Companies Act, 2013 is rule based Act. Sections 138 to 148 of the Companies Act, 2013 (hereinafter referred to as the Act unless otherwise mentioned) deal with provisions relating to audit of companies. Therefore, it is quite important to understand these provisions very carefully. You may also study sections 128 to 137 relating to “Accounts” of companies for better understanding of the subject. The provisions relating to ‘audit’ broadly deal with who can be appointed as an auditor under the Act, i.e., qualifications and disqualifications, the manner of appointment and removal of an auditor and rights and duties of an auditor. A scheme of the provisions of the Act relating to audit is given below for quick reference:

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<th>SECTIONS DEAL WITH PROVISIONS RELATING TO AUDIT OF COMPANIES</th>
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<td>138. Internal Audit.</td>
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<td>141. Eligibility, qualifications and disqualifications of auditors.</td>
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6.1 Eligibility, Qualifications and Disqualifications of an Auditor

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

1) A person shall be **eligible for appointment** as an auditor of a company **only if he is a chartered accountant**:

It may be noted that 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.

2) 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.

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

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(b) an officer or employee of the company;

According to Section 2(59) of the Companies Act, 2013, the term 'Officer' includes:

(i) Director
(ii) Manager
(iii) Key Managerial personnel
(iv) Shadow Directors.

Example 1: G, a CA in practice is director in RST Ltd. On combined reading of Section 141(3)(b) and Section 2(59), it may be concluded that CA. G would be disqualified to be appointed as an auditor of RST Ltd.

Example 2: G, a CA in practice is director in Zed Ltd., holding company of RST Ltd. On combined reading of Section 141(3)(b) and Section 2(59), it may be concluded that CA. G would be disqualified to be appointed as an auditor of Zed Ltd. but would not be disqualified in case of RST Ltd.

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

This sub-section disqualifies the below mentioned persons from being appointed as auditor of a company:

(i) partner of an officer of the company;
(ii) employee of an officer of the company;
(iii) partner of an employee of the company;
(iv) employee of an employee of the company.

(d) a person who, or his relative or partner -

(i) 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.

It may be noted that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.
It may also be noted that the condition of rupees one lakh shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities:

Students may also note that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition or interest.

The following points may be noted in this regard

(i) The value of shares of ₹1,00,000 that can be hold by relative is the face value not the market value.

(ii) The limit of ₹1,00,000 would be applicable where the securities are held by the relative of an auditor and not where the securities are held by an auditor himself or his partner. In case of an auditor or his partner, securities of even small value shall be a disqualification.

(iii) Grace period of 60 days for corrective action shall apply only in respect of securities held by relatives. This would not apply to auditor or his partner.

(iv) Limit of ₹1,00,000 and grace period of 60 days would be applicable where securities are held in the company only.

Section 2(77) of the Companies Act, 2013 defines the term “relative” to mean anyone who is related to another as:

(i) members of a Hindu Undivided Family;

(ii) husband and wife; or

(iii) one person is related to the other in such manner as may be prescribed.

Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014 prescribes the list of relatives as per Section 2(77). As per the said rule, a person shall be deemed to be relative of another if he or she is related to another in the below mentioned manner;

Father (including step- father), Mother (including step-mother), Son (including step-son), Son’s wife, Daughter, Daughter’s husband, Brother (including step- brother), Sister (including step- sister).

<table>
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<tr>
<th>Examples</th>
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<tbody>
<tr>
<td><strong>Ex 1</strong>: “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.”?</td>
</tr>
</tbody>
</table>
As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

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), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Further as per proviso to this Section, the relative of the person 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), is having securities of ₹ 90,000 face Value in ABC 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: “M/s BC & Co.” is an Audit Firm having partners “Mr. B” and “Mr. C”, and “Mr. A” the relative of “Mr. C”, is holding securities of “MWF Ltd.” having face value of ₹ 1,01,000/. Whether “M/s BC & Co.” is qualified from being appointed as an auditor of “MWF Ltd.”?

As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Further as per proviso to this Section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

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

Ex 4: M/s RM & Co. is an audit firm having partners CA. R and CA. M. The firm has been offered the appointment as an auditor of Enn Ltd. for the Financial Year 2016-17. Mr. Bee, the relative of CA. R, is holding 5,000 shares (face value of ₹ 10 each) in Enn Ltd. having market value of ₹ 1,50,000. Whether M/s RM & Co. is disqualified to be appointed as auditors of Enn Ltd.?

As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or
a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹1,00,000.

In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA. M. Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of ₹50,000 only (5,000 shares × ₹10 per share).

Therefore, M/s RM & Co. is not disqualified for appointment as an auditor of Enn Ltd. as the relative of CA. R (i.e. partner of M/s RM & Co.) is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

(iii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh; or

(iii) 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 one lakh rupees.

Disqualification due to indebtedness.

1. Direct Indebtedness

A person shall be disqualified to be appointed as auditor if he or his relative or his partner is indebted in excess of ₹ 5 Lakhs to -

(i) the company; or
(ii) its subsidiary; or
(iii) its holding company; or
(iv) its associate company; or
(v) a subsidiary of such holding company.

2. Indirect Indebtedness

A person shall be disqualified to be appointed as auditor if he or his relative or his partner has given a guarantee or provided any security in connection with the indebtedness of any third person in excess of ₹ 1 lakh to -

(i) the company; or
(ii) its subsidiary; or
(iii) its holding company; or
(iv) its associate company; or
(v) a subsidiary of such holding company.
(e) a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed;

Students may note that for the purpose of clause (e) above, the term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except -

(i) 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;

(ii) 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.

(f) a person whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel;

(g) 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 other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ` 100 crore;

(h) a person who has been convicted by a Court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

(i) accounting and book keeping services;

(ii) internal audit;

(iii) design and implementation of any financial information system;

(iv) actuarial services;

(v) investment advisory services;

(vi) investment banking services;
(vii) rendering of outsourced financial services;
(viii) management services; and
(ix) any other kind of services as may be prescribed.

It may be noted that an auditor or audit firm who or which has been performing any non audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

Further, 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, shall be termed as rendering of services directly or indirectly by the auditor; and 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, shall be termed as rendering of services directly or indirectly by the auditor.

Example: CA. Poshin is providing the services of investment banking to C Ltd. Later on, he was also offered to be appointed as an auditor of the company for the current financial year. Advise.

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144. Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor which includes investment banking services.

Therefore, CA. Poshin is advised not to accept the assignment of auditing as the service he rendering is specifically notified in the list of services not to be rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

(4) Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

CASE STUDY

Mr. A, a chartered accountant has been appointed as an auditor of Laxman Ltd. In the Annual General Meeting of the company held in September, 2016, which assignment he accepted. Subsequently in January, 2017 he joined Mr. 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, Mr. A, an auditor of Laxman Ltd., joined as partner with Mr. B, who is Manager Finance of Laxman Limited. The given situation has attracted sub-section (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited.

6.2 Appointment of Auditor

Section 139 of the Companies Act, 2013 contains provisions regarding Appointment of Auditors. Discussion on appointment of auditors may be grouped under two broad headings-

I  Appointment of First Auditors.

II  Appointment of Subsequent Auditors
6.2.1 Appointment of First Auditor

6.2.1.1 Appointment of First Auditors in the case of a company, other than a Government Company: As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

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<thead>
<tr>
<th>CASE STUDY</th>
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<tbody>
<tr>
<td>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.</td>
</tr>
<tr>
<td><strong>Provisions and Explanation:</strong> 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 proposed appointment of Shri Ganpati, 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.</td>
</tr>
<tr>
<td><strong>Conclusion:</strong> In view of the above, the Managing Director of PQR Ltd should be advised not to appoint the first auditor of the company.</td>
</tr>
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</table>

6.2.1.2 Appointment of First Auditors in the case of Government Company: A “Government company” is a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Section 139(7) provides that 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.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.
CASE STUDY
The first auditor of Healthy Wealthy Ltd., a Government company, was appointed by the Board of Directors.

Provisions and Explanation: Section 139(6) of the Companies Act, 2013 (the Act) lays down that “the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company”. Thus, the first auditor of a company can be appointed by the Board of Directors within 30 days from the date of registration of the company. However, in the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013 which states that in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. Hence in the case of Healthy Wealthy Ltd., being a government company, the first auditors shall be appointed by the Comptroller and Auditor General of India.

Conclusion: Thus, the appointment of first auditors made by the Board of Directors of Healthy Wealthy Ltd. is null and void.

6.2.2 Appointment of Subsequent Auditor/Re-appointment of Auditor

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

The following points need to be noted in this regard-

(i) The company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.

(ii) Before such 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.

(iii) The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141.

(iv) The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

6.2.2.2 Appointment of subsequent auditors in case of Government Companies: As per Section 139(5), 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, in respect of a financial year,
appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

6.2.3 Filling of a Casual Vacancy

As per Section 139(8), any casual vacancy in the office of an auditor shall -

(i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

(ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

6.2.3.1 Casual Vacancy by Resignation: As per section 140(2), the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT–3 (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in section 139(5) i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India,
indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees as per section 140(3).

**Other Important Provisions Regarding Appointment of Auditors**

1. A retiring auditor may be re-appointed at an annual general meeting, if-
   (a) he is not disqualified for re-appointment;
   (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and
   (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

2. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

### 6.3 Rotation of Auditor

**6.3.1 Applicability of section 139(2) Rotation of Auditor**

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the **class of companies** shall mean the following classes of companies:-

- **All unlisted public companies having paid up share capital ≥ ₹10 crore**
- **All private limited companies having paid up share capital ≥ ₹20 crore**
- **All companies having paid up share capital of below threshold limit mentioned, but having public borrowings from financial institutions, banks or public deposits ≥ ₹50 crore**

(a) all unlisted public companies having paid up share capital of rupees ten crore or more;
(b) all private limited companies having paid up share capital of rupees twenty crore or more;
(c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.
6.13 Advanced Auditing and Professional Ethics

**Example:** Rano Ltd. is a private limited Company, having paid up share capital of rupees 18 crore but having public borrowing from nationalized banks and financial institutions of rupees 72 crore, manner of rotation of auditor will be applicable.

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

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

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

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

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

**Example:** Jolly Ltd., a listed company, appointed M/s Polly & Co., a Chartered Accountant firm, as the statutory auditor in its AGM held at the end of September, 2016 for 11 years. Here, the appointment of M/s Polly & Co. is not valid as the appointment can be made only for one term of five consecutive years and then another one more term of five consecutive years. It can’t be appointed for two terms in one AGM only. Further, a cooling period of five years from the completion of term is required i.e. the firm can’t be re-appointed for further 5 years after completion of two terms of five consecutive years.

The following points merit consideration in this regard-

1. 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 XYZ & Co., is an audit firm having partner Mrs. X, Mr. Y and Mr. Z, whose tenure has expired in the company immediately preceding the financial year, M/s ABZ & Co., is another audit firm in which Mr. Z is a common partner, will also be disqualified for the same company along with M/S XYZ & Co. for the period of five years.

2. Every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act.

**Example 1:** Mr. Raj, a Chartered Accountant, is an individual auditor of Binaca Limited for last 5 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013), here a break in the term for a continuous period of five years will not be considered as fulfilling the requirement of rotation. Thus, Mr. Raj can continue the audit of Binaca Ltd. upto
the first annual general meeting to be held after three years from the date of commencement of the Act due to transitional effect.

**Example 2:** M/s Raj Associates, a Chartered Accountants Audit Firm, is doing audit of Binaca Limited for last 11 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013), here a break in the term for a continuous period of two terms of five consecutive years will not be considered as fulfilling the requirement of rotation. Thus, M/s Raj Associates can continue the audit of Binaca Ltd. up to the first annual general meeting to be held after three years from the date of commencement of the Act due to transitional effect.

Students may interlink the above example with Illustrative table explaining rotation in case of individual auditor as well as audit firm which has been given after the 6.3.2 i.e. Manner of rotation of Auditors by the Companies on Expiry of their Term.*

The ICAI made a clarification dated 30.09.2016 on the difference in requirements relating to auditor’s rotation under SQC 1 vis-à-vis Companies Act, 2013.

In case of audits of listed entities, SQC 1 requires rotation of engagement partner after a pre-defined period normally not more than seven years. Now, since SQC 1 is applicable from April 1, 2009, the provisions regarding the rotation of engagement partner would be due from April 1, 2016 as per the SQC 1 during the transition phase.

Further, the Companies Act, 2013 is also applicable from April 1, 2014 and the existing companies which is required to comply with provisions of this sub-section, shall comply with the requirements of this auditor’s rotation provisions within 3 years from the date of commencement of this Act. Therefore, the provisions regarding auditor’s rotation would be due from April 1, 2017 as per the Companies Act, 2013 during the transition phase.

Hence, there is a difference of 1 year in the compliance of auditor’s rotation provision between SQC 1 vis-à-vis the Companies Act, 2013 during the transition phase of implementation of the Companies Act, 2013.

Thus, the Council of the ICAI decided to provide relaxation in the requirement of rotation of engagement partner given in SQC 1 for the transition phase (i.e. for the financial year 2016-17).

3. It has also been provided that right of the company to remove an auditor or the right of the auditor to resign from such office of the company shall not be prejudiced.

4. Subject to the provisions of this Act, members of a company may resolve to provide that-
   (a) 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
   (b) the audit shall be conducted by more than one auditor.

5. The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.
6.3.2 Manner of Rotation of Auditors by the Companies on Expiry of their Term

Rule 6 of the Companies (Audit and Auditors) Rules, 2014 prescribes the manner of rotation of auditors on expiry of their term which is given below:

(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.

*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>
</tr>
</thead>
<tbody>
<tr>
<td>5 Years (or more than 5 years)</td>
<td>3 years</td>
<td>8 years or more</td>
</tr>
<tr>
<td>4 years</td>
<td>3 years</td>
<td>7 years</td>
</tr>
</tbody>
</table>

Explanation I - For the purposes of these rules the term “same network” includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Explanation II - 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.
Note:
1. Individual auditor shall include other individuals or firms whose name or trade mark or brand is used by such individual, if any.
2. 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>
</thead>
<tbody>
<tr>
<td>I</td>
<td>II</td>
<td>III</td>
</tr>
<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>
</tr>
<tr>
<td>8 years</td>
<td>3 years</td>
<td>11 years</td>
</tr>
<tr>
<td>7 years</td>
<td>3 years</td>
<td>10 years</td>
</tr>
<tr>
<td>6 years</td>
<td>4 years</td>
<td>10 years</td>
</tr>
<tr>
<td>5 years</td>
<td>5 years</td>
<td>10 years</td>
</tr>
<tr>
<td>4 years</td>
<td>6 years</td>
<td>10 years</td>
</tr>
<tr>
<td>3 years</td>
<td>7 years</td>
<td>10 years</td>
</tr>
<tr>
<td>2 years</td>
<td>8 years</td>
<td>10 years</td>
</tr>
<tr>
<td>1 year</td>
<td>9 years</td>
<td>10 years</td>
</tr>
</tbody>
</table>

Note:
1. Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.
2. 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.
6.4 Provisions relating to Audit Committee

6.4.1 Applicability of section 177 i.e. Constitution of Audit Committee

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.

Diagram showing class of companies to constitute Audit Committee

It is important to know that in addition to listed companies, following classes of companies shall constitute an Audit Committee -

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

Explanation- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.
Example: XYZ Ltd., a public company having paid up capital of ₹ 9 crore but having turnover of ₹ 150 crore, will be required to constitute an Audit Committee under section 177 because the requirement for constitution of Audit Committee arises if the company falls into any of the prescribed condition.

6.4.2 Manner and procedure of selection and appointment of auditors

Rule 3 of CAAR 2014 prescribes the following manner and procedure of selection and appointment of auditors.

(1) In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, 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.

It may be noted that while considering the appointment, the Audit Committee or the Board, as the case may be, 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.

(2) The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.

(3) Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.

(4) 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 annual general meeting.

(5) 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.

(6) 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 annual general meeting.

(7) The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

It may be noted that such appointment shall be subject to ratification in every annual general meeting till the sixth such meeting by way of passing of an ordinary resolution.
Explanation.- For the purposes of this rule, it is hereby clarified that, 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.

6.5 Auditor’s Remuneration

As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. However, board may fix remuneration of the first auditor appointed by it.

Further, the remuneration, 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 does not include any remuneration paid to him for any other service rendered by him at the request of the company. Therefore, it has been clarified that the remuneration to Auditor shall also include any facility provided to him.

6.6 Removal of Auditors

6.6.1 Removal of Auditor before Expiry of Term

According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014:

(1) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(2) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

(3) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

Direction by Tribunal in case auditor acted in a fraudulent manner: As per sub-section (5) of the section 140, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

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

It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

6.6.2 Appointment of Auditor other than retiring Auditor

Section 140 lays down procedure to appoint an auditor other than retiring auditor who was removed:

1. Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case may be, ten years, as provided under sub-section (2) of section 139.

2. On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

3. 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,-

(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(b) 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, and 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.

Students may note that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

6.7 Ceiling on Number of Audits

It has been mentioned earlier that 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, other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore, shall not be eligible for appointment as an Auditor of a Company.

In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affair.

**CASE STUDY**

“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.

(iii) Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company?

(iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each?

**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, other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

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

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Number of Audits available to the Firm</td>
<td>$20 \times 3$</td>
<td>60</td>
</tr>
<tr>
<td>Number of Audits already taken by all the partners</td>
<td>$4 + 6 + 10$</td>
<td>20</td>
</tr>
<tr>
<td>Remaining number of Audits available to the Firm</td>
<td></td>
<td>40</td>
</tr>
</tbody>
</table>

(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.

(iii) In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

(iv) As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores. In the given case, out of the 60 private companies ABC & Co. is offered, 45 companies having paid-up share capital of ₹ 110 crore each.

Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crore and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.

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**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 224 and / or Section 226 of the Companies Act, 1956 (Section 141(3)(g) of the Companies Act, 2013).

It may be noted that in the case of a firm of chartered accountants in practice, the specified number of audit assignments shall be construed as the specified number of audit assignments for every partner of the firm.

It may also be noted that where any partner of the firm of chartered accountants in practice is also a partner of any other firm or firms of chartered accountants in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not
exceed the specified number of audit assignments in the aggregate.

it is further provided that where any partner of a firm or firms of chartered accountants in practice accepts one or more audit assignments in his individual capacity, or in the name of his proprietary firm, the total number of such assignment which may be accepted by all firms in relation to such chartered accountant and by him shall not exceed the specified number of audit assignments in the aggregate.

1. In computing the specified number of audit assignments.
   (a) the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other chartered accountant in practice or firm of such chartered accountants, shall be taken into account.
   (b) the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.
   (c) a chartered accountant in full time employment elsewhere shall not be taken into account.

2. A chartered accountant in practice as well as firm of chartered accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of chartered accountants, or by any of the partner of the firm in his individual name or as a partner of any other firm as far as possible, in the prescribed manner.

Ceiling on Tax Audit Assignments: The specified number of tax audit assignments that an auditor, as an individual or as a partner of a firm, can accept is 60 numbers. The ceiling limit was increased from 45 to 60 numbers in the year 2014. ICAI has notified that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments u/s 44AB.

6.8 Powers/Rights of Auditors

The auditor has following powers/rights while conducting an audit:

(a) Right of access to books, etc.– Section 143(1) of the Act provides that the auditor of a company, at all times, shall have a right of access to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

It may be noted that according to section 2(59) of the Act, the term ‘officer’ includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

The phrase ‘books, accounts and vouchers’ includes all books which have any bearing, or are likely to have any bearing on the accounts, whether these be the usual financial books or the statutory or statistical books; memoranda books, e.g., inventory books, costing records and the
like may also be inspected by the auditor. Similarly the term ‘voucher’ includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts. Thus, the right of access is not restricted to books of account alone and it is for the auditor to determine what record or document is necessary for the purpose of the audit.

The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto as per section 143(8).

Further, 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.

### Case Study

While conducting the audit of a limited company for the year ended 31\(^{\text{st}}\) March, 2016, the auditor wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor.

**Provisions and Explanation:** Section 143 of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit. In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company.

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

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

(b) **Right to obtain information and explanation from officers**—This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.

(c) **Right to receive notices and to attend general meeting**—The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at
which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Section 146 of the Companies Act, 2013 discusses right as well as duty of the auditor. According to the section 146:

“all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and 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 and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.”

Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

(d) **Right to report to the members of the company on the accounts examined by him**-
The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this 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 there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company’s affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(e) **Right to Lien**- In terms of the general principles of law, any person having the lawful possession of somebody else’s property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents. The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

(i) Documents retained must belong to the client who owes the money.

(ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.

(iii) The auditor can retain the documents only if he has done work on the documents assigned to him.

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

SA 230 issued by ICAI on Audit Documentation (explanatory text, A-25), “Standard on Quality Control (SQC) 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”, issued by the Institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.”

6.8.1 Powers / Rights of Comptroller and Auditor-General of India

Section 143(5) of the Act states that, 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 sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor (discuss in the beginning of the chapter) and direct such auditor the manner in which the accounts of the company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,

(a) conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(b) comment upon or supplement such audit report under section 143(6)(b).

It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures
issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

**Test Audit under section 143(6)(b):** Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General’s (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

### 6.9 Duties of Auditors

Sections 143 of the Companies Act, 2013 specifies the duties of an auditor of a company in a quite comprehensive manner. It is noteworthy that scope of duties of an auditor has generally been extending over all these years.

1. **Duty of Auditor to Inquire on certain matters:** It is the duty of auditor to inquire into the following matters-

   (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

   (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

   (c) 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;

   (d) whether loans and advances made by the company have been shown as deposits;

   (e) whether personal expenses have been charged to revenue account;

   (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) is reproduced below:

> "The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor’s Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider..."
his duties under section 143(1)."

Therefore, it could be said that the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

2. **Duty to Sign the Audit Report:** As per section 145 of the Companies Act, 2013, 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 and the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditors' report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

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

4. **Duty to audit report:** As per sub-section (3) of section 143, the auditor’s report shall also state –

(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company’s auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) whether the company’s balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under sub-section
(2) of the section 164;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

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

(i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

[Notes: (1) Students may note that the auditor is also required to report on certain additional matters specified under Companies (Auditor's Report) Order, 2016 which is discussed in Chapter 8 on Audit Report.

(2) Students are also required to refer Guidance note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013.]
(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

B. Reporting to the Audit Committee or Board- Sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ₹1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub-rule (1) [i.e. less than ₹1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

(a) Nature of Fraud with description;

(b) Approximate amount involved; and

(c) Parties involved.

C. Disclosure in the Board’s Report: Sub-section (12) of section 143 of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board’s report in such manner as may be prescribed.

In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the company is required to disclose in the Board’s Report the
following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year:

(a) Nature of Fraud with description;
(b) Approximate Amount involved;
(c) Parties involved, if remedial action not taken; and
(d) Remedial actions taken.

Sub-section (13) of section 143 of the Companies Act, 2013 safeguards the act of fraud reporting by the auditor if it is done in good faith. It states that 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 above if it is done in good faith.
It is very important to note that the provisions regarding fraud reporting shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12) of section 143, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees).

The auditor is also required to report under clause (x) of paragraph 3 of Companies (Auditor’s Report) Order, 2016 [CARO, 2016], whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

The Auditing and Assurance Standards Board of the ICAI has issued the Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013 to provide guidance to the members on this new reporting requirement.

The definition of fraud as per SA 240 and the explanation of fraud as per Section 447 of the 2013 Act are similar, except that under section 447, fraud includes ‘acts with an intent to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.’ However, an auditor may not be able to detect acts that have intent to injure the interests of the company or cause wrongful gain or wrongful loss, unless the financial effects of such acts are reflected in the books of account/financial statements of the company. For example,

(i) an auditor may not be able to detect if an employee is receiving pay-offs for favoring a specific vendor, which is a fraudulent act, since such pay-offs would not be recorded in the books of account of the company;

(ii) if the password of a key managerial personnel is stolen and misused to access confidential/restricted information, the effect of the same may not be determinable by the management or by the auditor;

Therefore, the auditor shall consider the requirements of the SAs, insofar as it relates to the risk of fraud, including the definition of fraud as stated in SA 240, in planning and performing his audit procedures in an audit of financial statements to address the risk of material misstatement due to fraud.

[Note: Students are required to refer Guidance note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013 for detailed knowledge.]

Example: The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹50 lakh and cleared all the payments to such bogus creditor. Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board’s Report.

It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than ₹1 crore, however, reporting under CARO, 2016 is required.
6. **Duty to report on any other matter specified by Central Government:** The Central Government may, in consultation with the National Financial Reporting Authority (NFRA), by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

*However, as per the notification dated 29.03.2016, till the time NFRA is constituted, the Central Government may hold consultation required under this sub-section with the Committee chaired by an officer of the rank of Joint Secretary or equivalent in the MCA and the Committee shall have the representatives from the ICAI and Industry Chambers and also special invitees from the National Advisory Committee on Accounting Standards (NACAS) and the office of the C&AG.*

7. **Duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor are discussed separately in the chapter under heading 6.13 branch audit.**

8. **Duty to state the reason for qualification or negative report:** As per sub-section (4) of section 143, where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons there for.

6.9.1 **Other Duties under Companies Act, 2013**

The following are the other duties of an auditor under Companies Act 2013 -

(i) **Register of charges** - Every company under Section 85 is required to keep a Register of charges at its registered office to enter therein particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge. The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be. Entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose. The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company. The register kept under this section shall be kept open for inspection during business hours. This register should be examined by the auditor to ascertain whether any of the assets belonging to the company except bearer securities, is subject to charge, and, if so, its nature.

Where the instrument creating or modifying a charge is not filed within a period of 300 days from the date of its creation (including acquisition of a property subject to a charge) or modification and where the satisfaction of the charge is not filed within 30 days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government. The application for condonation of delay shall be filed with the Central Government in relevant Form along with the fee.
(ii) Register of contracts with companies and firms in which the directors are interested - This Register is maintained pursuant to sub-section (1) of Section 189. It contains a record of particulars of all contracts or arrangements that attract the provisions of Sections 184 and 188.

Every Director or key managerial personnel shall within a period of 30 days of his appointment, or relinquishment of his office, as the case may be disclose to the company the particulars related to his concern or interest in the associations which are required to be included in the register. The particulars of the company or companies or bodies corporate in which a director himself together with any other director holds not more than 2 percent of the paid-up share capital would not be required to be entered in the register.

The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

The company shall provide extracts from such register to a member of the company on his request, within 7 days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company but not exceeding ten rupees per page.

The provisions of Section 189 are not applicable to; (a) contracts or arrangements for the sale or purchase or supply of goods, materials or services, if the value or cost thereof in any year does not exceed ₹ 5,00,000 in aggregate; and (b) contracts or arrangements by banking companies for the collection of bills in the ordinary course of business.

It is the duty of the auditor to examine the Register to find out whether transactions of purchase or sale of goods in which a director or directors were interested were entered into under the sanction of the Board and the directors concerned had disclosed their interest.

(iii) Register of investment or loan made, guarantee given or security provided in relation to any body corporate - In pursuance of sub-section (9) of Section 186, every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.

The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

The entries in the register shall be made chronologically in respect of each such transaction within 7 days of making such loan or giving guarantee or providing security or making acquisition.

The extracts from the register maintained may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

(iv) Register of investments held in the names of Nominees - Normally, a company is expected to hold investments in its own name [Section 187]. But where in pursuance of Section-
187(2)(d), any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person. The company is also required to record whether such investments are held in a third party’s name for the time being or otherwise. The register shall be maintained at the registered office of the company. It shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

The auditor should examine the register during the course of inspection of securities.

(v) Register of directors and key managerial personnel and their shareholding - Under the provisions of Section 170(1) of the Companies Act, 2013, it is obligatory for a company to maintain a record, in a register containing particulars of the directors and key managerial personnel which shall include the details of securities held by each of them in the company or its holding, subsidiary, subsidiary of company’s holding company or associate companies.

Under Sub-section (2) of the aforesaid section, a return containing the particulars of appointment of director or key managerial personnel and changes therein, shall be filed with the Registrar in Form DIR-12 along with such fee as may be provided in the Companies (Registration Offices and Fees) Rules, 2014 within 30 days of such appointment or change, as the case may be.

The auditor should refer to this register to find out the names of persons who had held different offices during the year under audit to confirm that various transactions entered into by the company have been authorised by a competent person.

(vi) Managerial Remuneration - Disclosure in the accounts is made.

A note showing the computation of net profits in accordance with Section 198 of the Act with relevant details of calculation of the commission payable by way of such profits the directors (including managing directors or managers) should be given.

Personal expenses of Directors - All payments to directors by way of remuneration or perquisites whether in the case of a public or private company are required to be authorised both in accordance with the provisions of the Companies Act and Articles of Association of the company. In some cases, depending upon the provisions contained in the Articles, the remuneration may require sanction of the shareholders either by an ordinary or special resolution while, in other cases, it may require only approval of the Directors. If the terms of appointment of a director include payment of expenses of personal nature then such expenses can be incurred by the company. Where, however, the contract with the director or the conditions of employment does not contain any provision for payment of expenses of a personal nature, then there is no warrant for incurring or reimbursement of such expenses by the company and if such expenses are paid the auditor should disclose the fact in his report, as also in the accounts. Attention in this regard is invited to Section 143(1)(e) of the Companies Act.
(vii) Loan and investment by company (Section 186) –

(1) Section 186(1) of the Act states that a company shall make investment through not more than two layers of investment companies.

‘Layer’ in relation to a holding company means its subsidiary or subsidiaries [Explanation (d) of Section 2(87) of the Companies Act, 2013].

(2) No company shall directly or indirectly:

(a) give any loan to any person or any other body corporate;

(b) give any guarantee, or provide security in connection with a loan to any other person or body corporate; and

(c) acquire by way of subscription, purchase or otherwise, the securities of any other body corporate,

exceeding 60 per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more.

It may be noted that where the giving of any loan or guarantee or providing any security or the acquisition exceeds the limits specified in that sub-section, prior approval shall be necessary by means of a special resolution passed at a general meeting.

The company is required to disclose to the members in the financial statement the full particulars of the loan given, investment made or guarantee given or security provided and the purpose for which the same mentioned above proposed to be utilized by the recipient of the loan or guarantee or security.

(3) The company cannot make investment, or give loan or guarantee or security unless the resolution sanctioning it is passed at the Board meeting with the consent of all the Directors present at the meeting and the prior approval of the public financial institution (PFI) concerned where any term loan is subsisting is obtained. It is provided that the prior approval of PFI shall not be required where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit as specified in sub-section (2), and there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the PFI.

As per the Companies Act, ‘Public Financial Institution’ means:

(i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956;

(ii) the Infrastructure Development Finance Company Limited, referred to in clause (vi) of sub-section (1) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;

(iv) institutions notified by the Central Government under sub-section (2) of section 4A of the
Companies Act, 1956 so repealed under section 465 of this Act;

(v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Students may note that no institution shall be so notified unless—

(A) it has been established or constituted by or under any Central or State Act; or

(B) not less than fifty-one percent of the paid-up share capital is held or controlled 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.

(4) The Companies which are registered under section 12 of the Securities and Exchange Board of India act, 1992 and covered under such class or classes of companies as may be prescribed shall not take inter-corporate loan or deposits exceeding prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

(5) No loan under this section shall be given at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

(6) No company, which has defaulted in repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any loan or guarantee, or provide any security or make an acquisition till such default is subsisting.

(7) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.

(8) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

The entries in the register shall be made chronologically in respect of each such transaction within 7 days of making such loan or giving guarantee or providing security or making acquisition.

The extracts from the register maintained may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

(9) Nothing contained in this section, except sub-section (1) shall apply to—

- a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities.
• any acquisition made by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

• any acquisition made by a company whose principal business is the acquisition of securities.

• any acquisition of shares allotted in pursuance of clause (a) of sub-section (1) of section 62.

(10) The Central Government may make rules for the purpose of this section from time to time.

(11) If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

[Explanation: “free reserves” means those reserves which, as per latest audited balance sheet of the company, are free for distribution as dividend and shall not include any other amount shown as a reserve or otherwise representing unrealised gains, notional gains or revaluation of assets; or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in statement of profit and loss on measurement of the asset or the liability at fair value.]

6.10 Audit Report

Auditor’s Report - An audit report should be clear, specific and complete, in order that anyone who has an occasion to read it may know exactly what is wrong with the company. An Auditor who gives the shareholders “the means of information” in respect of company’s financial position, does so, at his peril and runs the serious risk of being held judicially to have failed to discharge his duty (Lindley L.J in Re London and General Bank).

The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements.

The auditor’s report should contain a clear written expression of opinion on the financial statements taken as a whole.

(Students may refer Chapter 8 on Audit Report for detailed reporting requirements)

6.11 Disclosure in the Auditor’s Report

The following paragraphs deal with the manner of qualification and the manner of disclosure, if any, to be made in the auditor’s report.
AS-1 – Disclosure of Accounting Policies

In the case of a company, members should qualify their audit reports in case –

(a) accounting policies required to be disclosed under Revised Schedule VI or any other provisions of the Companies Act, 1956 have not been disclosed (now Schedule III to the Companies Act, 2013), or

(b) accounts have not been prepared on accrual basis, or

(c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or

(d) proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated above but the fact of such exemption has not been adequately disclosed in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

In view of the above, the auditor will have to consider different circumstances whether the audit report has to be qualified or only disclosures have to be given.

In the case of enterprises not governed by the Companies Act, the member should examine the relevant statute and make suitable qualification in his audit report in case adequate disclosures regarding accounting policies have not been made as per the statutory requirements. Similarly, the member should examine if the fundamental accounting assumptions have been followed in preparing the financial statements or not. In appropriate cases, he should consider whether, keeping in view the requirements of the applicable laws, a qualification in his report is necessary.

In the event of non-compliance by enterprises not governed by the Companies Act, in situations where the relevant statute does not require such disclosures to be made, the member should make adequate disclosure in his audit report without necessarily making it a subject matter of audit qualification.

In making a qualification/disclosure in the audit report, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification/disclosure in respect of items which, in his judgement, are not material.

A disclosure, which is not a subject matter of audit qualification, should be made in the auditor’s report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor’s opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

6.12 Joint Audit

The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work.
This is by itself a great advantage. In specific terms the advantages that flow may be the following:

(i) Sharing of expertise.
(ii) Advantage of mutual consultation.
(iii) Lower workload.
(iv) Better quality of performance.
(v) Improved service to the client.
(vi) Displacement of the auditor of the company taken over in a take-over often obviated.
(vii) In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
(viii) Lower staff development costs.
(ix) Lower costs to carry out the work.
(x) A sense of healthy competition towards a better performance.

The general disadvantages may be the following:

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

With a view to providing a clear idea of the professional responsibility undertaken by the joint auditors, the Institute of Chartered Accountants of India had issued a statement on the Responsibility of Joint Auditors which now stands withdrawn with the issuance of SA 299, “Responsibility of Joint Auditors” w.e.f. April, 1996. It requires that where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of work would usually be in terms of audit of identifiable units or specified areas. In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time. Certain areas of work, owing to their importance or owing to the nature of the work involved, would often not be divided and would be covered by all the joint auditors. Further, it states that in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –

(a) in respect of the audit work which is not divided among the joint auditors and is carried out
by all of them;

(b) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;

(c) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

(d) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and

(e) for ensuring that the audit report complies with the requirements of the relevant statute.

If any matters of the nature referred above are brought to the attention of the entity or other joint auditors by an auditor after the audit report has been submitted, the other joint auditors would not be responsible for those matters.

[Note: Student may refer SA 299 “Responsibility of Joint Auditors” reproduced in “Auditing Pronouncements” for comprehensive knowledge.]

6.13 Audit of Branch Office Accounts

As per section 128(1) of the Companies Act, 2013, 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, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

It may be noted that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within 7 days thereof, file with the Registrar a notice in writing giving the full address of that other place.

Students may also note that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Sub-section (2) provides that where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or the other place referred in (1).

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

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

Further as per Rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Using the Work of another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, “Using the Work of another Auditor”. It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.

When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

(a) advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and

(b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a
completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

6.14 Cost Audit

It is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company.

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

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

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

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

In this regard, the Central Government has notified the Companies (Cost Records and Audit) Rules, 2014 which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

As per Rule 5 of the Companies (cost records and audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year is required to maintain cost records in **Form CRA-1**. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Additionally, as per clause (vi) to Paragraph 3 of the CARO, 2016, **the auditor has to report whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained**.

Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an Auditor within 180 days of the commencement of every financial year. **However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him or it shall be obtained.** Every referred company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such
appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

The cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

The cost auditor shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in Form CRA-3. He shall forward his duly signed report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

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

Cost Audit Rules not to apply in certain cases: The requirement for cost audit under these rules shall not be applicable to a company which is covered under rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue; or

(ii) which is operating from a special economic zone.

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

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 under sub-section (1) 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.

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

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

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

Appointment and Remuneration of Cost Auditor: As per rule 14 of the Companies (Audit and Auditors) Rules, 2014,
6.45 Advanced Auditing and Professional Ethics

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

(i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;

(ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant 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.

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

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

Submission of Cost Audit Report: A company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language (XBRL) format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014. If, after considering the cost audit report referred to under this section and the, information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Penal Provisions in case of default: If any default is made in complying with the provisions of this section,

(a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147. (Section 147 is discussed separately in para 6.15);

(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. (Section 147 is discussed separately in para 6.15).

[Note: Students may refer Chapter 16 on Cost Audit for more details]
6.15 Punishment for non-compliance

Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

(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 twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.

(2) If an auditor of a company contravenes any of the provisions of section 139 section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

(3) Where an auditor has been convicted under sub-section (2), he shall be liable to:–

(i) refund the remuneration received by him to the company;

(ii) and pay for damages to the company statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(4) The Central Government shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages the 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.

(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 an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil criminal as provided in this Act or in any other law for the time being in force, for such act shall be the partner or partners concerned of the audit firm and of the firm jointly and severally.

6.16 Final Accounts Preparation and Presentation

6.16.1 Financial Statements

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recommendations made by the National Financial Reporting Authority (NFRA).

However, as per the notification dated 29.03.2016, till the time NFRA is constituted, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by National Advisory Committee on Accounting Standards (NACAS).

The Central Government has also notified Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015 in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.

Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder, however, are not applicable to an insurance or banking company or a company engaged in the generation or supply of electricity or to any other class of companies for which a form of financial statement has been specified in or under the Act governing such class of companies. The provisions that companies, other than those aforementioned, should comply with are:

(a) That financial statement shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards notified under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013.

(b) That the items contained in such financial statements shall be in accordance with the accounting standards.

The third proviso to section 129(1) of the Act provides that the financial statements not to be treated as not disclosing true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—

(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;

(b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;

(c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;

(d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

Section 129(2) of the Act, requires the Board of Directors of the company to lay before every annual general meeting the financial statements for the financial year.

Re-opening of accounts on Court’s or Tribunal’s orders: Section 130 of the Companies Act, 2013 states that a company shall not re-open its books of account and not recast its
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financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board, any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

However, a notice shall be given by the Court or Tribunal in this regard and shall take into consideration the representations, if any.

Voluntary revision of financial statements or Board’s report: Section 131 of the Companies Act, 2013 states that if it appears to the directors of a company that—

(a) the financial statement of the company; or

(b) the report of the Board,
do not comply with the provisions of section 129 (Financial statement) or section 134 (Financial statement, Board’s report, etc.) they may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar.

6.16.2 Consolidated Financial Statement

Section 129(3) of the Act has now made mandatory for consolidation of financial statement. It states that where a company has one or more subsidiaries, it shall, in addition to the financial statements provided above, prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner so that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2) above.

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and the applicable accounting standards. And in case of a company covered under sub-section (3) of section 129 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.

However, the requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

(i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available
with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

The company is also required to 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.

[Explanation- For the purpose of sub-section (3) of section 129, the word “subsidiary” shall include associate company and joint venture.]

The provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements referred to in section 129(3).

Where the financial statements of the company do not comply with the accounting standards, such companies 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 effect, if any, arising due to such deviation.

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 the companies from complying with any of the requirements of this section or the rules, if it is considered necessary to grant such exemption in the public interest and such exemption may be granted either conditionally or unconditionally.

6.16.3 Penalty for contravention

If a company contravenes the provisions of this section:

(a) 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 shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both, and

(b) in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

[Explanation- For the purpose of section 129, except where the context otherwise requires, 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.]

6.16.4 Constitution of National Financial Reporting Authority

According to Section 132 of the Act, the Central Government may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards for adoption by companies or class of companies under this Act.

However, the central government, vide its notification dated September 18, 2014, clarified that the chairperson and members of “National Advisory Committee on Accounting Standards” shall continue to hold office for a period of one year from the notification date or till the constitution of “National Financial Reporting Authority” whichever is earlier.

6.16.5 Form of the Balance Sheet

Only vertical format of balance sheet and statement of profit and loss is prescribed under Schedule III to the Companies Act, 2013. Only vertical format is allowed and consequently compulsory. There is no option to prepare balance sheet and statement of profit and loss in horizontal format (‘T Form’).

Some of the features of Schedule III are as under:

(i) The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies act, 2013. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

(ii) This Schedule does not recognize presenting information in Schedules. Instead it requires presenting the information in details through notes to account.

(iii) Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts.

(iv) The corresponding amount for the immediately preceding year for all the items shown in the Financial Statements including notes shall also be given [excluding the cases where first Financial Statements laid before the company (after its incorporation)].

Schedule III to the Companies Act, 2013 –

The Schedule III to the Companies Act, 2013 (brought into force with effect from 1st April, 2014) will apply to all the companies (except to the companies as referred to in the second proviso to section 129(1) of the Companies Act, 2013) uniformly for the financial statements to be prepared for the financial year 2014-15 and onwards.

The requirements of Schedule III do not apply to the Companies excused in the second proviso

1 Section 132 of the Companies Act, 2013 is not yet notified.
to section 129(1) of the Companies Act, 2013, namely:

(a) an insurance company, or
(b) banking company, or
(c) a company engaged in the generation or supply of electricity, or
(d) any other class of companies for which a form of financial statement has been specified in or under the Act governing such class of companies.

The Schedule III to the Companies Act, 2013 has been divided into two divisions vide notification dated 06.04.2016. Division I deals with Financial Statements for a company whose Financial Statements are required to comply with the Companies (Accounting Standards) Rules, 2006 and Division II deals with Financial Statements for a company whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015.

Division I has been divided as follows:

Part I contains the form in which the Balance Sheet of a company should be drawn up, and states the general instructions as regard to presentation of different assets and liabilities.

Part II contains the form and states the general instructions as regard to preparation and presentation of information in the Statement of Profit and Loss.

General instructions for preparation of Consolidated Financial Statements have also been provided in Schedule III where a company is required to prepare Consolidated Financial Statements. The company shall mutatis mutandis follow the requirements of this Schedule as applicable to a company in the preparation of balance sheet and statement of profit and loss.

Division II has been divided as follows:

Part I contains the form in which the Balance Sheet of a company required to comply with Ind AS and states the general instructions as regard to preparation of Balance Sheet.

Part II contains the form and states the general instructions as regard to preparation of Statement of Profit and Loss.

PART III contain general instructions for preparation of Consolidated Financial Statements.

[Note: Students are required to refer Appendix annexed at the end of this Chapter for detailed understanding of Schedule III to the Companies Act, 2013]

6.17 Significance of True and Fair

The concept of true and fair is a fundamental concept in auditing. The phrase “true and fair” in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit. This requires that the auditor should examine the accounts with a view to verify that all assets, liabilities, income and expenses are stated as amounts which are in accordance with accounting principles and policies which are
relevant and no material amount, item or transaction has been omitted.

The importance of the concept of true and fair view can also be understood and appreciated from the fact that sections 128, 129 and 143 of the Companies Act, 2013 also discuss this concept in relation to account books, financial statements and reporting on financial statements respectively.

Section 128(1) of the Companies Act, 2013 provides that 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. The company shall be in a position to explain the transactions effected both at the registered office and its branches. Such books of Accounts shall be kept on accrual basis and according to the double entry system of accounting.

Section 129(1) of the Companies Act, 2013 provides that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 of the Companies Act, 2013, (in which the Central Government may prescribe the standards of accounting 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) and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III to the said Act.

The term “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 the said Act.

It may be noted that nothing contained in sub-section (1) of section 129 shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to 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.

However, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose-

(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;

(b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;

(c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
(d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

It may be noted that where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

Further, according to section 143(2) of the said Act, the auditor is required to make a report to the members of the company indicating that, to the best of his information and knowledge, the 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.

SA 700 “Forming an Opinion and Reporting on Financial Statements”, requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that it gives a true and fair view in conformity with the accounting principles generally accepted in India (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX; (b) in the case of the Statement of Profit and Loss, of the profit/loss for the year ended on that date; and (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

In the context of audit of a company, the accounts of a company shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of provisions of Schedule III to that Act, or by virtue of a notification or an order of the Central Government modifying the disclosure requirements. Therefore, the auditor will have to see that the accounts are drawn up in conformity with the provisions of Schedule III of the Companies Act, 2013 and whether they contain all the matters required to be disclosed therein. In case of companies which are governed by special Acts, the auditor should see whether the disclosure requirements of the governing Act are complied with. It must be noted that the disclosure requirements laid down by the law are the minimum requirements. If certain information is vital for showing a true and fair view, the accounts should disclose it even though there may not be a specific legal provision to do so. Thus, what constitutes a ‘true and fair’ view is a matter of an auditor’s judgment in the particular circumstances of a case. In more specific terms, to ensure true and fair view, an auditor has to see: (i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles, (ii) no material asset is omitted; (iii) the charge, if any, on assets are disclosed; (iv) material liabilities should not be omitted; (v) the statement of profit and loss discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with Part I of Schedule III; (vii) accounting policies have been followed consistently; and (viii) all unusual, exceptional or non-recurring items have been disclosed separately.
In this context, it is noteworthy that the Council of the Institute while issuing a clarification regarding authority attached to documents issued by the Institute also observed that, the Companies Act, as well as many other statutes require that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. However, what constitutes ‘true and fair’ view has not been defined either in the Companies Act, 2013 or in any other statute. The pronouncements of the Institute seek to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view. The pronouncements issued by the Institute include various statements, standards and guidance notes.

6.18 Divisible Profits, Dividends and Reserves

Profit is the central theme for almost all business activities. Decision about the future of the business, i.e., whether to close down, expand or modify largely depend on the trend of profits or losses; investors' interest in a business is also dependent upon the yield that they get. For all these, determination of correct profit is obviously important and, no wonder, it is a matter to which accountants attach great importance. The auditor must necessarily have regard to generally accepted accounting practices, legal provisions and judicial pronouncements in carrying out his duties. Should more profit be distributed than is permissible, because of a wrong process of computation, it may be treated as paying a dividend out of capital which is legally not permissible unless the company is being wound up. Apart from legal consequences, the management of the business would be depleting capital of the company which may have dangerous results.

Reserves can be created only when there is profit. Some reserves can also be utilised to pay dividends. Apart from the specific law governing creation and maintenance of reserves in certain cases, the articles of association of companies generally contain provisions in this respect. In addition, accepted accounting practices suggest situations, where, even in the absence of any specific law, reserves should be maintained. Despite the existence of accounting principles, judicial rulings and legal requirements controversy in these respects cannot be considered to have come to an end. For example, though professional bodies as well as law have tried to distinguish revenue reserves from capital reserves, still there is large scope of disagreement on whether capital reserves are distributable. It is imperative that there should be a clear idea about profit, distributable profit, dividend and reserves. The auditor should, within the broad framework of available guidelines, exercise his own judgement in each case.

A special note in this connection should be taken for depreciation and valuation of stocks, the two major elements influencing the correct determination of profit or loss. These two are related to the valuation of assets of the business which directly and significantly affect the figure of profit or loss. One should be aware of the various possibilities in this regard.

6.18.1 Concept of profit

Like the term “value” in Economics, accountants have used the word ‘profit’ for many years
without assigning a definite meaning to it. This state of affairs has given rise to much uninformed criticism of accountants and their work; added to this is the difficulty an economist and an accountant differ as to computation of profit of a business.

**Economist's concept** - Profit is the increase in the value of total net assets of a business over a period of time after making an allowance for any withdrawal or introduction of capital. This is known as the “Increased Net Worth Theory of Profit”. It is ascertained by determining the market value on the two accounting dates of all the assets reduced by the amount of liabilities incurred. The increase or reduction in the net worth is the profit or loss for the intervening period.

Accountant’s concept - To an accountant, profit is the margin between operating income and associated expenses as related to a given period of time. Nevertheless, he is conscious of the fact that a business is a continuing operation and its wheels do not cease to grind, as is assumed for the purpose of preparing the periodical statements of account. So, while he agrees that these should be prepared in order that proprietors may have periodical reports of the stewardship, he is conscious of their limitations. It is on this account that he is continually striving to perfect his method to evaluate the expenditure which has not resulted in an income so that, on its exclusion the accounts may become more accurate and meaningful.

In this regard some of the ideas which have dominated the thinking of accountants in the past are: the necessity of preserving the monetary value of the proprietary capital originally contributed, the unpredictable nature of the future course of events and sale as an essential step to the emergence of profit. These ideas in due course have developed into a completed fabric of “generally accepted accounting practices” which are stated below:

(i) The book value of fixed assets should be assessed at their historical cost regardless of their market price.

(ii) The book value of current assets should be based on their cost or net realisable value whichever is lower.

(iii) A mere rise in market value is not a profit, but if the asset is a current asset, decline in its market value is a loss.

(iv) No profits are earned unless the product is sold and cash is received or an enforceable obligation against a debtor is created.

(v) In general, underestimation of prospective revenue (i.e., conservatism) is commendable: overstatement is not permissible. This is based on the dictum: anticipate no profits, provide for all losses. No a day, concept of procedure is gaining importance over the conservatism.

(vi) In general, known expenditure or loss even though not incurred should be provided for.

(vii) Consistency of accounting policy adopted from year to year should be ensured as far as practicable.

On a consideration of the aforementioned practices it would appear that if any of them are disregarded, the accuracy of profits disclosed by the statements of account would be vitiated and elements of guess work and uncertainty would creep in.
6.18.2 Valuation of assets

The question of determination of profits is inextricably bound up with the valuation of assets. Therefore, when the basis of valuation is altered or a wrong basis is adopted, it affects the amount of profit or loss disclosed by the Statement of Profit and Loss. Some of the significant factors which affect the determination of profit are: rate of depreciation of fixed assets, the manner in which expenditure on research is adjusted in the accounts, valuation of work in progress, provision for bad and doubtful debts, etc. The different bases on which assets are valued are briefly explained below to show that the method conventionally followed for the determination of profits does not necessarily give profit which have been actually earned. This is because a lot of estimation enters in determining the value of assets and liabilities:

(i) **Fixed assets** - The charge for depreciation is always approximate. There are several elements of estimation involved in its computation, e.g., the life of the asset, its residual scrap, value of obsolescence, etc. Further, the charge for depreciation is made merely to amortize the original cost. It may or may not at the end of its useful life, result in accumulating enough liquid resources to replace the asset on account of the increase which may have taken place in the replacement cost.

(ii) **Intangible assets** - Accounting theory so far has not sufficiently developed to prescribe a uniform method of valuation of intangible assets like goodwill, patent rights, technical know-how, etc. This class of assets is thus treated differently by different industries; sometimes even in the same industry their treatment at different units is not the same.

(iii) **Deferred revenue expenditure and other fictitious assets** - Again there is no uniformity of treatment of these items. Successful companies write off their preliminary expenses or development expenses, etc. immediately. Less successful ones write them off over a period of years, the argument being that such initial expenditure also benefits future years.

(iv) **Valuation of Work in Progress** - There are several senses in which the words “cost” and “net realisable value” may be construed. The rule that profit must only be taken into account when realised by sale is again responsible for some distortion. Its application logically to companies doing long-term construction contracts may involve a great fluctuation in profits from year to year. AS-2 issued by the Institute deals with uniform approach and practice as regards valuation and presentation of inventories.

**Judicial rulings on ascertainment of profits** - The fact of the three cases given below should be studied carefully:

In Re. Spanish Prospecting Co. Ltd. (1911), the company had contracted to pay a certain salary to some of its staff subject to the condition that they shall not be entitled to draw their salary "except only out of profits" if any, arising from the business of the company. The salary was cumulative. Any arrears were to be payable out of future profits. The company dealt in shares and securities. The company went into liquidation and some of the securities held were sold by the liquidator. It was contended that the proceeds should be credited to the Statement of Profit and Loss (their book value was nil) in order to enable the staff to receive their arrears to salary.
This contention was rejected at first but was upheld by the Court of Appeal. This case establishes the fundamental nature of profit (impliedly the economist's profit).

In Re. Crabtree Thomas vs. Crabtree (1912), the testator left his business to be carried on by trustees and to pay thereof to his wife while she lived and on her death, to a residuary legatee. The trustee charged in the accounts depreciation on machinery. It was contended on behalf of the life tenant that the profits before charging depreciation were paid to her. But it was ruled out on the ground that depreciation must be charged on the assets of a business to arrive at the amount of profit.

Edwards vs. Saunton Hotel Co. Ltd. (1942), a director of the company was to be paid by way of remuneration 20% of the profit “available” for distribution each year. It was held that depreciation on assets calculated on the straight line method must be deducted from the surplus to arrive at the amount of profit, 20% whereof was payable to the director, but the income tax payable by the company was not to be deducted.

6.18.3 Depreciation under Section 123 of the Companies Act, 2013 read with Schedule II to the Companies Act, 2013

Section 123 of the Act, provides that the dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in a manner prescribed under Schedule II “Useful lives to compute Depreciation”, to the Companies Act, 2013.

The useful life or residual value of any specific asset as notified for accounting purpose by a Regulatory Authority constituted under an Act of Parliament or by the Central Government intend to be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of Schedule II.

The Schedule II to the Companies Act, 2013 needs disclosure in the financial statements about the depreciation method used and the useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule II. [Discussed later in detail under Para 6.19 Depreciation].

6.18.4 Law relating to dividends -

6.18.4.1 Sources of dividends - The Companies Act, 2013 lays down the law relating to distribution of profits by making certain provisions under Section 123. Accordingly, dividend cannot be declared or paid by a company for any financial year except:

(a) out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or

(b) out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or

(c) out of the balances of profit mentioned in (a) and (b) above; or

(d) out of money provided by the Central Government or a State Government for the payment of dividend by the company pursuant to the guarantee given by that Government.
6.18.4.2 Dividends out of current profits- Transfer to Reserves is optional – The first proviso to Section 123(1) of the Act provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profit for that financial year as it may consider appropriate to the reserves of the company irrespective of the size of the declared dividend.

6.18.4.3 Dividends out of past profits - The second proviso to Section 123(1) of the Companies Act, 2013 read with the Companies (Declaration and Payment of Dividend) Rules, 2014 provides that in the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of surplus subject to the fulfillment of following conditions that:

(i) The rate of the dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year.

It is also provided that this sub-rule shall not apply to a company, which has not declared any dividend in each of the three preceding financial year.

(ii) The total amount to be drawn from such accumulated profits shall not exceed an amount equal to one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(iii) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(iv) The balance of reserves after such withdrawal shall not fall below 15% of its paid-up share capital as appearing in the latest audited financial statement.

The fourth proviso to section 123(1) provides that no company shall declare dividend unless carried over previous losses and depreciation not provided in previous year(s) are set off against profit of the company for the current year.

No dividend from Reserves other than Free Reserves- It is further provided under third proviso to Section 123(1) of the Companies Act, 2013 that no dividend shall be declared or paid by a company from its reserves other than free reserves.

6.18.4.4 Dividends includes Interim dividend- As per Section 2(35) of the Companies Act, 2013, dividend has been defined to include any interim dividend also.

6.18.4.5 Dividend policy and related financial considerations - Normally an auditor, in the discharge of his duties is not concerned with the policy about dividends. He is merely concerned with the legality and actual payment of the dividend. The basis of legality is provided by the Companies Act, 2013 and the related Articles of Association. However, sometimes auditors are consulted in the matter of deciding upon the quantum of dividend that can be distributed by a company. Apart from this, Chartered Accountants as such also act as consultants to various companies on a number of matters, including dividend. The basic decision about the dividend is that of the management; the shareholders do not have the authority to enhance the sum proposed by the directors unless the articles allow such a procedure. On the other hand, the management, because of its very thorough and intimate knowledge of the financial state of
affairs of the company and of the business environment, is considered to be the best equipped to deal with the matter.

Dividend is a phenomenon involved with the question of financial management of the company, rationality or feelings of the shareholders and other allied factors; it is therefore very difficult to lay down any definite policy in this regard. However, as a guiding rule a broad frame of policy has often been adopted by companies for guidance in deciding each year the quantum of dividend having regard to the specific situations faced by the company in the concerned year or situations that are in offing. In deciding upon a policy of dividend the financial considerations generally get the place of prominence, though the aspects of shareholders’ aspirations are also taken into consideration. A balance is generally struck to bring about compromise and adjustment between these without unduly impairing the financial state of the company. In this context, it should be appreciated that the amount of the profit available as dividend has competing claimants. It is a source of finance so far as the company is concerned. This can often be very profitably employed to finance expansion or diversification or for setting right the adverse working capital or liquidity position.

As a general proposition, the following are determinants of dividend policy:
1. Nature of earnings.
2. Re-investment alternative.
3. Dividends and liquidity.
4. Dividends and working capital.
5. Dividends and new capital requirements.
6. Dividends and market value of shares.
7. Tax brackets of shareholders.

**6.18.4.6 Payment of Dividends**

(1) Dividends once declared become the liability of the company and must be paid within 30 days from the date of declaration. Any failure to do so attracts a penalty for the various persons associated with the management [Section 127].

(2) Payment of dividend on any share should be made only to the registered shareholder of such share or to his order or to his banker. Dividends are not payable except in cash; or by cheque or warrant; or in any electronic mode to the shareholder entitled to the payment of the dividend.

But the profits or reserves can be capitalised for purpose of issuing fully paid-up bonus shares subject to the guidelines issued by the SEBI also they may be applied for paying up any amount for the time being unpaid on any share held by the members of the company.

(3) A company may, if so authorised by its articles, pay dividends in proportion to the amount paid-up on each share in accordance with Section 51.
(4) The Board may deduct from any dividend payable to any member all sums of money, if any, presently payable by him to the company on account of calls or otherwise in relation to the shares of the company [Table F of Schedule I to the Companies Act, 2013].

Deposit of amount of Dividend in separate bank account - The amount of the dividend, including interim dividend, should be deposited in a scheduled bank in a separate account within 5 days from the date of declaration of such dividend.

As per Section 123(6) of the Act, a company which fails to comply with the provisions of section 73 (matters to be followed while inviting, accepting or renewing deposits under the new Companies Act, 2013 from the public), and section 74(2) (matters to be followed for repayment of deposits etc. before the commencement of this Companies Act, 2013) shall not, so long as such failure continues, declare any dividend on its equity shares.

6.18.4.7 Punishment for failure to distribute dividends - According to Section 127 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted, within 30 days from the date of declaration to any shareholder entitled to the payment of the dividend, following shall be punishable:

(i) every director of the company, if he is knowingly a party to the default, be punishable with imprisonment which may extend to 2 years and with fine which shall not be less than one thousand rupees for every day during which such default continues and,

(ii) the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.

Proviso to Section 127 of the Act provides that no offence under this section shall be deemed to have been committed:-

(a) where the dividend could not be paid by reason of the operation of any law;

(b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;

(c) where there is a dispute regarding the right to receive the dividend;

(d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

(e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

6.18.4.8 Unpaid Dividend Account [Section 124]

Section 124 of the Act provides that dividend declared which remains unpaid or unclaimed within 30 days from the date of declaration of such dividend shall be transferred by the company to a special account called "Unpaid Dividend Account" opened in any scheduled bank. Such transfer

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2 Only Sub-section (1) of Section 74 of the Companies Act, 2013 is enforced till date.
shall be made within 7 days from the date of expiry of the said period of 30 days. In case of any
default in transferring the amount unpaid/ unclaimed dividend to the Unpaid Dividend Account,
the company shall pay interest at the rate of 12% per annum on the amount not transferred. The
interest accrue on such amount shall endure to the benefit of the members of the company in
proportion to the amount remaining unpaid to them.

Any person claiming to be entitled to any of the money transferred to the Unpaid Dividend
Account of the company may apply to the company for the payment of the money claimed.

Obligation to place details of transfer to Unpaid Dividend Account on website- The
company is required to prepare a statement containing the names, their last known addresses
and the unpaid dividend to be paid to each person within a period of 90 days of making any
transfer of an amount to the Unpaid Dividend Account and place it on the website of the
company, if any, and also on any other website approved by the Central Government for this
purpose, in such form, manner and other particulars as may be prescribed.

Unpaid or unclaimed amount of Unpaid Dividend Account- Any money transferred to Unpaid
Dividend Account remains unpaid or unclaimed for a period of 7 years from the date of such
transfer shall be transferred by the company along with interest accrued, if any, thereon to the
Investor Education and Protection Fund.

The company shall send a statement of the details of such transfer to the authority in the Form
DIV 5 which administers the said fund and that authority shall issue a receipt to the company
an evidence of such transfer.

All shares in respect of which unpaid or unclaimed dividend has been transferred shall also be
transferred by the company in the name of Investor Education and Protection Fund along with
a statement containing such details as may be prescribed. Any claimant of shares transferred
shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in
accordance with such procedure and on submission of such documents as may be prescribed.

Sub-section (7) of Section 124 of the Act provides that the company shall be punishable with
fine which shall not be less than five lakh rupees but which may be extend to twenty-five lakh
rupees. Every officer of the company who is in default shall be punishable with fine which shall
not be less than one lakh rupees but which may be extend to five lakh rupees.

6.18.4.9 Establishment of Investor Education and Protection Fund [Section 125]  
(1) The Central Government shall establish a fund to the called the Investor Education and
Protection Fund (hereafter in this section referred to as the “Fund”).
(2) There shall be credited to the Fund the following amounts, namely:
(a) the amount given by the Central Government by way of grants after due appropriation
made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

3 Some part of section 125 of the Companies Act, 2013 enforced with effect from 07.09.2016.
(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124 of the Companies Act, 2013;

(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;

(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) the interest or other income received out of investments made from the Fund;

(g) the amount received under sub-section (4) of section 38;

(h) the application money received by companies for allotment of any securities and due for refund;

(i) matured deposits with companies other than banking companies;

(j) matured debentures with companies;

(k) interest accrued on the amounts referred to in clauses (h) to (j);

(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) such other amount as may be prescribed.

It is provided that no such amounts referred to in clauses (h) to (j) shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

(3) The Fund shall be utilised for the following purposes in accordance with such rules as may be prescribed:-

(a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(b) promotion of investors’ education, awareness and protection;

(c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
(d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245\(^4\) by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(e) any other purpose incidental thereto.

It is provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C of the Companies Act, 1956, transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

**Explanation** - The disgorged amount refers to the amount received through disgorgement or disposal of securities.

(4) Any person claiming to be entitled to the amount referred in section 125(2) may apply to the authority constituted under section 125(5) for the payment of the money claimed.

(5) The Central Government shall constitute, by notification, an authority for administration of the fund consisting of a chairperson and such other members, not exceeding seven and a chief executive officer, as the Central Government may appoint.

(6) The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed.

(7) The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed.

(8) The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the C&AG of India.

(9) It shall be competent for the authority constituted under sub-section (5) to spend money out of the Fund for carrying out the objects specified in sub-section (3) of 125.

The accounts of the Investor Education and Protection Fund is required to be audited by the C&AG of India at such interval as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government.

The authority is required to prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government. The Central Government shall cause the annual report and the audit report given by the C&AG of India to be laid before each House of Parliament.

\(^4\) Section 245 of the Companies Act, 2013 is not yet enforced.
6.18.4.10 Right to dividend, rights shares and bonus shares to be held in abeyance pending registration of transfer of shares- As per section 126 of the Act, payment of dividend and allotment of bonus and right shares to the transferee to be held in abeyance till the title to shares is decided. This section requires that where any instrument of transfer of shares has been delivered to the company for registration and the transfer of such shares has not been registered by the company, it shall transfer the dividend in relation to such shares to the special account referred to in section 124 i.e. Unpaid Dividend Account unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer. Further, the company shall also keep in abeyance in relation to such shares, any offer of right shares and any issue of fully paid up bonus shares.

6.18.4.11 Power to close register of members or debenture-holders or other security holders- As per section 91 of the Act, a company may close the register of members or the register of debenture-holders or the register of other security holders for any period or periods not exceeding in the aggregate 45 days in each year, but not exceeding 30 days at any one time, subject to giving of previous notice of at least 7 days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in such manner as may be prescribed.

The auditor may take the following steps to ensure that the dividend has been paid only out of profits:

(a) Check whether dividend was declared out of profits arrived at after providing for depreciation as per Section 123(2).

(b) Check whether:

(i) the depreciation was provided according to provisions of Schedule II to the Companies Act, 2013.

(ii) a board resolution recommending dividend was passed.

(iii) the dividend was declared only in the annual general meeting.

(iv) no dividend declared in general meeting exceeds the amount recommended by the Board.

(v) amount paid or credited as paid on a share in advance of calls is not treated for the purpose of this regulation as paid on the share.

(vi) register of members was closed as per the provisions of section 91 of the Companies Act, 2013.

(vii) dividend has been paid in the prescribed manner within 30 days of time to the registered holder or to their order (Section 127).

(viii) Amount of dividend deposited in a separate bank account within 5 days from the date of declaration of dividend.

(ix) intimation sent to stock exchange, in case of listed company.
(x) there were any complaints regarding non-payment or delay in payment of dividend? If, so, whether corrective action was taken.

6.18.4.12 Interim Dividend - The definition of term dividend has been modified to include interim dividend also. Interim dividend stands at par with the final dividend. Therefore, all aforesaid requirements applicable in case of final dividend would also apply to interim dividend.

The Board of Directors of a company may declare interim dividend during the financial year out of the surplus in the Statement of profit and loss and out of profits of the financial year in which such interim dividend is sought to be declared. Further, if in a case, the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding 3 financial years.

6.18.4.13 Payment of dividend and the Income tax Act - Payment of dividends by a company though basically governed by the provisions of the Companies Act, has to reckon with a number of provisions contained in the Income tax Act, having direct or indirect relevance to the determination of the amount of dividend. The Companies Act, 2013 has prescribed the sources from which dividend may be declared/ paid in Section 123. In particular it requires provision for depreciation, setting off of past losses etc. It also provides for the circumstances under which dividend can be paid out of past profits. The manner of payment of the dividend is also provided for in the Companies Act. It may be mentioned that any deviation from these provisions will render the dividend illegal. The payment of dividend is a corporate phenomenon based on accounting, financial and legal considerations. The accounting and legal considerations are highly related. In determining the accounting profit, as indicated above a number of provisions from the Income tax Act have got to be considered. For example, distributable profit of a company gets conditioned by the requirements to create and retain reserves e.g. investment allowance reserves. It may be pointed out that any departure from the provisions of the Income tax Act will not make the payment of dividend illegal but may increase the tax liability of the company.

6.18.4.14 Should all fictitious assets be written off before distribution of dividends? - The Accounting Standards Board of ICAI has issued a guidance note on terms used in financial statements where the term 'fictitious asset' has been described as an item grouped under assets in a balance sheet which has no real value. The guidance note cites the example of the debit balance of the statement of profit and loss. We can also give other examples like, (1) Goodwill recorded at a particular figure whereas the company may have no goodwill at all in the ordinary commercial sense, (2) Patents appearing in the balance sheet which in fact are useless.

There is no mandatory rule in accounting or any legal requirement that fictitious assets must be written off before declaration of dividend. This is more in the nature of preferable practice but is not mandatory in its nature. Accordingly it may be said that though writing off of fictitious assets on a proper accounting consideration is desirable, it is not mandatory. However, the following points must be noted in this regard:
If there exists debit balance in the Statement of profit and loss, depreciation, if any, contained therein should first be set off before declaration of dividend out of current profits.

In the case of *Verner vs. The General Commercial Investment Trust Ltd.*, it was held that a company may pay dividends if it is solvent and is acting within its articles that distribution of dividend is permissible if there exists revenue surplus even though some portion of the value of the assets disclosed in the balance sheet may turn out to be fictitious.

### 6.18.4.15 Audit procedure for “Payment of Dividend”:
The Auditor should obtain appropriate audit evidence as regard to audit of payment of dividends. The procedure includes the following:

(i) Check that all the rules and regulations concerning the declaration or payment of dividends have been complied with.

(ii) Examine that the accounting and disclosure procedure has been complied with related to the declaration and payment of dividend like depreciation has been provided before declaration, disclosure has been made by way of notes to the accounts etc.

(iii) Scrutinize that the dividends have been declared or paid only out of distributable profit i.e. profits for the current year for which dividend is declared, or accumulated profits of the previous years, or money provided by the Central or State Government as per Section 123(1) of the Act.

(iv) Inspect that the dividend has been paid only out of “free reserves” i.e. the reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend except- any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in statement of profit and loss on measurement of the asset or the liability at fair value, as laid down under third proviso to Section 123(1) read with Section 2(43) of the Act.

(v) If dividend has been paid out of accumulated profits, earned by it in previous years and transferred to the reserves, in case of inadequacy or absence of profits in any financial years, verify that the rules related to such distribution has been complied i.e. the maximum amount allowable to be distributed as a dividend in case of inadequate or no profit as required by second proviso to Section 123(1) of the Act.

(vi) Verify that the dividend recommended by the Board has been approved by the members at the annual general meeting.

(vii) Verify that the dividend has been transferred to the separate scheduled bank account within 5 days from the declaration of such dividend as required by Section 123(4) of the Act.

(viii) Verify that the dividend has been paid within 30 days from the declaration. If in case the dividend has not been claimed or paid within 30 days from the declaration, verify that the unpaid or unclaimed dividend amount has been transferred to a special account called unpaid dividend account as per Section 124(1) of the Act.

(ix) Verify that the company has prepared a statement within a period of 90 days of making any transfer of an amount to the Unpaid Dividend Account containing the names, their last
known addresses and the unpaid dividend to be paid to each person, and have placed it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose as required under Section 124(2) of the Act.

(x) Check the procedures that have been followed for the payment of unclaimed dividend out of unpaid dividend account.

(xi) Verify that, if any money transferred to Unpaid Dividend Account has remained unpaid or unclaimed for a period of 7 years from the date of such transfer then, whether it has been transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund established under section 125(1) of the Act and a statement regarding such transfer has also been sent to the authority which administers such fund.

(xii) In case the company has outsourced the activity to the Service Organisation, check that all the compliances with laws, regulations, accounting and disclosure related to the dividends have been made appropriately.

6.18.5 Reserves - The term “reserves” is not defined in Companies Act, 2013. But the term “free reserves” has been defined under section 2(43) of the Act as means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend except:

any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in statement of profit and loss on measurement of the asset or the liability at fair value. Further, as per the relevant extract of the Schedule III to the Companies Act, 2013, “Reserve” has been classified as capital reserve, capital redemption reserve, securities premium reserve, debenture redemption reserve, revaluation reserve, share options outstanding account and other reserves. The Guidance Note on Terms used in Financial Statements issued by the Institute of Chartered Accountants of India defines Reserves as

the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets of for a known liability. The reserves are primarily of two types: (a) Capital Reserves and (b) Revenue Reserves.

Such a distinction is essential for disclosing in the balance sheet the amount by which the equity of the shareholders has increased with the accumulation of undistributed profits. The distribution is carried further by segregating the reserve which is made up of fortuitous gains, unconnected with business activity (e.g., appreciation in values of fixed assets, receipts on account of share premiums), from those appropriated out of profits for credit to revenue reserve; the first is described as a capital reserve and the second merely as a reserve. The Companies Act does not specify the categories of accretions to the shareholders funds which are to be credited to the Capital Reserve, except indirectly by providing that the amounts, which in the opinion of directors cannot be distributed as a dividend through the Statement of Profit and Loss are to be credited to such a reserve. The language of the provision appears to suggest that directors are vested with an unrestricted right to decide which of the amounts to be credited to the Capital

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Reserve subject only to provisions of the Act as regards certain funds not being available for distribution as dividend. But, it is not so, for they cannot violate the accepted principles of accountancy which determine whether or not an item of income is capital or revenue. It may also be remembered that an appropriation once made can be revoked.

The following are examples of amounts retained in the business that are credited to one reserve account or another:

1. Securities Premium Reserve (Capital Reserve).
2. Capital Redemption Reserve created in pursuance of provision contained in Section 55 of the Companies Act, 2013 (Capital Reserve).
3. Debenture Redemption Reserve created in pursuance of provision contained in Section 71 of the Companies Act, 2013 (Capital Reserve).
4. Profit on reissuance of forfeited share (Capital Reserve).
5. Free Reserve available for distribution of dividend (Revenue Reserve).

Attention of the students is drawn to the provisions of Section 123 of the Companies Act, 2013, discussed earlier, about restrictions in the utilization of past profit kept in reserves for dividend purposes.

6.18.6 Deferred Taxation

It is a common experience that the profit or loss as per the Statement of Profit and Loss will be different from the income ultimately assessed to income tax. It is also generally different from the income shown in the tax-return submitted to 'tax authorities'. Consequently the taxation liability that is provided for in the accounts does not bear any direct relationship to the profit disclosed and readers of such account are left to guess the reasons. For instance, income tax should be treated on the same footing as is done in case of other expenses i.e., accounted for on accrual basis. From a management point of view income tax is an item of expense rather than an appropriation of pre-tax profit. AS-22 on “Accounting for Taxes on Income” now requires that tax should be treated as an expense. Students are advised to go through AS-22 on “Accounting for Taxes on Income” for comprehensive understanding.

6.18.7 Non-provision of tax in the accounts

The Council of the Institute of Chartered Accountants of India has taken note of the fact that there is a practice prevalent whereby companies do not make provision for tax even when such a liability is anticipated. It has expressed the view that on an overall consideration of the relevant provisions of law, non-provision for tax (where a liability is anticipated) would amount to contravention of the provisions of Sections 128 and 129 of the Companies Act, 2013. Accordingly, it is necessary for the auditor to qualify his report and such qualification should bring out the manner in which the accounts do not disclose a “true and fair” view of the state of affairs of the company and the profit or loss of the company. An example of the manner in which the report on the balance sheet and the Statement of Profit and Loss may be qualified in this respect is given below:
"The company has not provided for taxation in respect of its profits and the estimated aggregate amount of taxation not so provided for is ₹............... including ₹............ for the Year ended on .........To the extent of such non-provision for the year, the profits of the Company for the financial year under report have been overstated and to the extent of such aggregate non provision, the reserves of the company appearing in the said balance sheet have been overstated and the current liabilities and provisions appearing in the said balance sheet have been understated”.

6.19 Depreciation

Section 123 prohibits a company from declaring dividend out of its profits before providing for depreciation in the manner laid down in the section.

Section 123 provides that the dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Schedule II “Useful lives to compute Depreciation”, to the Companies Act, 2013.

Schedule II to the Act, provides that useful life of an asset shall not ordinarily be different from the useful life specified in Part ‘C’ to the said Schedule and the residual value of an asset shall not be more than 5% of the original cost of the asset. If a company does not use the useful life or residual value of the asset as provided in the Schedule II, then justification for the difference shall be disclosed in its financial statement.

Where during any financial year, any addition has been made to any asset, or where any asset has been sold, discarded, demolished or destroyed, the depreciation on such asset shall be calculated on a pro rata basis from the date of such addition, or as the case may be, upto the date on which such asset has been sold, discarded, demolished or destroyed.

If an asset is used for any time during the year for double shift, the depreciation will increase by 50% for that period and in case of the triple shift the depreciation shall be calculated on the basis of 100% for that period.

The useful life or residual value of any specific asset as notified for accounting purpose by a Regulatory Authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of Schedule II.

The Schedule II to the Companies Act, 2013 needs disclosure in the financial statements about the depreciation method used and the useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule II.

Schedule III “General Considerations for preparation of Balance Sheet and Statement of Profit and Loss of a Company”, to the Companies Act, 2013, requires separate disclosure of depreciation charged and impairment losses/reversals along with a reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments.
Section 123(1) of the Companies Act, 2013 also prescribes that if a company has not provided for depreciation for any previous financial year it shall, before declaring, or paying dividend, provide for such depreciation:

(a) either out of the profits of that financial year, or
(b) out of the profits of any other previous financial year or years.

The implication of this provision is that if, for example, the profits of a company for the year ending 31st March, 2014 are proposed to be distributed, and it is found that due to inadequacy of profits no provision for depreciation had been made for the year ended 31st March, 2013 it would be necessary to make provisions in respect of the depreciation, for the year ended 31st March, 2013 as well as 2014 and only the balance of the profits for the year 31st March, 2014 would be available for distribution as a dividend.

Ascertainment of depreciation for computing net profits for the purpose of managerial remuneration: Under Section 197(1) of the Companies Act, 2013, depreciation calculated in the manner specified in Section 198 of the Companies Act, 2013 must be deducted for arriving at the amount of net profits, on which remuneration payable to managerial personnel is to be calculated.