UNIT 1: ACCOUNTS OF COMPANIES

2.1 Books of account, etc., to be kept by company (Section 128 of the Companies Act, 2013)

A new section 128 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for Books of account, etc., to be kept by company. According to this section:

(i) **Maintenance of books of accounts** [Section 128(1)]:

   (a) Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any.

   (b) The company shall be in a position to explain the transactions effected both at the registered office and its branches.

   (c) Such books of Accounts shall be kept on accrual basis and according to the double entry system of accounting.

(ii) **Place of maintenance of books of accounts** [Section 128(1)]:

   (a) The books of account and other relevant papers are required to be kept at the registered office of the company.

   (b) The company may also keep all or any of the books of accounts at any other place in India as the Board of directors may decide. In such a case, the company should file with the Registrar of Companies, a notice in writing giving the full address of that place within 7 days of the Boards’ decision.

  
  *Vide Notification no. G.S.R 37(E) dated 16th January, 2015, Central Government further amended the Companies (Accounts) Rules, 2014 by the Companies (Accounts) Amendments Rules 2015. By this amendment, Rule 2A has been inserted in the Companies (Accounts) Rules, 2014 after Rule 2. Rule 2A deals with the notice of address at which books of accounts are to be maintained. The notice regarding the address at which books of account may be kept shall be in form AOC-5. This form has been inserted after AOC-4 in the Annexure given under the Companies Act, 2013.*

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(iii) **Electronic form of Books of accounts:**

(a) Rule 3 of the Companies (Accounts) Rules, 2014 provides that the company may keep its books of account or other relevant papers in electronic mode.

(b) The books of account and other relevant books and papers maintained in electronic mode shall:

1. remain accessible in India so as to be usable for subsequent reference.
2. be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.
3. The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.
4. The information in the electronic record of the document shall be capable of being displayed in a legible form.
5. There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:
6. The back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.

(c) The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement-

1. the name of the service provider;
2. the internet protocol address of service provider;
3. the location of the service provider (wherever applicable);
4. where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.

(iv) **Proper books of account in relation to a branch of the company:**

(a) Proper books of account relating to the transactions effected at the branch office in India or outside India shall be kept at that branch office.

(b) Proper summarised returns periodically must be sent by the branch office to the company at its registered office or the other place as decided by the Board of directors.

(v) **Persons who can inspect [Section 128(3) and (4)]:**

(a) The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours.
(b) In the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as prescribed under the Rule 4 of the *Companies (Accounts) Rules, 2014* which provides that:

1. The summarised returns of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and kept open to directors for inspection.

2. Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought, the period for which such information is sought.

3. The company shall produce such financial information to the director within 15 days of the date of receipt of the written request.

4. The financial information required under sub-rules (2) and (3) shall be sought for by the director himself and not by or through his power of attorney holder or agent or representative.

(c) The inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors.

(d) The officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

(vi) **Period of Maintenance [Section 128(5)]:**

(a) The books of account of every company together with the vouchers relevant to any entry in such books of accounts shall be kept in order by the company for a minimum period of 8 financial years immediately preceding a financial year.

(b) Where the company had been in existence for a period of less than 8 years, it shall maintain the books in respect of all such preceding years.

(c) Where an investigation has been ordered in respect of the company, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

(vii) **Persons responsible for Maintenance & Penalty [Section 128(6)]:**

(a) The following persons are responsible for the maintenance of proper books of account:

1. The managing director, the whole-time director in charge of finance, the Chief Financial Officer; or

2. any other person of a company charged by the Board.

(b) If any of the persons mentioned above contravenes such provisions, they shall be
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punishable with:
(1) Imprisonment for a term which may extend to 1 year; or
(2) Fine which shall not be less than ₹ 50,000 but which may extend to ₹5 lakh; or
(3) Both with imprisonment or fine.

The MCA vide General Circular No. 08/2014 dated 4th April, 2014 has clarified that the financial statements (and documents required to be attached thereto), auditor's report and Board's report in respect of financial years that commenced earlier than 1st April, 2014 shall be governed by the relevant provisions/ Schedules/ rules of the Companies Act, 1956 and that in respect of financial years commencing on or after 1st April, 2014, the provisions of the Companies Act, 2013 shall apply.

2.2 Financial Statement (Section 129 of the Companies Act, 2013)

Section 129 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for financial statement. This section deals with the following:

(i) Form of Financial statements [Section 129(1)]:

(a) The financial statements shall-
(1) give a true and fair view of the state of affairs of the company or companies,
(2) comply with the accounting standards notified under section 133 and
(3) shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.
(4) However, the items contained in such financial statements shall be in accordance with the accounting standards.

Ministry vide Notification dated 4th September, 2015 by the Companies (Accounts) Second Amendment Rules, 2015 incorporated the meaning of the Indian Accounting Standards under Rule 2(1) after clause (d), in the clause (da) as “Indian Accounting Standards means the Indian Accounting Standards referred to in rule 3 and Annexure to the Companies (Indian Accounting Standards) Rules, 2015”.

Vide Notification dated 4th September, 2015 by the Companies( Accounts) Second Amendment Rules, 2015, rule 4A has been inserted in the Companies( Accounts) Rules, 2014. This rule deals with the forms and items contained in the financial statements. According to it the financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or Indian Accounting Standards as applicable. Provided that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards as the case may be.

(b) The above provisions relating to nature and content of financial statement shall not apply to following companies:
(1) Insurance Companies
(2) Banking companies
(3) Company engaged in the generation or supply of electricity
(4) Any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

(c) If the following disclosures are not made, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company:

<table>
<thead>
<tr>
<th>Type of Company</th>
<th>Matters</th>
</tr>
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<tbody>
<tr>
<td>Insurance Company</td>
<td>Matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999</td>
</tr>
<tr>
<td>Banking company</td>
<td>Matters which are not required to be disclosed by the Banking Regulation Act, 1949</td>
</tr>
<tr>
<td>Company engaged in the generation or supply of electricity</td>
<td>Matters which are not required to be disclosed by the Electricity Act, 2003</td>
</tr>
<tr>
<td>Company governed by any other law</td>
<td>Matters which are not required to be disclosed by that law</td>
</tr>
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(d) Here, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.

(ii) Laying of financial statements [Section 129(2)]:
At every annual general meeting of a company, the Board of directors of the company shall lay before the company the financial statements for the financial year.

(iii) Consolidated Financial Statements [Section 129(3) & (4)]:
(a) Where a company has one or more subsidiaries, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.
(b) The Consolidated financial statements shall also be laid before the annual general meeting of the company along with the laying of its own financial statement.
(c) The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1.
(d) For the purposes of consolidated financial statements, “subsidiary” shall include associate company and joint venture.
(e) According to Rule 6 of the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act. (Proviso to Rule 6)

Clarification has been issued by MCA vide General Circular No, 39/2014, dated 14th October, 2014, on the manner of presentation of notes in Consolidated Financial Statement (CFS) to be prepared. Circular clarified that Schedule III to the Act read with the applicable Accounting Standards does not envisage that a company while preparing its CFS merely repeats the disclosures made by it under stand-alone accounts being consolidated. In the CFS, the company would need to give all disclosures relevant for CFS only.


“Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statement by an intermediate wholly-owned subsidiary, other than a wholly-owned subsidiary whose immediate parent is a company incorporated outside India.

Provided also that nothing contained in this rule shall, subject to any other law or regulation, apply for the financial year commencing from the 1st day of April, 2014 and ending on the 31st March, 2015, in case of a company which does not have a subsidiary or subsidiaries but has one or more associate companies or joint ventures or both, for the consolidation of financial statement in respect of associate companies or joint ventures or both, as the case may be.”

Vide Notification G.S.R. 37(E) dated 16th January 2015 the Central Government amended the Companies (Accounts) Rules, 2014 and following fourth proviso has been inserted in Rule 6 -

“Provided also that nothing in this rule shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year commencing on or after 1st April, 2014.

(f) The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements.
(iv) Deviations from Accounting Standards [Section 129(5)]:
If the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements the following namely:

(a) the deviation from the accounting standards,
(b) the reasons for such deviation and
(c) the financial effects, if any, arising out of such deviation

(v) Exemptions [Section 129(6)]:

(a) The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest.

(b) Any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

Vide Notification dated 4th September 2015, the Central Government in public interest, directs that Additional Information [under paras 5 (ii) (a) (1), 5 (ii) (a) (2), 5(ii) (e), 5 (iii), 5 (viii) (a), 5 (viii) (b), 5 (viii) (c) and 5 (viii) (e)] of the General Instructions for preparation of Statement of Profit and Loss in Schedule III of the Companies Act, 2013 shall not apply to government companies producing Defence Equipment including the Space Research subject to fulfilment of following conditions, namely:-

A. The Board of Directors of the Company has given consent with regard to non-disclosure of information relating to paras 5(ii)(a)(1), 5(ii)(a)(2), 5(ii)(e), 5(iii), 5(viii)(a), 5(viii)(b), 5(viii)(c) and 5(viii)(e), as may be applicable;
B. The Company shall disclose in the Notes forming part of the balance sheet and profit and loss account, the fact of grant of exemption under this notification;
C. The company shall comply with the prescribed Accounting Standards;
D. The company shall ensure that its financial statements represent a true and fair state of affairs of its finances; and
E. The company shall maintain and file such information as may be prescribed or called for or required by the Government or the Reserve Bank of India or any other regulator.

This notification shall be applicable in respect of financial statement prepared in respect of the financial years ending on or after the 31st March, 2016.

(vi) Contravention [Section 129(7)]:
If a company contravenes the provisions of this section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person...
charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with

(1) Imprisonment for a term which may extend to 1 year; or
(2) Fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5 Lakhs; or
(3) Both with imprisonment and fine.

Section 129 shall not apply to the Government Companies to the extent of application of Accounting Standard 17(Segment Reporting) to the companies engaged in defence production. [Inserted vide Notification dated 5th June 2015]

2.3 Central Government to prescribe Accounting Standards (Section 133 of the Companies Act, 2013)

Section 133 of the Companies Act, 2013 deals with the power of the Central Government to prescribe the accounting standards. “Accounting Standards” means the standards of accounting or any addendum thereto as recommended by the Institute of Chartered Accountants of India (ICAI) constituted under section 3 of the Chartered Accountants Act, 1949, as may be prescribed by the Central Government in consultation with and after examination of the recommendations made by the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013.

In respect of accounting standards, the role of National Financial Reporting Authority is limited to advise the Central Government on the accounting standards recommended by ICAI for adoption by companies.

The Ministry of Corporate Affairs (MCA) vide General Circular No. 15/2013 dated 13th September, 2013 has clarified that till the Standards of Accounting or any addendum thereto are prescribed by Central Government in consultation and recommendation of the National Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act, 1956 shall continue to apply.

2.4 Financial Statement, Board’s report, etc (Section 134 of the Companies Act, 2013)

Section 134 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for financial statement, Board’s report, etc. According to this section:

(i) Authentication of Financial statements [Section 134(1), (2) & (7)]:

(a) The financial statements, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the following:

(1) The chairperson of the company where he is authorised by the Board; or
(2) By two directors out of which one shall be managing director and other the Chief Executive Officer, if he is a director in the company;
(3) The Chief Financial Officer, wherever he is appointed; and
(4) The company secretary of the company, wherever he is appointed.

(b) In the case of a One Person Company, the financial statement shall be signed by only one director, for submission to the auditor for his report thereon.

(c) The auditors’ report shall be attached to every financial statement.

(d) A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—
   (1) Any notes annexed to or forming part of such financial statement;
   (2) The auditor’s report; and
   (3) The Board’s report.

(ii) Board’s report [Section 134(3) & (4)]:

(1) According to Companies (Accounts) Rules, 2014, the Board’s Report shall be prepared based on the stand alone financial statements of the company and the report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented.

As per Rule 12(1) of the Companies( Accounts) Rules, 2014, every company shall file the financial statements with Registrar together with Form AOC-4 and the Consolidated Financial statements, if any with Form AOC-4 CFS.[The Companies( Accounts) Second Amendment Rules, 2015]

(2) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include —
   (a) The extract of the annual return as provided under sub-section (3) of section 92;
   (b) Number of meetings of the Board;
   (c) Directors’ Responsibility Statement;

   (ca) By the Companies (Amendment) Act, 2015, this is a new clause added under the Section 134(3), whereby details in respect of frauds reported by auditors under section 143(12) other than those which are reportable to the Central Government.

   (d) a statement on declaration given by independent directors under sub-section (6) of section 149;
   (e) 1in case of a company covered under sub-section (1) of section 178, company’s policy on directors’ appointment and remuneration including criteria for

1 This clause is not applicable to the Government Company as per the Notification dated 5th of June 2015.
determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

(f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—
   (i) by the auditor in his report; and
   (ii) by the company secretary in practice in his secretarial audit report;

(g) particulars of loans, guarantees or investments under section 186;

(h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in Form AOC-2;

(i) the state of the company’s affairs;

(j) the amounts, if any, which it proposes to carry to any reserves;

(k) the amount, if any, which it recommends should be paid by way of dividend;

(l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;

(m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as prescribed under the Rule 8(3) of the Companies (Accounts) Rules, 2014 which provides for:

(A) **Conservation of energy**-
   (i) the steps taken or impact on conservation of energy;
   (ii) the steps taken by the company for utilising alternate sources of energy;
   (iii) the capital investment on energy conservation equipments;

(B) **Technology absorption**-
   (i) the efforts made towards technology absorption;
   (ii) the benefits derived like product improvement, cost reduction, product development or import substitution;
   (iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year)-
      (a) the details of technology imported;
      (b) the year of import;
      (c) whether the technology been fully absorbed;
      (d) if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and
   (iv) the expenditure incurred on Research and Development.
(C) Foreign exchange earnings and Outgo-

The Foreign Exchange earned in terms of actual inflows during the year and the Foreign Exchange outgo during the year in terms of actual outflows.

By the Companies (Accounts) Second Amendments Rules, 2015, vide Notification dated 4th September 2015, a proviso has been inserted saying that the requirement of furnishing information and details under this sub-rule shall not apply to a Government Company engaged in producing defence equipment.

(n) A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;

(o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;

(p) Every listed company and every other public company having a paid up share capital of 25 crore rupees or more calculated at the end of the preceding financial year shall include (as prescribed under the Companies (Accounts) Rules, 2014), in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.

This clause shall not apply to the Government Company in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, as per its own evaluation methodology.[Inserted vide Notification dated 5th June 2015]

(q) Such other matters as contain as prescribed under the Companies (Accounts) Rules, 2014. According to which the report of the Board shall also contain–

(i) the financial summary or highlights;

(ii) the change in the nature of business, if any;

(iii) the details of directors or key managerial personnel who were appointed or have resigned during the year;

(iv) the names of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year;

(v) the details relating to deposits like-

(a) accepted during the year;

(b) remained unpaid or unclaimed as at the end of the year;
(c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-
   (1) at the beginning of the year;
   (2) maximum during the year;
   (3) at the end of the year;
(vi) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;
(vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company’s operations in future;
(viii) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

(3) Board’s Report in case of OPC [Section 134(4)]: In case of a One Person Company, the report of the Board of Directors to be attached to the financial statement under this section shall, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

(iii) Directors’ Responsibility Statement [Section 134(5)]:

(a) The Directors’ Responsibility Statement referred to in 134(3) (c) shall state that—

(1) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(2) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(3) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(4) the directors had prepared the annual accounts on a going concern basis; and

(5) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.
Here, the term “internal financial controls” means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(6) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(iv) Signing of Board’s Report [Section 134(6)]:

The Board’s report and any annexures thereto shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

(v) Contravention [Section 134(8)]:

(a) If a company contravenes any provisions of this section, the company shall be punishable with fine which shall not be less than ₹50,000 but which may extend to ₹25 Lacs.

(b) Every officer of the company who is in default shall be punishable with:

(1) Imprisonment for a term which may extend to 3 years; or

(2) fine which shall not be less than ₹50,000 but which may extend to ₹ 5 Lacs; or

(3) Both with imprisonment and fine

2.5 Corporate Social Responsibility (Section 135 of the Companies Act, 2013)

There was no provision under the Companies Act, 1956 for corporate Social Responsibility (CSR). The Companies Act, 2013 for the first time has introduced a welcome provision requiring corporate to mandatorily spend a prescribed percentage of their profits on certain specified areas of social upliftment in discharge of their social responsibilities. A new section 135 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for it.

Broadly, CSR implies a concept, whereby companies decide voluntarily to contribute to a better society and a cleaner environment – a concept, whereby the companies integrate social and other useful concerns in their business operations for the betterment of its stakeholders and society in general in a voluntary way.

Corporate Social Responsibility: The Companies (CSR Policy) Rules, 2014 provides the exhaustive definition of CSR which provides that the CSR means and includes but is not limited to:-

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or
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(ii) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

According to section 135 of the Companies Act, 2013:

(i) Which Company is required to constitute CSR committee:

(a) Every company including its holding or subsidiary, and a foreign company defined under section 2(42) of the Companies Act, 2013 having its branch office or project office in India, having

1) net worth of rupees 500 crore or more, or
2) turnover of rupees 1000 crore or more or
3) a net profit of rupees 5 crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board.

(b) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

(c) However, the net worth, turnover or net profit of a foreign company shall be computed in accordance with balance sheet and profit and loss account of such company as prepared in accordance with the provisions of section 381(1)(a) and section 198 of the Act.

(ii) Exclusion of Companies

Every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years

1) shall not be required to constitute a CSR Committee, and
2) is not required to comply with the provisions as per section 135

(iii) Composition of CSR Committee:

(a) The CSR Committee shall be consisting of three or more directors, out of which at least one director shall be an independent director.

(b) An unlisted public company or a private company which is not required to appoint an independent director shall have its CSR Committee without such director.

(c) A private company having only two directors on its Board shall constitute its CSR Committee with two such directors.

(d) With respect to a foreign company covered as above, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under section 380(1)(d) of the Act and another person shall be nominated by the foreign company.
(e) The Board’s report under sub-section (3) of section 134 shall disclose the composition of the CSR Committee.

(iv) Duties of CSR Committee:

The CSR Committee shall,—

(a) formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

(c) monitor the CSR Policy of the company from time to time.

(v) Contents of the CSR Policy:

(a) List of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs:

(c) However, the CSR activities do not include the activities undertaken in pursuance of normal course of business of a company.

(d) The Board of Directors shall ensure that activities included by a company in its CSR Policy are related to the activities included in Schedule VII of the Act.

(e) The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

(vi) Duties of the Board in relation to CSR:

The Board of every company referred to in sub-section (1) shall,—

(1) after taking into account the recommendations made by the CSR Committee, approve the CSR Policy for the company and disclose contents of such Policy in its report and also place it on the company’s website, if any, in such manner as may be prescribed; and

(2) ensure that the activities as are included in CSR Policy of the company are undertaken by the company.

(vii) Amount of contribution towards CSR:

(a) The Board of every company shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR Policy.

(b) The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.

(c) If the company fails to spend such amount, the Board shall, in its report, specify the
reasons for not spending the amount

(d) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years. However, such expenditure including expenditure on administrative overheads, [inserted by the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2014] shall not exceed five percent of total CSR expenditure of the company in one financial year.

(viii) CSR Activities:

Rule 4 of the Companies (CSR Policy) Rules, 2014 states the various CSR activities that shall be undertaken by the companies. Following are the CSR activities -

(1) The CSR activities shall be taken by the company as per its CSR Policy, as projects or programmes or activities excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of accompany may decide to undertake its CSR activities approved by the CSR Committee through a registered trust or a registered society or a company established under section 8 of the Act by the company, either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company or otherwise.

Provide that – if such trust, society or company not established by the company, shall have an established track record of three years in undertaking similar programmes or projects;

The company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism

(3) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions contained in section 135(5), the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

(6) Companies may build CSR capacities of their own personnel as well as those of implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed 5% of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

(ix) Exceptions to CSR Activities:

The Companies (CSR Policy) Rules, 2014 provides for some activities which are not considered as CSR activities:

(1) The CSR projects or programs or activities undertaken outside India.

(2) The CSR projects or programs or activities that benefit only the employees of the company and their families.

(3) Contribution of any amount directly or indirectly to any political party under section 182 of the Act.

(x) Calculation of Average Net profit:

(a) Here, “average net profit” shall be calculated in accordance with the provisions of section 198.

(b) “Net profit” shall not include the following:

   (1) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

   (2) Any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act.

(c) However, net profits in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, shall not be required to be re-calculated in accordance with the provisions of the Act:

   (d) It is further provided that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act.

(xi) CSR Reporting:

(a) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR.
(b) In case of a foreign company, the balance sheet filed under section 381(1)(b) shall contain an Annexure regarding report on CSR.

(xii) Activities specified under Schedule VII:

Activities which may be included by companies in their CSR Policies Activities as specified under Schedule VII are as follows:

1. eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;

2. promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

3. promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

4. ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set up by the Central Government for rejuvenation of river Ganga;

5. protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

6. measures for the benefit of armed forces veterans, war widows and their dependents;

7. training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

8. contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

9. contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

10. rural development projects;

11. slum area development. [For the purposes of this item, the term ‘slum area’ shall mean any area declared as such by the Central Government or any State

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4 Central Government inserted vide Notification dated 24th October, 2014
5 Central Government inserted vide Notification dated 24th October, 2014

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Government or any other competent authority under any law for the time being in force.] [Inserted by MCA vide Notification G.S.R. 568(E) dated 6th August, 2014.]

The MCA vide General Circular No. 21/2014 dated 18th June, 2014 has provided many clarifications with regard to provisions of Corporate Social Responsibility under section 135 of the Companies Act, 2013 which are as under:

(i) The statutory provision and provisions of CSR Rules, 2014, is to ensure that while activities undertaken in pursuance of the CSR policy must be relatable to Schedule VII of the Companies Act 2013, the entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule.

(ii) It is further clarified that CSR activities should be undertaken by the companies in project/ programme mode. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be qualified as part of CSR expenditure.

(iii) Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under the Companies Act.

(iv) Salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company’s time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.

(v) “Any financial year” referred under Sub-Section (1) of Section 135 of the Act read with Companies CSR Rule, 2014, implies ‘any of the three preceding financial years’.

(vi) Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

(vii) ‘Registered Trust’ would include Trusts registered under Income Tax Act 1956, for those States where registration of Trust is not mandatory.

(viii) Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure as long as (a) the Trust/ society/ section 8 companies etc. is created exclusively for undertaking CSR activities or (b) where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.

2.6 Right of member to copies of Audited Financial Statement (Section 136 of the Companies Act, 2013)

Section 136 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for right of member to copies of audited financial statement. According to this section:
(i) Who are entitled for audited financial statement?

(a) A copy of the financial statements, which are to be laid before a company in its general meeting, shall be sent to the following:

(1) every member of the company,
(2) to every trustee for the debenture-holder of any debentures issued by the company, and
(3) to all persons other than such member or trustee, being the person so entitled.

(b) Consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements shall be annexed with financial statements.

(c) These financial statements shall be sent in not less than 21 days before the date of the meeting.

(d) In the case of a listed company:

(1) The above provisions shall be deemed to be complied with, if the copies of the documents are made available for inspection at its registered office during working hours for a period of 21 days before the date of the meeting.

(2) Along with it a statement containing the salient features of such documents in the Form AOC-3 or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company.

(3) The statement is to be sent not less than 21 days before the date of the meeting unless the shareholders ask for full financial statements.

(e) A company shall also allow every member or trustee of the debenture holder to inspect the audited Financial Statement at its registered office during business hours.

[Note: Vide Notification dated 5th June 2015 for the companies under section 8 the word “twenty one days”, the words “Fourteen days” shall be substituted]

(ii) Manner of circulation of financial statements in certain cases:

(a) In case of all listed companies and such public companies which have a net worth of more than one crore rupees and turnover of more than ten crore rupees, the financial statements may be sent-

(1) by electronic mode to such members whose shareholding is in dematerialized format and whose email Ids are registered with Depository for communication purposes;

(2) where Shareholding is held otherwise than by dematerialized format, to such members who have positively consented in writing for receiving by electronic mode; and
(3) by despatch of physical copies through any recognised mode of delivery as specified under section 20 of the Act, in all other cases.

(b) A listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

(iii) Subsidiary Companies:

Every company having a subsidiary or subsidiaries shall,—

(1) place separate audited accounts in respect of each of its subsidiary on its website, if any;

(2) provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the company who asks for it.

This sub-section (1) of the Section 136 shall apply to the Nidhis company in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than 1% of the total paid up share capital whichever is less. It shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the registered office of the Nidhi is situated stating the date, time and venue of the annual general meeting and the Financial statement with its enclosures can be inspected at the registered office of the company, and the financial statement with enclosures are affixed in the Notice Board of the company and a member is entitled to vote either in person or through proxy.[ As per the notification dated 5th June 2015]

(iv) Contravention:

(a) If any default is made in complying with the provisions of this section, the company shall be liable to a penalty of ₹ 25,000.

(b) Every officer of the company who is in default shall be liable to a penalty of ₹ 5,000.

Vide General Circular No. 11/2015, dated 21st July 2015, clarification was issued by Ministry of Corporate Affairs with regards to circulation and filing of financial statement.

It has been clarified that a company holding general meeting after giving shorter notice as provided under section 101 of the Act may also circulate financial statements (to be laid/considered in the same general meeting) at such shorter notice.

It has also been clarified that in case of foreign company which is not required to get its accounts audited as per the legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding or parent Indian may place or file such unaudited accounts to comply with requirements of section 136(1) and 137(1) as applicable. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/filed along with such accounts.
2.7 Copy of financial statements to be filed with Registrar (Section 137 of the Companies Act, 2013)

Section 137 of the Companies Act, 2013 provides for copy of financial statements to be filed with Registrar. According to this section:

(i) **Filing of financial statements [Section 137(1)]:**

A copy of the financial statements, including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the Registrar within 30 days of the date of annual general meeting in such manner, with such fees or additional fees as may be prescribed within the time specified under section 403.

*As per Rule 3 of the Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015 vide Notification dated 9th September, 2015, following class of companies shall file their financial statement and other documents under this section with the registrar in e-form AOC-4 XBRL given in Annexure I for the financial years commencing on or after 1st April, 2014 using the XBRL taxonomy, namely:-*

1. **All companies listed with any stock exchange(s)in India and their Indian subsidiaries,** or
2. **All companies having paid up capital of rupees five crore or above,** or
3. **All companies having turnover of rupees hundred crore or above,** or
4. **All companies which were hitherto covered under the Companies( Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011:**

   *Provided that the companies in Banking, Insurance, Power Sector and Non-Banking Financial companies are exempted from XBRL filing.*

(ii) **If Financial Statements are not adopted [Section 137(1)]:**

(a) Where the financial statements are not adopted at annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents shall be filed with the Registrar within 30 days of the date of annual general meeting.

(b) The Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose.

(c) If the financial statements are adopted in the adjourned annual general meeting, then they shall be filed with the Registrar within 30 days of the date of such adjourned annual general meeting with such fees or such additional fees as may be prescribed within the time specified under section 403.
(iii) Filing by One Person Company [Section 137(1)]:
A One Person Company shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within 180 days from the closure of the financial year.

(iv) Company having subsidiaries [Section 137(1)]:
A company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established their place of business in India.

*It has also been clarified vide General Circular no. 11/2015 dated 21st July 2015 that in case of foreign company which is not required to get its accounts audited as per the legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding or parent Indian may place or file such unaudited accounts to comply with requirements of section 136(1) and 137(1) as applicable. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.*

(v) Annual General meeting not held [Section 137(2)]:
Where the annual general meeting of a company for any year has not been held, the financial statements along with the documents required to be attached, duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held and in such manner, with such fees or additional fees as may be prescribed within the time specified, under section 403.

(vi) Penalty [Section 137(3)]: If any of the provisions of this section are contravened,
(a) The company shall be punishable with fine of `1,000 for every day during which the failure continues but which shall not be more than `10 Lacs, and
(b) The managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be punishable with:
   (1) Imprisonment for a term which may extend to 6 months or
   (2) Fine which shall not be less than `1 lac but which may extend to `5 Lacs, or
   (3) Both with imprisonment and fine.

**2.8 Internal Audit (Section 138 of the Companies Act, 2013)**
There was no provision under the Companies Act, 1956 for Internal Audit. Section 138 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for it. According to section 138 of the Companies Act, 2013 and the *Companies (Accounts) Rules, 2014:*
(i) **Companies required to appoint Internal Auditor:**

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

1. every listed company;
2. every unlisted public company having-
   - (A) paid up share capital of 50 crore rupees or more during the preceding financial year; or
   - (B) turnover of 200 crore rupees or more during the preceding financial year; or
   - (C) outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year; or
   - (D) outstanding deposits of 25 crore rupees or more at any point of time during the preceding financial year; and
3. every private company having-
   - (A) turnover of 200 crore rupees or more during the preceding financial year; or
   - (B) outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year.

(b) The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

(ii) **Transitional period:**

An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within 6 months of commencement of such section.

(iii) **Who is Internal Auditor**

(a) Internal Auditor shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

Here, the term “Chartered Accountant” shall mean a Chartered Accountant whether engaged in practice or not.

(b) The internal auditor may or may not be an employee of the company.
2.9 Appointment of auditors (Section 139 of the Companies Act, 2013)

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 1st annual general meeting (AGM) till the conclusion of its 6th 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:

<table>
<thead>
<tr>
<th>Categories of Companies</th>
<th>Competent authority</th>
<th>Responsibility of the competent authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>A company which is required to constitute an Audit Committee under section 177</td>
<td>Audit Committee</td>
<td>(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. (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. (iii) It may call for such other information from the proposed auditor as it may deem fit.</td>
</tr>
</tbody>
</table>

| A Company which is not required to constitute an Audit Committee under section 177 | Board | |
2.26 Corporate and Allied Laws

(2) Categories of Companies

<table>
<thead>
<tr>
<th>Category</th>
<th>Competent Authority</th>
<th>Responsibility of the Competent Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>A company which is required to constitute an Audit Committee under section 177</td>
<td>Audit Committee</td>
<td>the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration</td>
</tr>
<tr>
<td>A Company which is not required to constitute an Audit Committee under section 177</td>
<td>Board</td>
<td>the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment</td>
</tr>
</tbody>
</table>

(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 6th 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) 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, 2014. 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 2019. 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 2024.*

*Example: XYZ Ltd. which is a listed company appoints M/s Raghav & Associates as an audit firm in its AGM dated 29th September, 2014. M/s Raghav & Associates will hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2019. 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 2024. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years i.e. upto year 2029.*

(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 2014 to year 2024. 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 2029. 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 provisions of section 139(2), shall comply with the requirements of this sub-section within three years from the date of commencement of this provision.

(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:

<table>
<thead>
<tr>
<th>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)]</th>
<th>Maximum number of consecutive years for which he may be appointed in the same company (including transitional period)</th>
<th>Aggregate period which the auditor would complete in the same company in view of column I and II</th>
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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**

<table>
<thead>
<tr>
<th>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)]</th>
<th>Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)</th>
<th>Aggregate period which the firm would complete in the same company in view of column I and II</th>
</tr>
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<tbody>
<tr>
<td>10 years (or more than 10 years)</td>
<td>3 years</td>
<td>13 years or more</td>
</tr>
<tr>
<td>9 years</td>
<td>3 years</td>
<td>12 years</td>
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<tr>
<td>8 years</td>
<td>3 years</td>
<td>11 years</td>
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<td>7 years</td>
<td>3 years</td>
<td>10 years</td>
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<tr>
<td>6 years</td>
<td>4 years</td>
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<td>1 year</td>
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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 in general meeting 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.

For ex: 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.

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.

(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.

Clarification by MCA: The MCA vide General Circular No. 33/2014 dated 31st July, 2014 has clarified the following:
(I) **Applicability of provisions of section 139(5) and 139(7) of the Companies Act, 2013 on deemed Government company:** The MCA vide General Circular No. 33/2014 dated 31st July, 2014 has clarified that the new Act does not alter the position with regard to audit of such deemed Government companies (as per section 619B of the Companies Act, 1956) through C&AG and thus such companies are covered under sub-section (5) and (7) of section 139 of the Companies Act, 2013.

**Deemed government Company (as per section 619B of the Companies Act, 1956):** The following companies shall be deemed to be a Government company, if not less than 51% (impliedly, may be more) of the paid up share capital is held by one or more of the following or any combination thereof:

(a) the Central Government and one or more Government companies;

(b) any State Government or Governments and one or more Government companies;

(c) the Central Government, one or more State Governments and one or more Government companies;

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

(e) the Central Government, one or more State Governments and one or more corporations owned and controlled by the Central Government;

(f) one or more corporations owned or controlled by the Central Government or the State Government;

(g) more than one Government company.

(II) **Definition of control has to be read with:** Further, it has also been observed that the words “any other company owned or controlled, directly or indirectly…….by the Central Government and partly by one or more State Governments” appearing in sub-sections (5) and (7) of section 139 of the new Act are to be read with the definition of ‘control’ in section 2(27) of the new Act. Thus, documents like articles of association and shareholders agreements etc envisaging control under section 2(27) are to be taken into account while deciding whether an individual company, other than deemed Government companies, is covered under section 139(5) /139(7) of the new Act.

(III) **Information to be communicated to C&AG:** Various clarifications has also been sought about the manner in which the information about incorporation of a company subject to audit by an auditor to be appointed by the C&AG is to be communicated to the C&AG for the purpose of appointment of first auditors under section 139(7). The MCA clarified that such responsibility rests with both, the Government concerned and the relevant company. To avoid any confusion, it was further clarified that it will primarily be the responsibility of the company concerned to intimate to the C&AG about its incorporation along with name, location of registered
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office, capital structure of such a company immediately on its incorporation. It is also incumbent on such a company to share such intimation to the relevant Government so that such Government may also send a suitable request to the C&AG.

(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.

2.10 Removal, resignation of auditor and giving of special notice [except 2nd proviso to sub-section (4) and sub-section (5)] (Section 140 of the Companies Act, 2013)

Section 140 of the Companies Act, 2013 came into force partially from 1st April, 2014 which 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 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.

(d) Giving opportunity of being heard (Audi Alteram Partem): Before taking any action

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for 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 a period of 30 days from the date of resignation, a statement in the form ADT-3 with the company and the Registrar.

(b) 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.

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

(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.
2.11 Eligibility, qualifications and disqualifications of auditors (Section 141 of the Companies Act, 2013)

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;

   For Ex: 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, 2013, in which he accepted the assignment. Subsequently in January, 2014 he joined B, another Chartered Accountant, who is the Manager Finance of Laxman Ltd., as partner.

   **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 1,00,000 rupees 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.

Ex 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.”?

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.”.

Ex 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.”?

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.

Ex 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.”
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having face value of ₹ 1,01,000/-. Whether “BC & Co.” is qualified from being appointed as an Auditor of “MWF Ltd.”?

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.  

**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;

Further, Council General Guidelines, 2008 (Chapter VIII): In exercise of the powers conferred by clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India hereby specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the “specified number of audit assignments of the companies under Section 141(3)(g) of the Companies Act, 2013 i.e. 20.

**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

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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:

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

\[
\text{Number of Audits already taken by all the partners}
\]

In their individual capacity = 4 + 6 + 10 = 20

\[
\text{Remaining number of Audits available to the Firm} = 40
\]

(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) Mr. A can hold: 20 - 4 = 16 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.

2.12 Remuneration of auditors (Section 142 of the Companies Act, 2013)

Section 142 of the Companies Act, 2013 came into force from 1st April, 2014 which 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.
2.13 Powers and duties of auditors and auditing standards (Section 143 of the Companies Act, 2013)

Section 143 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for powers and duties of auditors and auditing standards. According to this section:

(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) **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 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;

   (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 financial statements with that of its subsidiaries.

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

   (a) 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

(b) 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).

(c) 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.

(d) 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 14th October, 2014 that*
for purposes of this clause under section 143(3), for the financial years commencing on or after 1st 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.

(e) 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.

(f) 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.

(g) Compliance with auditing standards:

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.

(h) Additional matters to be reported in case of specified companies: 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.

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

(a) Notwithstanding anything contained in this section, if an auditor of a company in the course of performance of his duties as auditor, has reason to believe that a offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government immediately but not later than 60 days of his knowledge and after following the procedure as prescribed in Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

1. Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within 45 days;

2. 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 alongwith his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days of receipt of such reply or observations;

3. 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 alongwith a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

4. 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.

5. The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.

6. The report shall be in the form of a statement as specified in Form ADT-4.

(b) 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.

(c) 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:
(1) 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:
   (1) 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.

(vi) The provisions of this section i.e. section 143 shall *mutatis mutandis* apply to—
   (a) the cost accountant in practice conducting cost audit under section 148; or
   (b) the company secretary in practice conducting secretarial audit under section 204.

2.14 Auditor not to render certain services (Section 144 of the Companies Act, 2013)

There was no provision for the Auditor not to render certain services but a new section 144 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for Auditor not to render certain services. According to this section:

(i) **Prohibited services**: 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.

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.

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

2.15 Auditors to sign audit reports, etc. (Section 145 of the Companies Act, 2013)

A new section 145 of the Companies Act, 2013 came into force from 1st April, 2014 which 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.

2.16 Auditors to attend general meeting (Section 146 of the Companies Act, 2013)

A new section 146 of the Companies Act, 2013 came into force from 1st April, 2014 which 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.

2.17 Punishment for contravention (Section 147 of the Companies Act, 2013)

A new section 147 of the Companies Act, 2013 came into force from 1st April, 2014 which 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 Lacs; or

   (3) Both with imprisonment and fine.

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

   (a) If an auditor of a company contravene 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.

2.18 Central Government to specify audit of items of cost in respect of certain companies (Section 148 of the Companies Act, 2013)

A new section 148 of the Companies Act, 2013 came into force from 1st April, 2014 which 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;
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(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.

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<th>Companies required to constitute Audit Committee</th>
<th>Companies not required to constitute Audit Committee</th>
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<td>(a) The Board shall appoint the cost auditor on the recommendation of the Audit Committee.</td>
<td>(a) The Board shall appoint the cost auditor.</td>
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<td>(b) The Audit Committee shall recommend the remuneration for cost auditor.</td>
<td>(b) The remuneration of such cost auditor shall be ratified by shareholders subsequently.</td>
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<td>(c) Such remuneration as recommended by the Audit Committee shall be considered and approved by the Board of Directors.</td>
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<td>(d) Then this remuneration subsequently to be ratified by the shareholders.</td>
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(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 9th 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 1st 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.