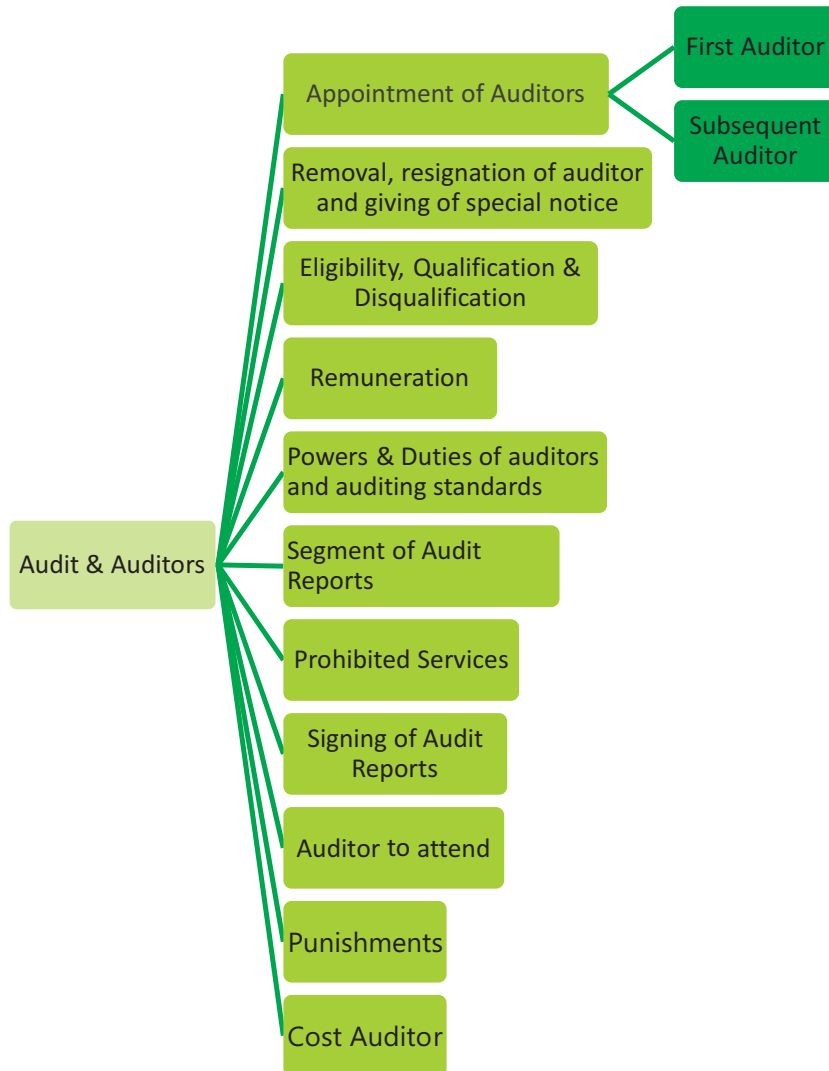


## LEARNING OUTCOMES

After studying this unit, you would be able to :

- Understand the procedure for appointment of auditors, their removal, resignation, eligibility, qualifications, disqualifications and remuneration
- Know the powers and duties of auditors and auditing services
- Know about certain services which an auditor cannot render
- Know the provisions relating to power of auditor to sign audit reports, to attend general meetings

## CHAPTER OVERVIEW



## 1. INTRODUCTION

Large business corporations are managed by the directors who represent the members who are the real owners of the company. In the absence of any check the directors may mismanage the finances of the organisation. Thus, members appoint auditor to look into the true and fair view of the financial affairs of the company. These auditors are independent from the management of the company and hence can express an unbiased opinion.



## 2. APPOINTMENT OF AUDITORS [SECTION 139]

Section 139 of the Companies Act, 2013 provides for appointment of auditors. According to this section :

### (i) Appointment of auditor [Section 139(1)] :

- (a) Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor of the company.
- (b) The auditor shall hold office from the conclusion of 1<sup>st</sup> annual general meeting (AGM) till the conclusion of its 6<sup>th</sup> AGM and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at AGM has been prescribed under the *Companies (Audit and Auditors) Rules, 2014*. According to the Rules:
- (c) Manner and procedure of selection and appointment of auditors :
  - (1)

Categories of Companies	Competent authority	Responsibility of the competent authority
A company which is required to constitute an Audit Committee under section 177 <sup>1</sup>	Audit Committee	(i) The competent authority shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.
A Company which is not required to constitute an Audit Committee under section 177	Board	

### 1 Companies that require to constitute an audit committee

For the purpose of constitution of Audit Committee section 177 of the Act read with *Companies (Meetings of Board and its Powers) Rules, 2014* provides that :

The Board of directors of every listed companies and the following classes of companies shall constitute an Audit Committee of the Board—

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

**Explanation :** 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 this rule.

		<p>(ii) It shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.</p> <p>(iii) It may call for such other information from the proposed auditor as it may deem fit.</p>
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(2)

Categories of Companies	Competent authority	Responsibility of the competent authority
A company which is required to constitute an Audit Committee under section 177	Audit Committee	the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration
A Company which is not required to constitute an Audit Committee under section 177	Board	the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment

- (3) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the AGM.
- (4) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- (5) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual

general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.

- (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 6<sup>th</sup> meeting by way of passing of an ordinary resolution.

If the appointment is not ratified by the members of the company, 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.

- (e) Before the appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

**Certificate by Auditor :** *The Companies (Audit and Auditors) Rules, 2014* provides the content of the Certificate. According to this, the auditor appointed shall submit a certificate that—

- (A) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
  - (B) the proposed appointment is as per the term provided under the Act;
  - (C) the proposed appointment is within the limits laid down by or under the authority of the Act;
  - (D) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.
- (f) The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 [Section 141 provides provisions on eligibility, qualification and disqualification of Auditor which will be discussed later]
- (g) **Communication to Auditor :** Further, the company shall inform the auditor concerned of his or 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

Here, "appointment" includes reappointment.

### (ii) Term of Auditor [Section 139(2)] :

- (a) Section 139(2) provides that listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or 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.
- (b) Rule 5 of the *Companies (Audit and Auditors) Rules, 2014* has prescribed the following classes of companies for the purposes of section 139(2) :

(1)	all unlisted public companies having paid up share capital of rupees 10 crore or more;
(2)	all private limited companies having paid up share capital of rupees 20 crore or more;
(3)	all companies having paid up share capital of below threshold limit mentioned in (2) and (3) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crores or more.

(c) **Cooling off Period :**

- (1) An individual auditor who has completed his term (i.e. one term of five consecutive years) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;
- (2) An audit firm which has completed its term (i.e. two terms of five consecutive years) shall not be eligible for re- appointment as auditor in the same company for five years from the completion of such term.

**Example :** XYZ Ltd. which is a listed company appoints Mr. Raghav as an auditor in its AGM dated 29th September, 2016. Mr. Raghav will hold office of Auditor from the conclusion of this meeting upto conclusion of sixth AGM i.e. AGM to be held in the year 2021. Now as per sub-section (2), Mr. Raghav shall not be re-appointed as Auditor in XYZ Ltd. for further term of five years i.e. he cannot be appointed as Auditor upto year 2026.

**Example :** XYZ Ltd. which is a listed company appoints M/s Raghav & Associates as an audit firm in its AGM dated 29th September, 2016. M/s Raghav & Associates will hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2021. Now as per sub-section (2), M/s Raghav & Associates can be appointed or re-appointed as auditor for one more term of five years i.e. upto year 2026. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years i.e. upto year 2031.

- (d) Further, as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

**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 2016 to year 2026. Now, if Golden Smith Ltd. wants to appoint M/s 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 2031. After 5 years Golden Smith Ltd. may appoint M/s Kukreja & Associates as its auditors.

- (e) **Transitional period :** 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 requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act.”
- (f) It is also provided that nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

**(iii) Rotation of auditor [section 139(3) and (4)] :**

- (a) Members of a company may resolve to provide that—
  - (1) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
  - (2) the audit shall be conducted by more than one auditor.
- (b) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.
- (c) Manner of rotation of auditors by the companies on expiry of their term as provided under the *Companies (Audit and Auditors) Rules, 2014* :
  - (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
  - (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.
  - (3) For the purpose of the rotation of auditors—
    - (i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for

calculating the period of five consecutive years or ten consecutive years, as the case may be;

- (ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

The term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

- (iii) For the purpose of rotation of auditors,-
- (A) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
- (B) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

#### Illustration explaining rotation in case of individual auditor :

Number of consecutive years for which an individual auditor 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 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
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

Here,

- (a) Individual auditor shall include other individuals or firms whose name or trade mark or brand is used by such individual, if any.



- (b) Consecutive years shall mean all the preceding financial years for which the individual auditor has been the auditor until there has been a break by five years or more.

**Illustration explaining rotation in case of audit firm**

<b>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)]</b>	<b>Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)</b>	<b>Aggregate period which the firm would complete in the same company in view of column I and II</b>
<b>I</b>	<b>II</b>	<b>III</b>
10 years (or more than 10 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 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 year	9 years	10 years

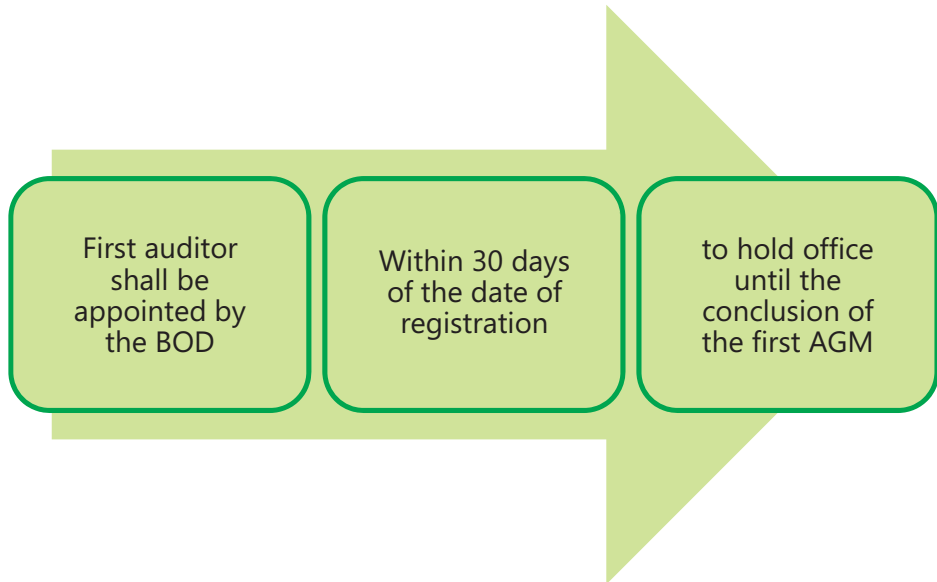
Here,

- (a) Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.
- (b) Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.
- (4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

- (d) Here, the word “firm” shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008.

**(iv) First auditors [Section 139(6)] :**

- (a) Notwithstanding anything contained in sub-section (1), 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; and the auditor so appointed shall hold office until the conclusion of the first annual general meeting.



- (b) If the Board fails to exercise its powers i.e. appointment of first auditor, it shall inform the members of the company and the company may appoint the first auditor within 90 days at an extra ordinary general meeting and such auditor shall hold office till the conclusion of the first annual general meeting.

**Example :** 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 : Provisions and Explanation :** Section 139(6) of the Companies Act, 2013 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 of the company.

**Conclusion :** In view of the above, the Managing Director of PQR Ltd should be advised not to appoint the first auditor of the company.

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

- (a) The Board may fill any casual vacancy in the office of an auditor within 30 days but where such vacancy is caused by 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.
- (b) Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

## Casual vacancy of Auditor

Filling the casual vacancy by Board within 30 days

if vacancy is caused by Resignation-appointment by Board shall also be approved by company at GM convened within 3 months of recommendation of Board

the Auditor so appointed shall hold office until the conclusion of next AGM

**Example :** Prakash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2016. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2016 for personal reasons. The Board of directors seeks advice for filling up the vacancy by appointment of Mr. Albert as auditor.

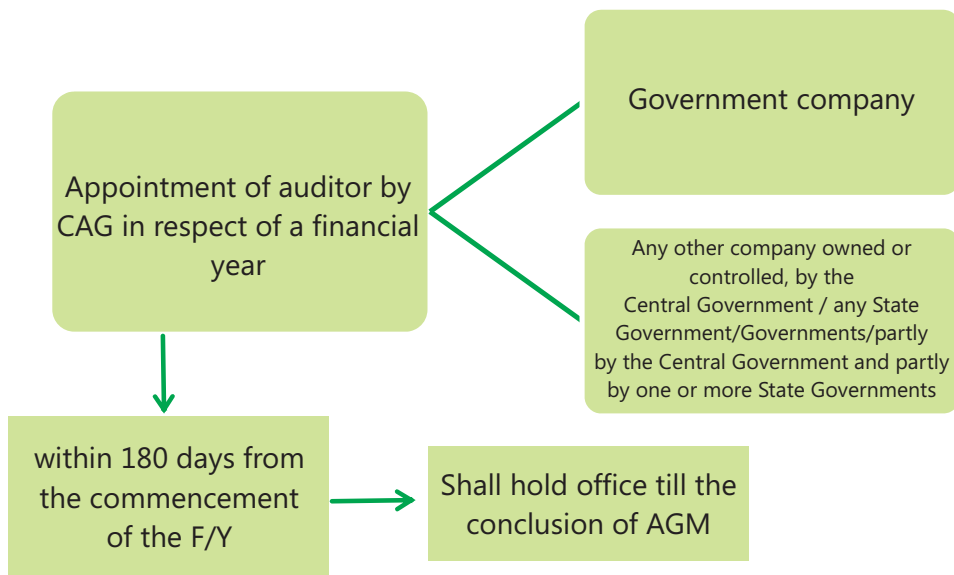
In the present case, as the auditor has resigned, the casual vacancy so created can be filled up by the Board appointing Mr. Albert. However, the appointment of Mr. Albert must be approved by the company by passing of an ordinary resolution at a general meeting of the company which must be convened by the Board within 3 months of the recommendation of the Board. Mr. Albert will be entitled to hold office till the conclusion of the next Annual General Meeting.

**(vi) Appointment of auditors in case of Government Company or any other company having controlled by State Government or Central Government [Section 139(5), 139(7) and 139(8)]**

- (a) As per section 139(5), the Comptroller and Auditor-General of India shall, in

respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act in the case of:

- (1) a Government company; or
  - (2) 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,
- (b) The auditor shall be appointed within a period of 180 days from the commencement of the financial year. The auditor appointed shall hold office till the conclusion of the annual general meeting.



(c) **First auditor [section 139(7)] :**

- (1) 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 first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.
- (2) In case the Comptroller and Auditor-General of India does not appoint first auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next 30 days.
- (3) Further, in the case of failure of the Board to appoint such auditor within the next 30 days, it shall inform the members of the company who shall appoint such auditor within the 60 days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

**(d) Casual vacancy [section 139(8)] :**

- (1) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, casual vacancy of an auditor be filled by the Comptroller and Auditor-General of India within 30 days.
- (2) In case the Comptroller and Auditor-General of India do not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.

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

- (a) At any annual general meeting, a retiring auditor may be re-appointed at an AGM, if—
  - (1) he is not disqualified for re-appointment;
  - (2) he has not given the company a notice in writing of his unwillingness to be re-appointed; and
  - (3) 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 annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

**(viii) Audit committee's recommendation [Section 139(11)] :**

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.



### **3. REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE [SECTION 140]**

Section 140 of the Companies Act, 2013 provides for removal, resignation of auditor and giving of special notice. According to this section :

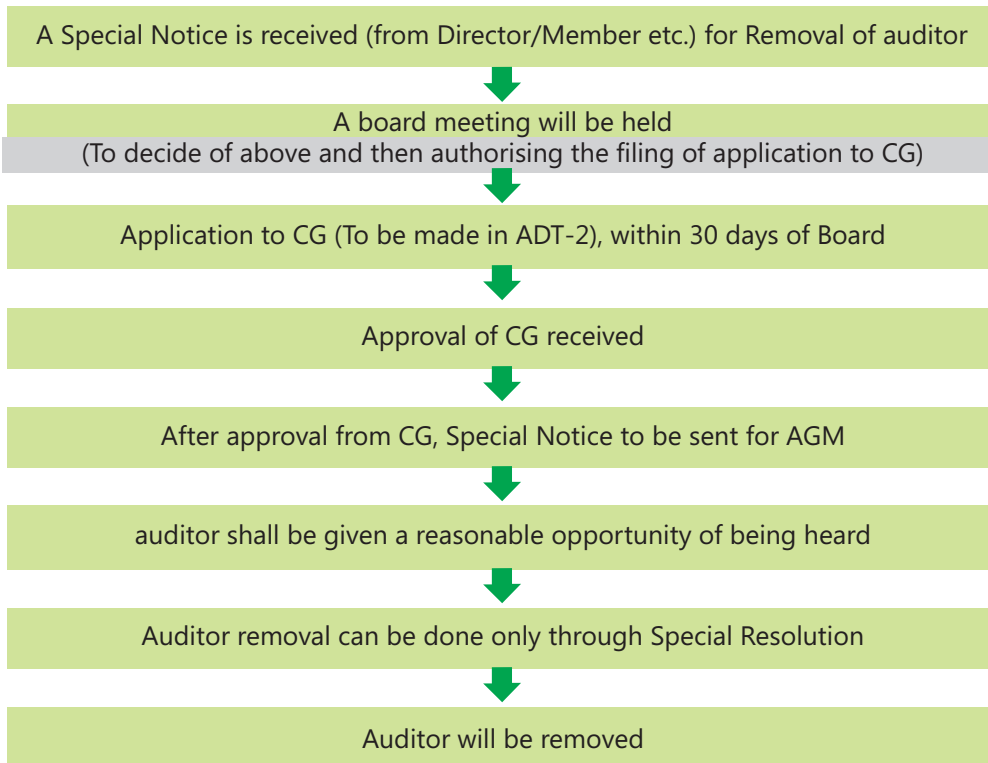
**(i) Removal of auditor before the expiry of his term [Section 140(1)] :**

- (a) The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company and after obtaining the previous approval of the Central Government<sup>2</sup> by making an application in Form ADT-2 and shall be accompanied with the prescribed fees.
- (b) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- (c) The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

<sup>2</sup> Powers are delegated to Regional Director.

- (d) **Giving opportunity of being heard** (*Audi Alteram Partem*) : Before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

### STEPS FOR REMOVAL OF AUDITOR

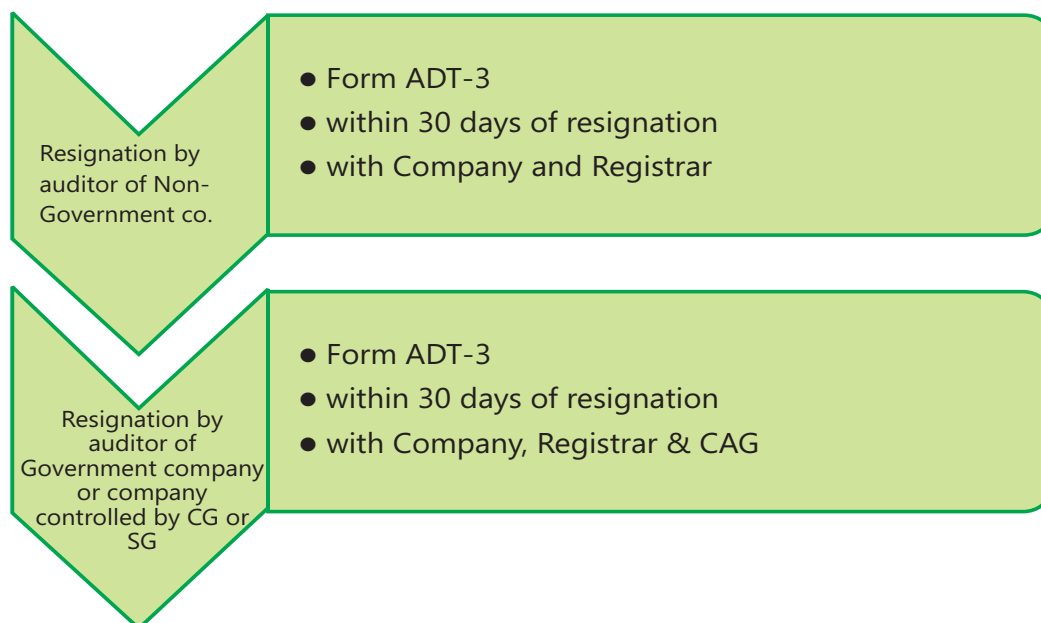


**Example :** Mr. Suresh, a Chartered Accountant, was appointed by the Board of Directors of AB Limited as the First Auditor. The company in General Meeting removed Mr. Suresh without seeking the approval of the Central Government and appointed Mr. Gupta as Auditor in his place. In this case, the first auditors appointed by Board of Directors can be removed in accordance with the provision of Section 140(1) of the Companies Act, 2013. Hence, the removal of the first auditor appointed by the Board without seeking approval of the Central Government is invalid. The company contravened the provision of the Act.

### (ii) Resignation by Auditor [Section 140(2) & (3)]

- (a) 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 the form ADT-3 with the company and the Registrar.

- (b) The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation, in the statement.
- (c) In case of government companies or company controlled by Central Government or State Government, the auditor shall also file such statement with the Comptroller and Auditor-General of India also along with company and the Registrar.
- (d) If the auditor does not comply with aforesaid provision, he or it shall be punishable with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 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 or, as the case may be, 10 years, as provided under sub-section (2) of section 139, 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.
- (b) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- (c) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to

do so,—

- (1) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
- (2) 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,
- (d) 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 (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.
- (e) However, if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.
- (f) If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

**(iv) Auditor acts in a fraudulent manner or abetted or colluded in any fraud [Section 140(5)]**

- (a) **On satisfaction of Tribunal that the auditor of a company has acted in a fraudulent manner etc.:** Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either—

suo motu; or

on an application made to it by the Central Government; or

by any person concerned,

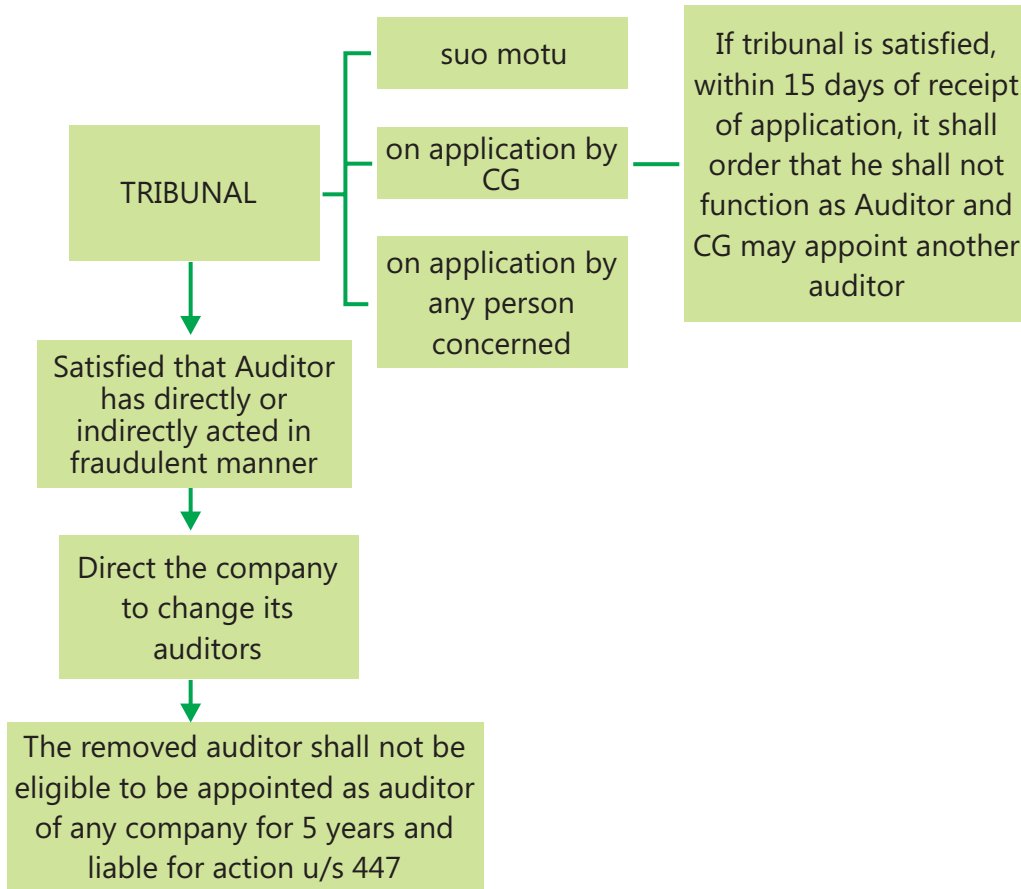
if it is satisfied that the auditor of a company has, whether directly or indirectly, **acted in a fraudulent manner or abetted or colluded in any fraud by**, or in relation to, the company or its directors or officers,

it may, by order, **direct the company to change its auditors.**

- (b) **Requirement for change of auditor :** If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.
- (c) **Ineligibility of auditor to be appointed :** An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.



- (d) **Explanation I.**—It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.
- (e) **Explanation II.**—For the purposes of this Chapter the word “auditor” includes a firm of auditors.



## 4. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS [SECTION 141]

Section 141 of the Companies Act, 2013 provides for eligibility, qualifications and disqualifications of auditors. This section deals with :

### (i) **Qualifications of an auditor [Section 141(1) & (2)] :**

- (a) A person shall be eligible to be appointed as auditor of a company only if he is a Chartered Accountant 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 may be appointed by its firm name to be auditor of a company.
- (c) 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 authorised to act and sign on behalf of the firm.

**(ii) Disqualifications of auditors [Section 141(3)] :**

- (a) The following persons shall not be qualified for appointment as auditor of a company—
  - (1) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
  - (2) an officer or employee of the company;
  - (3) a person who is a partner, or who is in the employment, of an officer or employee of the company;

**Example :** Mr. A, a Chartered accountant has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2016, in which he accepted the assignment. Subsequently, in January, 2017 he joined B, another Chartered Accountant, who is the Manager Finance of Laxman Ltd., as partner.

**Answer : Provisions and Explanation :** 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 becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

**Conclusion :** 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.

- (4) a person who, or his relative or partner—
  - (A) 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 Rs. 1,00,000 as prescribed under the *Company (Audit and Auditors) Rules, 2014*.

The *Company (Audit and Auditors) Rules, 2014* provides that a relative

of an auditor may hold securities in the company of face value not exceeding ₹ 1 Lac. Further, the above condition shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities. If the relative acquires any security or interest above the prescribed threshold i.e. ₹ 1 Lac, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest.

**Example 1 :** "Mr. A", a practicing Chartered Accountant, is holding securities of "XYZ Ltd." having face value of ₹ 900/-. Whether Mr. A is qualified for appointment as an Auditor of "XYZ Ltd."?

**Answer :** As per section 141 (3)(d) (i) 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:

In the present case, Mr. A. is holding security of ₹ 900 in the XYZ Ltd, therefore he is not eligible for appointment as an Auditor of "XYZ Ltd".

**Example 2 :** "Mr. P" is a practicing Chartered Accountant and "Mr. Q", the relative of "Mr. P", is holding securities of "ABC Ltd." having face value of ₹ 90,000/-. Whether "Mr. P" is Qualified from being appointed as an Auditor of "ABC Ltd."?

**Answer :** As per section 141 (3)(d)(i) 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: Further as per 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.

In the present case, Mr. Q. (relative of Mr. P, an auditor), is having securities of ₹ 90,000 face Value in the ABC Pvt. Ltd., which is as per requirement of proviso to section 141 (3)(d)(i), Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.

**Example 3 :** "BC & Co." is an Audit Firm having partners "Mr. B" and "Mr. C", and "Mr. A" the relative of "Mr. C", is holding securities of "MWF Ltd." having face value of ₹ 1,01,000/-. Whether "BC & Co." is qualified from being appointed as an Auditor of "MWF Ltd."?

**Answer :** As per section 141 (3)(d) (i) 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: Further as per 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.

In the instant case, BC & Co, will be disqualified for appointment as an auditor of MWF Ltd as the relative of Mr. C i.e. partner of BC & Co., is holding the securities in MWF Ltd which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

- (B) 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 Lacs; or
  - (C) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 1 Lac.
- (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. According to the *Companies (Audit and Auditors) Rules, 2014*, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except—
- (A) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
  - (B) commercial transactions which are in the ordinary course of business of the company at arm's length price-like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
- (6) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- (7) 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 persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies other than one person companies, small companies and private companies having paid-up share capital less than one hundred crore rupees.

**Ceiling numbers 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 Companies Act, 2013 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;

**Example :** "ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

- (i) Provide the maximum number of Audits remaining in the name of "ABC & Co."
- (ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.

**Fact of the Case :** In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

**Provisions and Explanations :** 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;

As per section 141 (3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be  $3 \times 20 = 60$  company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

**Conclusion :**

- (i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

$$\text{Total Number of Audits available to the Firm} = 20 \times 3 = 60$$

Number of Audits already taken by all the partners

$$\text{In their individual capacity} = 4 + 6 + 10 = \underline{20}$$

$$\text{Remaining number of Audits available to the Firm} = \underline{40}$$

- (ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)-already holding appointments as an auditor. Hence

$$(1) \text{ Mr. A can hold: } 20 - 4 = 16 \text{ more audits.}$$

- (2) Mr. B can hold  $20 - 6 = 14$  more audits and  
 (3) Mr. C can hold  $20 - 10 = 10$  more audits.
- (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 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 (section 144 deals with certain services not to be tendered by auditor).

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

If a person appointed as an auditor of a company incurs any of the disqualifications specified in Section 141(3), 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.



## 5. REMUNERATION OF AUDITORS [SECTION 142]

Section 142 of the Companies Act, 2013 provides for remuneration of auditors. According to this section :

- (i) 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.
- (ii) In the case of first auditor, remuneration may be fixed by the Board.
- (iii) The remuneration mentioned aforesaid shall, in addition to the fee payable to an auditor, include the expenses, if any, 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.



## 6. POWERS AND DUTIES OF AUDITORS AND AUDITING STANDARDS [SECTION 143]

**(i) Powers of Auditors [Section 143(1)] :**

- (a) **Access to books of accounts and vouchers:** 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.
- (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) **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 financial statements with that of its subsidiaries.

## (ii) Duties of Auditors

- (a) **Matters of inquiry :** The auditor shall 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 on which they have been made are prejudicial to the interests of the company or its 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 that at which they were purchased by the company;
  - (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 and documents of the company 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 is correct, regular and not misleading:

### **The Statement on reporting under section 227(1)(A)**

- These are specific enquiries to be made during course of Audit
  - It is not required to report unless has any special comments to make on any of the items if satisfied, no further duty to report.
  - Only enquiries and not investigations
- (b) The auditor shall make a report to the members of the company on the following :
- (1) On the accounts examined by him; and
  - (2) On every financial statements which are required by or under this Act to be laid before the company in general meeting; and
- (c) The auditor while making the report shall take into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under section 143(11).

- (d) The auditor shall express his opinion of the accounts and financial statements examined by him. He shall express the opinion which according to him and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.
- (e) The auditors' report shall also state—
- (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 and if not, the details thereof and the effect of such information on the financial statements;
  - (2) 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 returns adequate for the purposes of his audit have been received from branches not visited by him;
  - (3) 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 auditor 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;
  - (4) 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;
  - (5) whether, in his opinion, the financial statements comply with the accounting standards;
  - (6) the observations or comments of the auditors 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 as a director under sub section (2) of section 164;
  - (8) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
  - (9) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;  
As per the rule 10A inserted by the *Companies(Audit and Auditors) Amendments Rules, 2014 vide Notification dated 14<sup>th</sup> October, 2014* that for purposes of this clause under section 143(3), for the financial years commencing on or after 1<sup>st</sup> April, 2015, the report of the Auditor shall state about existence of adequate internal financial controls system and its operating effectiveness.
  - (10) such other matters as may be prescribed.



- (f) Rule 11 of the *Companies (Audit and Auditors) Rules, 2014* provides that the auditor's report shall also include their views and comments on the following matters, namely :
- (1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
  - (2) 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;
  - (3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
  - (4) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company"
- (g) Where any of the matters is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.
- (h) **Compliance with auditing standards [Section 143(9) and 143(10)] :**
- (1) Every auditor shall comply with the auditing standards
  - (2) 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.
  - (3) It is further 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.
- (i) **Additional matters to be reported in case of specified companies [Section 143(11)] :** In respect of such class or description of companies, as may be specified in the general or special order by the Central Government may, in consultation with the National Financial Reporting direct, the auditor's report shall also include a statement on such matters as may be specified therein.
- Accordingly, CARO, 2016 [Companies Auditor Report Order] is issued in pursuance of Section 143 (11) of Companies Act 2013 for inclusion of the matters specified therein in auditors' report. CARO 2016 issued by MCA should be complied by the statutory auditor of every company on which it applies.

CARO 2016 applicable to every company including a foreign company as defined in clause (42) of Section 2 of the Companies Act 2013.

Until the National Financial Reporting Authority is constituted under section 132, the Central Government may hold consultation required under this subsection with the Committee chaired by an officer of the rank of Joint Secretary or equivalent in the Ministry of corporate Affairs and the committee shall have the representatives from the Institute of Chartered Accountants of India and Industry Chambers and also special invitees from the National Advisory Committee on Accounting Standards and the office of the Comptroller and Auditor-General.

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

- (1) Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving amount of Rs. One crore or above (as prescribed under the Rule 13) is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner prescribed in Rule 13 of the Companies (Audit and Auditors) Rules, 2014 which is as under :

The auditor shall report the matter to the Central Government as under :

- (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
- (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;
- (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
  - (f) The report shall be in the form of a statement as specified in Form ADT-4
- (2) In case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner prescribed in Rule 13 of the *Companies (Audit and Auditors) Rules, 2014*.
- (a) In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following :
    - (i) Nature of Fraud with description;
    - (ii) Approximate amount involved; and
    - (iii) Parties involved.
  - (b) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report :
    - (i) Nature of Fraud with description;
    - (ii) Approximate Amount involved;
    - (iii) Parties involved, if remedial action not taken; and
    - (iv) Remedial actions taken.
- (3) The companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner prescribed in Rule 13 of the *Companies (Audit and Auditors) Rules, 2014*.
- (4) The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively.
- (5) No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred above if it is done in good faith.
- (6) **Penalty for non compliance of section 143(12):** If any auditor, the cost accountant in practice conducting cost audit under section 148 or the

company secretary in practice conducting secretarial audit under section 204 do not comply with the provisions of section 143(12) (reporting about the offence to the Central Government), he shall be punishable with fine which shall not be less than ` 1 Lacs but which may extend to ` 25 Lacs.

**(iv) Audit of Government Companies [Section 143(5), (6) & (7)] :**

- (a) The auditor of a Government company is appointed by the Comptroller and Auditor-General of India under section 139(5) or section 139(7).
- (b) 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 Comptroller and Auditor-General of India shall appoint the auditor under section 139(5) or 139(7) and direct such 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.
- (c) The audit report among other things, include the following:
  - (1) the directions, if any, issued by the Comptroller and Auditor-General of India,
  - (2) the action taken thereon and
  - (3) its impact on the accounts and financial statement of the company.
- (d) The Comptroller and Auditor-General 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 financial statement of the company by such person or persons as he may authorise 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; and
  - (2) comment upon or supplement such audit report.
- (e) 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 section 136(1) 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.
- (f) **Test Audit :** For Government Company or Company controlled by State Government or Central Government, the Comptroller and Auditor- General of India may, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company, without prejudice to the

provisions related to Audit and Auditors. 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.

**(v) Audit of accounts of branch office of company [Section 143(8)] :**

**(a) Branch office in India :**

Where a company has a branch office, the accounts of that office shall be audited either by:

- (A) the company's auditor appointed under section 139, or
- (B) by any other person qualified for appointment as an auditor of the company under section 139.

**(b) Branch office outside India :**

If the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by:

- (A) the company's auditor or
- (B) by an accountant or
- (C) 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 with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.

(d) 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.

(e) The provisions of regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.



## **7. AUDITOR NOT TO RENDER CERTAIN SERVICES [SECTION 144]**

Section 144 of the Companies Act, 2013 provides for Auditor not to render certain services. According to this section :

(i) 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;

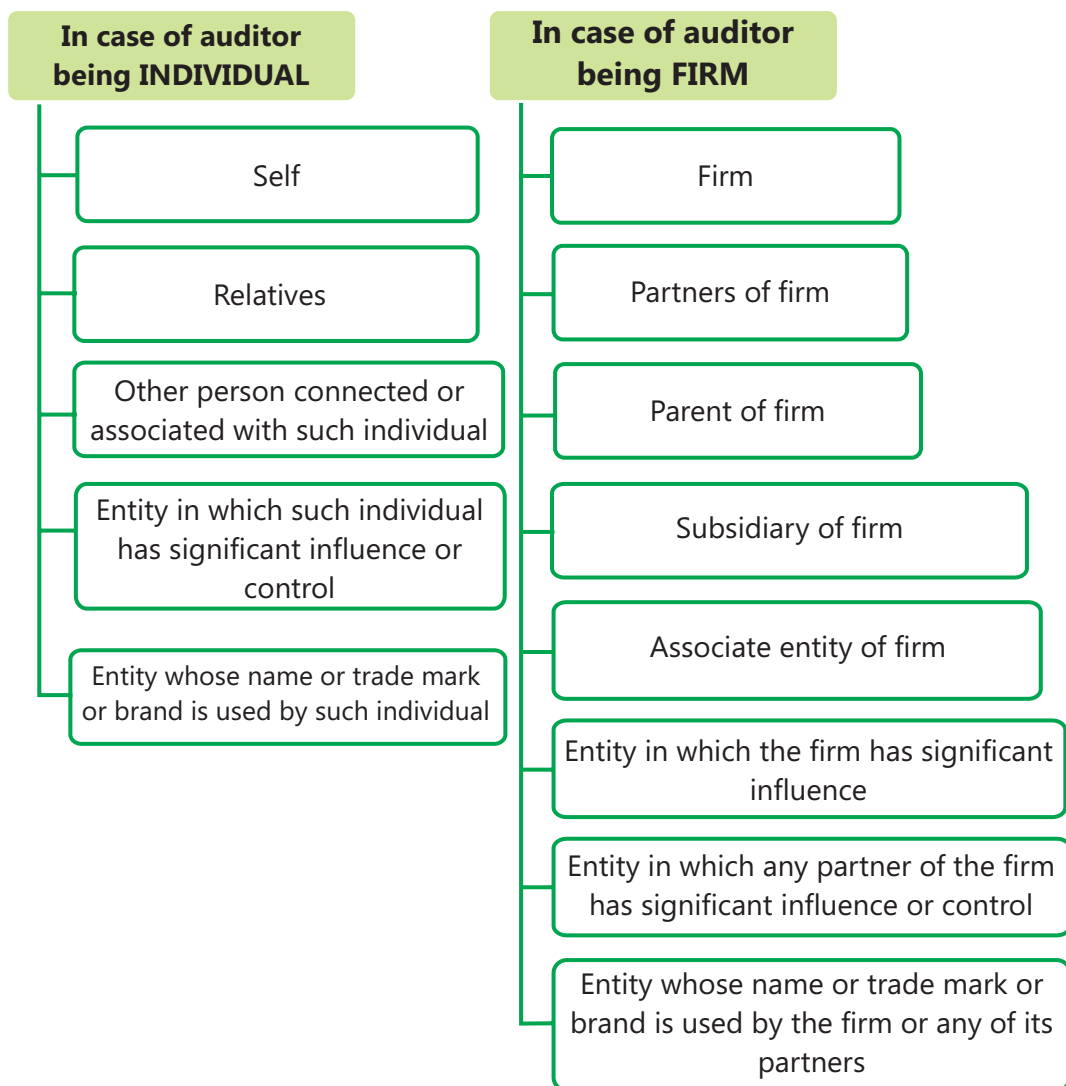
- (d) actuarial services;
- (e) investment advisory services;
- (f) investment banking services;
- (g) rendering of outsourced financial services;
- (h) management services; and
- (i) any other kind of services as may be prescribed. [However no other kind of services has been prescribed till date]



- (ii) **Explanation :** The term "directly or indirectly" shall include rendering of services by the auditor,—
  - (1) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;

- (2) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

**RENDERING OF SERVICES 'DIRECTLY OR INDIRECTLY'**





## 8. AUDITORS TO SIGN AUDIT REPORTS, ETC. [SECTION 145]

Section 145 of the Companies Act, 2013 provides for auditors to sign audit reports, etc. According to this section :

- (i) 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. in case of firm including LLP, only Chartered Accountants are authorised to act and sign).
- (ii) The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.



## 9. AUDITORS TO ATTEND GENERAL MEETING [SECTION 146]

Section 146 of the Companies Act, 2013 provides for auditors to attend general meeting. According to this section :

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



## 10. PUNISHMENT FOR CONTRAVENTION [SECTION 147]

Section 147 of the Companies Act, 2013 provides for punishment for contravention. According to this section :

### (i) **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 which shall not be less than ₹ 25,000 but which may extend to ₹ 5 Lacs.

### (ii) **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

- (1) imprisonment for a term which may extend to 1 year or



- (2) With fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1 Lac; 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, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 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
  - (1) imprisonment for a term which may extend to 1 year and
  - (2) fine which shall not be less than ₹ 1 Lac but which may extend to ₹ 25 Lacs.
- (c) Further, where an auditor has been convicted as above, he shall be liable to—
  - (1) refund the remuneration received by him to the company; and
  - (2) 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.

- (iv)** The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons. Such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

**[Section 147(4)]**

**(v) Liability of Audit firm [Section 147(5)] :**

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 and shall also be liable under section 447.



## **11. CENTRAL GOVERNMENT TO SPECIFY AUDIT OF ITEMS OF COST IN RESPECT OF CERTAIN COMPANIES [SECTION 148]**

Section 148 of the Companies Act, 2013 provides the provisions for Central Government to specify audit of items of cost in respect of certain companies. According to this section :

- (i) Notwithstanding anything contained in the provisions related to audit and auditor (Chapter X), 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 under section 128 by that class of companies.
- (ii) 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.
- (iii) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered aforesaid and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.
- (iv) The cost 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.
- (v) Rule 14 of *the Companies (Audit and Auditors) Rules, 2014* provides that—
- (1) in the case of companies which are required to constitute an audit committee—
    - (A) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
    - (B) the remuneration recommended by the Audit Committee under (A) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
  - (2) 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 in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

Companies required to constitute Audit Committee	Companies not required to constitute Audit Committee
(a) The Board shall appoint the cost auditor on the recommendation of the Audit Committee. (b) The Audit Committee shall recommend the remuneration for cost auditor.	(a) The Board shall appoint the cost auditor. (b) The remuneration of such cost auditor shall be ratified by shareholders subsequently.

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| <p>(c) Such remuneration as recommended by the Audit Committee shall be considered and approved by the Board of Directors.</p> <p>(d) Then this remuneration subsequently to be ratified by the shareholders.</p> |  |
|---|--|

- (vi) No person appointed under section 139 as an auditor of the company (i.e. company auditor) shall be appointed for conducting the audit of cost records.
- (vii) Cost auditor to comply with cost auditing standards: The auditor conducting the cost audit shall comply with the cost auditing standards.  
Here, the expression "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.
- (viii) An audit conducted under section 148 shall be in addition to the audit conducted under section 143.
- (ix) The qualifications, disqualifications, rights, duties and obligations applicable to auditors (i.e. applicable to company auditor) shall, so far as may be applicable, apply to a cost auditor appointed under section 148 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.
- (x) The report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors (BoD) of the company.
- (xi) A company shall within 30 days from the date of receipt of a copy of the cost audit report furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.  
*Vide Notification dated 9<sup>th</sup> September, 2015 under the rule 4 of the Companies(Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015, a company is required to furnish cost audit report and other documents to the Central Government under this above sub- section 6 of the section 148 of the Act and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure III for the financial year commencing on or after 1<sup>st</sup> April, 2014 in e-form CRA-4 specified under the Companies(Cost Records and Audit) Rules, 2014.*
- (xii) If, after considering the cost audit report and the information and explanation furnished by the company, 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.

- (xiii) **Contravention** : If any default is made in complying with the provisions of section 148,—
- (a) The company and every officer of the company who is in default shall be punishable in the manner as provided in section 147(1);
  - (b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.
- (xiv) The provisions of section 143 shall mutatis mutandis apply to the cost accountant in practice conducting cost audit under section 148.



## SUMMARY

- **First auditor** : 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, and the auditor so appointed shall hold office until the conclusion of the first AGM.  
If the Board fails to appoint first auditor, it shall inform the members of the company and the company may appoint the first auditor within 90 days at an extra ordinary general meeting.
- **Appointment of Auditors** :
  - Auditors to be appointed at 1<sup>st</sup> AGM for period of 5 years
  - Ratification of appointment of Auditors at each AGM
  - Consent of auditors required
  - Auditors to attend AGM (have right to be heard in matters concerning him)
- **Rotation of Auditors** :
  - Individual auditors :one term of 5 years
  - Audit Firm : Two terms of 5 years each
  - No reappointment for 5 years from expiry of term.
- **Removal of Auditors** :
  - Auditor to be given reasonable opportunity to be heard
  - Prior approval of CG required
  - Special resolution in GM

Special notice to be given in case retiring auditor is not appointed in AGM.

 **TEST YOUR KNOWLEDGE****Multiple Choice Questions**

- For appointing an auditor other than the retiring auditor,
  - Special notice is required.
  - Ordinary notice is required.
  - Neither ordinary nor special notice is required
  - Approval of Central Government is required.
- The auditors of a company can be removed by the
  - Board of directors of the company
  - Audit committee
  - Company in general meeting by ordinary resolution and previous approval of CG
  - Company in general meeting by special resolution and previous approval of CG
- After registration of a company, first auditors shall be appointed within
  - 30 days
  - 90 months
  - 180 days
  - One year
- The auditor of a Government Company shall be appointed or re-appointed by
  - The Central Government
  - Comptroller and Auditor General of India.
  - Central Government on the advise of Comptroller and Auditor General of India.
  - None of the above
- Which of the following is a prohibited services to be rendered by the auditor of the Company
  - design and implementation of any financial information system
  - making report to the members of the company on the accounts examined by him
  - compliance with the auditing standards
  - Reporting of fraud against the company by officers or employees to the Central Government

**Answer to MCQs**

1. (a)	2. (d)	3. (a)	4. (b)	5. (a)
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## QUESTION AND ANSWER

### Question 1

State the procedure for the following, explaining the relevant provisions of the Companies Act, 2013 :

- (i) Appointment of First Auditor, when the Board of directors did not appoint the First Auditor within one month from the date of registration of the company.
- (ii) Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.

### Answer

- (i) Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days of the registration of the company.

Section 139 (6) continues to provide further that if the Board of Directors fails to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

From the above provisions of law if the Board of Directors fails to appoint the first auditors within the stipulated 30 days, it shall take the following steps:

- a. Inform the members of the Company;
  - b. Immediately take steps to convene an extra ordinary general meeting not later than 90 days;
  - c. Members shall at that extra ordinary meeting appoint the first auditors of the company;
  - d. The first auditors so appointed shall hold office upto the conclusion of the first AGM of the company.
- (ii) Section 140 of the Companies Act, 2013 prescribes certain procedure for removal of auditors. Under section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner. From this sub section it is clear that the approval of the Central Government shall be taken first and thereafter the special resolution of the company should be passed.

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Therefore, in terms of section 140 (1) of the Companies Act, 2013 read with rule 7 of the *Companies (Audit & Auditors) Rules, 2014* the following steps should be taken for the removal of an auditor before the completion of his term :

- a. The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014
- a. The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
- b. The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

### Question 2

*Explain how the auditor will be appointed in the following cases :*

- (i) *A Government Company within the meaning of section 394 of the Companies Act, 2013.*
- (ii) *The Auditor of the company (other than government company) has resigned on 31<sup>st</sup>December, 2016, while the Financial year of the company ends on 31<sup>st</sup>March, 2017.*
- (iii) *A company, whose shareholders include the following:*
  - (a) *Bank of Baroda (A Nationalized Bank) holding 12% of the subscribed capital in the company.*
  - (b) *National Insurance Company Limited (carrying on General Insurance Business) holding 10% of the subscribed capital in the company.*
  - (c) *Maharashtra State Financial Corporation (A Public Financial Institution) holding 8% of the subscribed capital in the company.*

### Answer

- (i) The appointment and re-appointment of auditor of a Government Company or a government controlled company is governed by the provisions of section 139 of the Companies Act, 2013 which are summarized as under :

The first auditor shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General of India shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

- (ii) The situation as stated in the question relates to the creation of a casual vacancy in the office of an auditor due to resignation of the auditor before the AGM in case of a company other government company. Under section 139 (8)(i) any casual vacancy in the office of an auditor arising as a result of his resignation, such vacancy can be filled by the Board of Directors within thirty days thereof and in addition the appointment of the new auditor 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.
- (iii) The Companies Act, 2013 categorizes companies into government companies and non Government Companies and lists down the provisions relating to appointment, of auditors as per this classification. Hence, in the given case as the total shareholding of the three institutions adds up to 30% of the subscribed capital of the company it is not a government company. Hence, the provisions applicable to non-government companies in relation to the appointment of auditors shall apply.

### Question 3

*One-fourth of the subscribed capital of AMC Limited was held by the Government of Rajasthan. Mr. Neeraj a qualified Chartered Accountant was appointed as an auditor of the Company at the Annual General Meeting held on 30th April, 2016 by an ordinary resolution. Mr. Sanjay, a shareholder of the Company objects to the manner of appointment of Mr. Neeraj on the ground of violation of the Companies Act 2013. Decide, whether the objection of Mr. Sanjay is tenable? Also examine the consequences of the above appointment under the said Act.*

### Answer

As per the section 2(45) of the Companies Act, 2013, the holding of 25% shares of AMC Ltd. by the government of Rajasthan does not make it a government company. Hence, it will be treated as a non-government company.

Under section 139 of the Companies Act, 2013, the appointment of an auditor by a company vests generally with the members of the company except in the case of the first auditors and in the filling up of the casual vacancy not caused by the resignation of the auditor, in which case, the power to appoint the auditor vests with the Board of Directors. The appointment by the members is by way of an ordinary resolution only and no exceptions have been made in the Act whereby a special resolution is required for the appointment of the auditors.

Therefore, the contention of Mr. Sanjay is not tenable. The appointment is valid under the Companies Act, 2013.



### Question 4

*EF Limited appointed an individual firm, Naresh & Company, Chartered Accountants, as Auditors of the company at the Annual General Meeting held on 30<sup>th</sup> September, 2016. Mrs. Kamala, wife of Mr. Naresh, invested in the equity shares face value of Rs. 1 lakh of EF Limited on 15<sup>th</sup> October, 2016. But Naresh & Company continues to function as statutory auditors of the company. Advice*

### Answer

**Disqualification of auditor :** According to section 141(3)(d)(i) of the Companies Act, 2013, a person who, or his relative or partner holds any security of the company or its subsidiary or of its holding or associate company a subsidiary of such holding company, which carries voting rights, such person cannot be appointed as auditor of the company. Provided that the relative of such person may hold security or interest in the company of face value not exceeding 1 lakh rupees as prescribed under the Companies (Audit and Auditors) Rules, 2014.

In the case Mr. Naresh, Chartered Accountants, did not hold any such security. But Mrs. Kamala, his wife held equity shares of EF Limited of face value ₹ 1 lakh, which is within the specified limit.

Further Section 141(4) provides that if an auditor becomes subject, after his appointment, to any of the disqualifications specified in sub-section 3 of section 141, he shall be deemed to have vacated his office of auditor. Hence, Naresh & Company can continue to function as auditors of the Company even after 15<sup>th</sup> October 2016 i.e. after the investment made by his wife in the equity shares of EF Limited.

### Question 5

*The auditors of a company refuses to make their report on the annual accounts of a company before it is signed on behalf of the Board of directors. Advise the company.*

### Answer

The auditor is right. Theoretically, accounts are presented to auditors only after they are approved by the Board and signed by authorized persons. The auditor is only expected to submit his report on the accounts presented to him for audit after conducting an examination of the necessary documents, analyzing relevant information and test checking accounting records in order to be able to form an opinion of the financial statements presented to him. In practice, the checking of accounts is already completed before accounts are approved by the Board. Auditor informally approves the draft account with notes etc., before the accounts are approved by the Board. However, auditor signs the accounts only after these are approved by Board and signed by persons authorized by Board of the company.

