After studying this chapter, you will be able to:

- Know the procedures of appointment, reappointment, filling up of the casual vacancies and removal of auditor.
- Understand qualification, disqualification, powers and duties of an auditor.
- Gain the knowledge of the provisions relating to rotational retirement.
- Analyse the significance of true and fair view, reporting requirements under the Companies Act, 2013 including reporting under CARO, 2016.
- Learn the salient features of audit of limited liability partnership.
CHAPTER OVERVIEW

The Companies Act 2013 is an Act of the Parliament of India which regulates incorporation of a company, responsibilities of a company, directors, dissolution of a company. It is a rule based Act. The Companies Act, 2013 is divided into 29 chapters containing 470 sections as against 658 Sections in the Companies Act, 1956 and has 7 schedules. 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.

<table>
<thead>
<tr>
<th>Sections w.r.t. Company Audit</th>
<th>138. Internal Audit.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>139. Appointment of auditors.</td>
</tr>
<tr>
<td></td>
<td>140. Removal, resignation of auditor and giving of special notice.</td>
</tr>
<tr>
<td></td>
<td>141. Eligibility, qualifications and disqualifications of auditors.</td>
</tr>
<tr>
<td></td>
<td>142. Remuneration of auditors.</td>
</tr>
<tr>
<td></td>
<td>143. Powers and duties of auditors and auditing standards.</td>
</tr>
<tr>
<td></td>
<td>144. Auditor not to render certain services.</td>
</tr>
<tr>
<td></td>
<td>145. Auditors to sign audit reports, etc.</td>
</tr>
<tr>
<td></td>
<td>146. Auditors to attend general meeting.</td>
</tr>
<tr>
<td></td>
<td>147. Punishment for contravention.</td>
</tr>
<tr>
<td></td>
<td>148. Central Government to specify audit of items of cost in respect of certain companies.</td>
</tr>
</tbody>
</table>

1. APPOINTMENT OF AUDITORS

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-

- Appointment of First Auditors.
- Appointment of Subsequent Auditors.
1.1 Appointment of First Auditors

1.1.1 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.

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

Provisions and Explanation: Section 139(6) of the Companies Act, 2013 lays down that “the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company”. In the instant case, the 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.

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

1.1.2 Appointment of First Auditors in the case of 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.

“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.

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.

### 1.2 Appointment of Subsequent Auditors/Re-appointment of Auditors

#### 1.2.1 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) | 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. |
| (ii) | The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141. |
| (iii) | 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. |

#### 1.2.2 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 a 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.

### 1.3 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.

1.3.1 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 or the remuneration of the auditor, whichever is less, and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of 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.

2. 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).

Eligibility, Qualifications and Disqualifications of an Auditor (Section 141 of The Companies Act, 2013)

Eligibility and Qualification of Auditor:

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.

Where a firm including a limited liability partnership is appointed as an auditor of a company, partners who are chartered accountants shall be authorised to act and sign on behalf of the firm

**DISQUALIFICATIONS OF AN AUDITOR:** Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 following persons shall not be eligible for appointment as an auditor of a company

(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.

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.

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).

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

As per section 141(3)(d)(i), 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 x ₹ 10 per share).

Therefore, M/s RM & Co. is not disqualified for appointment as an auditors 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.

(ii) 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) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

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.

Certain services not to be rendered by the Auditor as per section 144 of the Companies Act 2013.

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.

CA. P is providing the services of Design and implementation of any financial information system 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. P 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.

**3 ROTATION OF AUDITORS**

**3.1 Applicability of section 139(2) Rotation of Auditors**

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:-

© The Institute of Chartered Accountants of India
(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 fifty 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.

Rano Ltd. is a private limited Company, having paid up share capital of rupees 48 crore but having public borrowing from nationalized banks and financial institutions of rupees 42 crore, manner of rotation of auditor will not 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.

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.

   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. 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.

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 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.

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.

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.

*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>I</td>
<td>II</td>
<td>III</td>
</tr>
<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>
<tr>
<td>3 years</td>
<td>3 years</td>
<td>6 years</td>
</tr>
<tr>
<td>2 years</td>
<td>3 years</td>
<td>5 years</td>
</tr>
<tr>
<td>1 year</td>
<td>4 years</td>
<td>5 years</td>
</tr>
</tbody>
</table>

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 year</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 year</td>
<td>7 years</td>
<td>10 years</td>
</tr>
</tbody>
</table>
5.18 ADVANCED AUDITING AND PROFESSIONAL ETHICS

<table>
<thead>
<tr>
<th>2 years</th>
<th>8 years</th>
<th>10 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 years</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.

4. PROVISIONS RELATING TO AUDIT COMMITTEE

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 ≥ 10 crore |
| (ii) all public companies having turnover ≥ 100 crore |
| (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits > 50 crore |

© The Institute of Chartered Accountants of India
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.

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.
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. REMOVAL OF AUDITORS

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.

(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.

6.2 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.

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 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 private company (which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).
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.

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. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

**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 which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the Companies Act with the Registrar, 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 private company (which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

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:
COMPANY AUDIT

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Number of Audits available to the Firm</td>
<td>20*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>20</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 (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar), 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 (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar). 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 (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar."

and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.

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.

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 section143(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 31st 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.”

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.
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 with reference to financial statements* in place and the operating effectiveness of such controls;

(Note: Clause (i) of Sub-Section (3) of Section 143 shall not apply to a private company:- (i) which is a one person company or a small company; or (ii) which has turnover less than rupees fifty crores

© The Institute of Chartered Accountants of India
as per latest audited financial statement and which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than rupees twenty five crore)

(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.

Note: Students may refer Guidance note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013 for better understanding.]

5. Duty to report on frauds:

A. Reporting to the Central Government: As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the Rule 13 states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

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

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

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

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

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:

<table>
<thead>
<tr>
<th>(a) Nature of Fraud with description;</th>
<th>(b) Approximate amount involved; and</th>
<th>(c) Parties involved.</th>
</tr>
</thead>
</table>

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:

<table>
<thead>
<tr>
<th>(a) Nature of Fraud with description;</th>
<th>(b) Approximate Amount involved;</th>
</tr>
</thead>
<tbody>
<tr>
<td>(c) Parties involved, if remedial action not taken; and</td>
<td>(d) Remedial actions taken.</td>
</tr>
</tbody>
</table>

© The Institute of Chartered Accountants of India
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 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.

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. However, by virtue of notification dated 21st March 2018, in exercise of the powers conferred by sub-section (3) of section 1 of the Companies Act, 2013 (18 of 2013), the Central Government hereby appoints the 21st March, 2018 as the date on which the provisions of subsections (3) and (11) of section 132 of the said Act shall come into force.

The role of National Financial Reporting Authority shall be as follows:

(a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;

(b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;

(c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed.

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 this chapter.

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.

10. 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.
11. 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.

© The Institute of Chartered Accountants of India
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.

12. 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 prescribed 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 Accountants of India, constituted under the Cost 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,

(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 this Chapter);

(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 this Chapter).

### 13. 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 or four times the remuneration of the auditor, which ever is less.
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 fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, which every is less.

(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 members or the creditors of the Company 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 a 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. Provided that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

14. FINAL ACCOUNTS PREPARATION AND PRESENTATION

14.1 Financial Statements

Statutory Requirements – Central Government to prescribe accounting standards.

Section 133 of the Companies Act, 2013

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 (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. In exercise of the powers conferred under sub section 132(1) of the Companies Act, 2013, the Central Government appoints the October 1, 2018
as the date of constitution of National Financial Reporting Authority and provisions of sub section 132(1) and 132(12) of Companies Act, 2013 came in to force. Further sub sections (2), (4), (5), (10), (13), (14) and (15) of section 132 of the Act was notified with effect from October 24, 2018. The sections deals with constitution of National Financial Reporting authorities and powers conferred to it.

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. By vide notification dated October 11, 2018, the Central Government made few amendments in Schedule III of the Companies Act, 2013 regarding the disclosures required to be made in the financial statements.

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

By virtue of notification dated February 23, 2018, the Central Government has exempted the companies engaged in defence production to the extent of application of relevant Accounting Standard on segment reporting.

Similarly as per MCA notification dated February 5, 2018, the provision of deferred tax asset as per Ind AS 12 or Accounting Standard 22 shall not apply to Government Company which is a public financial institution under sub-clause (iv) of clause (72) of section 2 of the Companies Act, 2013; a Non-Banking Financial Company registered with the Reserve Bank of India under section 45-IA of the Reserve bank of India Act, 1934; and engaged in the business of infrastructure finance leasing with not less than seventy five per cent. of its total revenue being generated from such business with Government companies or other entities owned or controlled by Government.

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 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.

The Order for reopening of accounts not to be made beyond eight financial years immediately preceding the current financial year unless and until Government has, under Section 128(5) issued a direction for keeping books of account longer than 8 years, reopening of accounts can be made for such longer period.

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.

14.2 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.

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). If the Companies even have associate companies, then also they are required to prepare Consolidated Financial Statements
For detailed content on Audit of Consolidated Financial Statements students are required to refer Chapter 9 given in Module 2.

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.

14.3 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.]

14.4 Constitution of National Financial Reporting Authority

According to Section 132\(^1\) 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.

\(^{1}\) Section 132 of the Companies Act, 2013 is not yet notified.
14.5 **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 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: (i) The Ministry of Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with Ind-AS has been prescribed which is discussed in Chapter 12 Audit of Non-Banking Financial Corporations.

(ii) Students are required to refer Appendix annexed at the end of this Chapter for detailed understanding of Schedule III to the Companies Act, 2013]

15. **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:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>that the assets are neither undervalued or overvalued, according to the applicable accounting principles,</td>
</tr>
<tr>
<td>(ii)</td>
<td>no material asset is omitted;</td>
</tr>
<tr>
<td>(iii)</td>
<td>the charge, if any, on assets are disclosed;</td>
</tr>
<tr>
<td>(iv)</td>
<td>material liabilities should not be omitted;</td>
</tr>
<tr>
<td>(v)</td>
<td>the statement of profit and loss discloses all the matters required to be disclosed by Part II of Schedule III</td>
</tr>
<tr>
<td>(vi)</td>
<td>the balance sheet has been prepared in accordance with Part I of Schedule III;</td>
</tr>
<tr>
<td>(vii)</td>
<td>accounting policies have been followed consistently; and</td>
</tr>
<tr>
<td>(viii)</td>
<td>all unusual, exceptional or non-recurring items have been disclosed separately.</td>
</tr>
</tbody>
</table>

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.

16. 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.

16.1 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.

16.2 Law relating to 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.

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.

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 prescribed conditions.

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.

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

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.

**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.

© The Institute of Chartered Accountants of India
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.

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 (manners to be followed while inviting, accepting or renewing deposits under the new Companies Act, 2013 from the public), and section 74 (manners 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.

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.

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 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.

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;

(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 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.

**16.3 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.
16.4 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.

16.5 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.
16.6 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.

16.7 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.

16.8 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 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 reissue 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 utilisation of past profit kept in reserves for dividend purposes.

16.9 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” or Ind AS 12 now requires that tax should be treated as an expense. Students are advised to go relevant accounting standard for comprehensive understanding.

16.10 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 over-stated and the current liabilities and provisions appearing in the said balance sheet have been understated”.

As per Section 134 of the Companies Act, 2013:

(1) The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorized by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

(2) The auditors' report shall be attached to every financial statement.

(3) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—

(a) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;

(b) number of meetings of the Board;

(c) Directors’ Responsibility Statement;

(d) a statement on declaration given by independent directors under sub-section (6) of section 149;

(e) in case of a company covered under sub-section (1) of section 178, company’s policy on directors’ appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

(f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—

(i) by the auditor in his report; and

(ii) by the company secretary in practice in his secretarial audit report;
(g) particulars of loans, guarantees or investments under section 186;
(h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;
(i) the state of the company’s affairs;
(j) the amounts, if any, which it proposes to carry to any reserves;
(k) the amount, if any, which it recommends should be paid by way of dividend;
(l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;
(m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;
(n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;
(o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;
(p) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal “annual evaluation of the performance of the Board, its Committees and of individual directors has been made;
(q) such other matters as may be prescribed.

Provided that where disclosures referred to in this sub-section have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's report

Provided further that where the policy referred to in clause (e) or clause (o) is made available on company's website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board's report and the web-address is indicated therein at which the complete policy is available.

(3A) The Central Government may prescribe an abridged Board's report, for the purpose of compliance with this section by One Person Company or small company.

(4) The report of the Board of Directors to be attached to the financial statement under this section shall, in case of a One Person Company, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.
The Directors’ Responsibility Statement referred to in clause (c) of sub-section (3) shall state that—

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

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

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

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

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation.—For the purposes of this clause, the term “internal financial controls” means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

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

The Board’s report and any annexures thereto under sub-section (3) shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

(a) any notes annexed to or forming part of such financial statement;

(b) the auditor’s report; and

(c) the Board’s report referred to in sub-section (3).

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-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 three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.
17. 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.

18. **SALIENT FEATURES OF LIMITED LIABILITY PARTNERSHIPS (LLP) AUDIT**

An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. A “Statement of Accounts and Solvency” in prescribed form shall be filed by every LLP with the Registrar every year.

The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

No mandatory insurance has been proposed in the Act. It would be difficult to assess insurance requirements of different types and sizes of LLPs. This would depend upon the nature of commercial risk attached with work or assignment handled by each. Applying common insurance requirements across a class of LLPs would result in increasing their costs of operation. Therefore, the underlying concern as to the credit worthiness of the LLP in the event of a contractual default is being addressed through statutory provisions for solvency declaration, disclosure of financial information and audit.

Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.
Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the financial year to which the Statement of Account and Solvency relates.

Registrar would have power to obtain such information which he may consider necessary for the purposes of carrying out the provisions of the Act, from any designated partner, partner or employee of the LLP. He would also have power to summon any designated partner, partner or employee of any LLP before him for any such purpose, in case the information has not been furnished to him or in case the Registrar is not satisfied with the information furnished to him.

The following documents/information will be available for inspection by any person:

- Incorporation document,
- Names of partners and changes, if any, made therein,
- Statement of Account and Solvency
- Annual Return

The fees for such inspection of an LLP is Rs 50/- and fees for certified copy or extract of any document u/s 36 shall Rs. 5/- per page.

The provisions of the Act require LLPs to file the documents like Statement of Account and Solvency (SAS) and Annual Return (AR) and notices in respect of changes among partners etc. within the time specifically indicated in relevant provisions. The Act contains provisions for allowing LLPs to file such documents after their due dates on payment of additional fees. It has been provided that in case LLPs file relevant documents after their due dates with additional fees upto 300 days, no action for prosecution will be taken against them. In case there is delay of 300 days or more, the LLPs will be required to pay normal filing fees, additional fee and shall also be liable to be prosecuted.

The Act also contains provisions for compounding of offences which are punishable with fine only.

**Appointment of Auditor:** The auditor may be appointed by the designated partners of the LLP –

1. At any time for the first financial year but before the end of first financial year,
2. At least thirty days prior to the end of each financial year (other than the first financial year),
3. To fill the causal vacancy in the office of auditor,
4. To fill the casual vacancy caused by removal of auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them.

**LLP's are required to maintain books of accounts which shall contain**-

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

**Advantages / Purpose / Need of Audit**

1. Auditing the accounts of a LLP helps in detecting errors & frauds & verification of financial statements
2. Disputes, if any between any partners in the matter of accounts can be settled with the help of audited accounts.
3. Banks & financial institutions lend money to the firms only on the basis of audited accounts.
4. Periodical visits & suggestions by the auditor will be helpful in improving the management of the LLP
5. For settling accounts between partners at the time of admission, death, retirement, insolvency, insanity, etc audited accounts are accepted by those concerned who have dealings with the LLP

**Auditor’s Duty Regarding Audit of LLP**

1. The auditor should get definite instructions in writing as to the work to be performed by him.
2. The auditor should mention
   a) Whether the records of the firm appear to be correct & reliable
   b) Whether he was able to obtain all information & explanation necessary for his work
   c) Whether any restriction was imposed upon him
3. The auditor should read the LLP agreement & note the following provisions
   a) Nature of the business of the LLP
   b) Amount of capital contributed by each partner
   c) Interest – in respect of additional capital contributed
   d) Duration of partnership
   e) Drawings allowed to the partners
   f) Salaries, commission etc payable to partners
   g) Borrowing powers of the LLP
   h) Rights & duties of partners
   i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
j) Any loans advanced by the partners  
k) Profit sharing ratio  

4. If partners maintain minute book he shall refer it for any resolution passed regarding the accounts  

(Source: http://www.mca.gov.in/MinistryV2/disclosureauditandfilingrequirements.html)  

19. 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 6 on Audit Report for detailed reporting requirements as prescribed under Standards on Auditing)  

19.1 Reporting Under CARO, 2016  

In exercise of the powers conferred by section 143(11) of the Companies Act, 2013, the Central Government, after consultation with the Institute of Chartered Accountants of India, has issued the Companies (Auditor’s Report) Order, 2016, (CARO, 2016) dated 29th March, 2016.  

1. Applicability of the Order: The CARO, 2016 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies
(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

2. **Auditor's report to contain matters specified in paragraphs 3 and 4.** - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable: It may be noted that the Order shall not apply to the auditor's report on consolidated financial statements.
3. **Matters to be included in the auditor’s report.** - The auditor’s report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

   (i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

   (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

   (c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

   (ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

   (iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

   (a) whether the terms and conditions of the grant of such loans are not prejudicial to the company’s interest;

   (b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

   (c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

   (iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

   (v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

   (vi) 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.

   (vii) (a) whether the company is regular in depositing undisputed statutory dues including
provide fund, employees' state insurance, income-tax, sales-tax, Goods and Services Tax (with effect from July 1, 2017), service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

(viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(x) 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;

(xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

(xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;
(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

(xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

1. ABC Pvt. Ltd. is a holding company of XYZ Ltd. Whether CARO is applicable to ABC Pvt. Ltd.?

CARO 2016 will be applicable to a private limited company which is holding company of a public company, which was not there in previous CARO. Therefore, CARO is applicable on ABC Pvt. Ltd.

2. Physical verification of only 50% (in value) of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.

Reporting for Physical Verification of Inventory: clause (ii) of Para 3 of CARO, 2016 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

In the given case, the above requirement of CARO, 2016 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

3. K Ltd. has taken a term loan from a nationalized bank in 2010 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March, 2011 onwards. It had repaid the loans due in 2011 & 2012, but defaulted in 2013, 2014 & 2015. As the auditor of K Ltd. what is your responsibility assuming that company has sought rescheduling of loan?

Reporting for Default in Repayment of Dues: As per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to report whether the Company has defaulted in repayment of its dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In this case, K Ltd. has defaulted in repayment of dues for three years Application for rescheduling will not change the default position. Hence the auditor has to report in his CARO report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 lakhs and evaluate its consequential impact on the audit report as well.

4. LM Ltd. had obtained a Term Loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits.
Term Loan Invested in Short Term Deposits: As per clause (ix) of Para 3 of CARO, 2016, an auditor need to state in his report that whether the term loans were applied for the purpose for which the loans were obtained.

In the present case, the term loan obtained by LM Ltd. have not been put to use for construction activities and temporarily invested the same in short term deposit.

Here, the auditor should report the fact in his report that pending utilization of the term loan for construction of a factory, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2016.

5. **For the purpose of availing exemption from CARO what kind of loan to be considered?**

All sorts of loan whether term loan, demand loan, export credit, working credit limits, cash credits. Overdrafts, bill purchased or discounted, but does not include non-fund based facilities like LC BG.

6. **Whether CARO is Applicable to the auditor of consolidated financial statement?**

Order shall not apply to the auditor’s report on consolidated financial statements. In previous order it was not expressly provided hence CFS auditors used to include CARO in their report.

7. **What documents Constitute Title Deed?**

Following constitute title deeds of the immovable property:

(i) Registered sale deed / transfer deed / conveyance deed, etc. of land, land & building together, etc. purchased, allotted, transferred by any person including any government, government authority / body / agency/ corporation, etc. to the company.

(ii) In case of leasehold land and land & buildings together, covered under the head fixed assets, the lease agreement duly registered with the appropriate authority.

8. **Should the auditor examine the cost record in detail while reporting under CARO?**

CARO does not require a detailed examination of Cost Records. The Auditor should, therefore, conduct a general review of Cost Records to ensure that the records as prescribed are made and maintained. The word "made" applies in respect of Cost Accounts, and the word "maintained" applies in respect of Cost Records relating to Materials, Labour, Overheads, etc.

4. **Reasons to be stated for unfavourable or qualified answers**-

(a) Where, in the auditor’s report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor’s report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(b) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

*****************************************************************************
Comprehensive Case Studies on CARO 2016

1. Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability? [Paragraph 3(xii)]

Ans. Relevant Provisions

(a) This clause requires the auditor to report whether, in the case of a Nidhi Company, net-owned funds to deposit liability ratio is more than 1:20 and the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules 2014 to meet out the liability.

(b) Section 406(1) of the Act defines “Nidhi” to mean a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

(c) It may be noted that Ministry of Corporate Affairs on 31st March 2014, vide its Notification No. GSR 258(E) notified the ‘Nidhi Rules 2014’, which came into force on the first day of April 2014. These Rules apply to Nidhi company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act and also to the Nidhi companies declared under sub-section (1) of section 620A of the Companies Act 1956.

Audit Procedures and Reporting

(d) It may be noted that Rule 5(1) prescribes the requirements for minimum number of members, net owned fund etc. As per Rule 5(1) every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has— (i) not less than two hundred members; (ii) net owned funds of ten lakh rupees or more; (iii) unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in Rule 14; and (iv) ratio of net owned funds to deposits of not more than 1:20. The auditor should note that as such a Nidhi Company can accept deposits not exceeding twenty times of its net owned funds as per last audited balance sheet. Furthermore, as per Rule 14, every Nidhi is to invest and continue to keep invested, in encumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month, which needs to be examined.

(e) As per Rule 3(d) Net Owned Funds are defined as the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet: Provided that, the amount representing the proceeds of issue of preference shares, shall not be included for calculating Net Owned Funds.
(f) A Nidhi company can accept fixed deposits, recurring deposits accounts and savings deposits from its members in accordance with the directions notified by the Central Government. The aggregate of such deposits is referred to as "deposit liability".

(g) The auditor should ask the management to provide the computation of the deposit liability and net owned funds on the basis of the requirements contained herein above. This would enable him to verify that the ratio of deposit liability to net owned funds is in accordance with the requirements prescribed in this regard. The auditor should verify the ratio using the figures of net owned funds and deposit liability computed in accordance with what is stated above. The comments of the auditor should be based upon such a statement provided by the management and verification of the same by the auditor.

(h) The auditor may report, incorporating the following as at the balance sheet date:- (i) In case of shortfall in the ratio of net owned funds to the deposits, report the amount of shortfall and state the actual ratio of net owned funds to the deposits. (ii) In case of shortfall with regard to the minimum amount of 10% as unencumbered term deposits, as specified in Nidhi Rules 2014, report the amount thereof.

2. 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? [Paragraph 3(x)]

Ans. Relevant Provisions

(a) This clause requires the auditor to report 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 auditor is required to state the amount involved and the nature of fraud. The clause does not require the auditor to discover such frauds. The scope of auditor’s inquiry under this clause is restricted to frauds ‘noticed or reported’ during the year. The use of the words “noticed or reported” indicates that the management of the company should have the knowledge about the frauds by the company or on the company by its Officer and employees that have occurred during the period covered by the auditor’s report. It may be noted that this clause of the Order, by requiring the auditor to report whether any fraud by the company or on the company by its Officer or employees has been noticed or reported, does not relieve the auditor from his responsibility to consider fraud and error in an audit of financial statements. In other words, irrespective of the auditor’s comments under this clause, the auditor is also required to comply with the requirements of Standard on Auditing (SA) 240, “The Auditor’s Responsibility Relating to Fraud in an Audit of Financial Statements”. In this context, the auditor should also have regard to the Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013, issued by ICAI.

(b) The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, involving the use of deception to obtain an unjust or illegal advantage. Although fraud is a broad legal concept, the auditor is concerned with
fraudulent acts that cause a material misstatement in the financial statements. Misstatement of the financial statements may not be the objective of some frauds. Auditors do not make legal determinations of whether fraud has actually occurred. Fraud involving one or more members of management or those charged with governance is referred to as "management fraud"; fraud involving only employees including officers of the entity is referred to as "employee fraud". In either case, there may be collusion with third parties outside the entity. In fact, generally speaking, the "management fraud" can be construed as "fraud by the company".

(c) Two types of intentional misstatements are relevant to the auditor's consideration of fraud - misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

(d) Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve: (i) Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared. (ii) Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information. (iii) Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

(e) Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

(f) Fraudulent financial reporting may be committed by the company because management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target particularly when the consequences to management of failing to meet financial goals can be significant. The auditor must appreciate that a perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system.

Audit Procedures and Reporting

(g) While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. While planning, the auditor should also make inquiries of management to determine whether management is aware of any known fraud or suspected fraud that the company is investigating.
(h) The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire from the management about any frauds on the company that it has noticed or that have been reported to it. The auditor should also discuss the matter with other employees including officers of the company. The auditor should also examine the minute book of the board meeting of the company in this regard.

(i) The auditor should obtain written representations from management that: (i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error; (ii) it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation; (iii) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and (iv) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

(j) Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence. In some circumstances, management may not believe that certain of the uncorrected financial statement misstatements aggregated by the auditor during the audit are misstatements. For that reason, management may want to add to their written representation words such as, "We do not agree that items constitute misstatements because [description of reasons]."

(k) The auditor should consider if any fraud has been reported by them during the year under section 143(12) of the Act and if so whether that same would be reported under this Clause. It may be mentioned here that section 143(12) of the Act requires the auditor has reasons to believe that a fraud is being committed or has been committed by an employee or officer. In such a case the auditor needs to report to the Central Government or the Audit Committee. However, this Clause will include only the reported frauds and not suspected fraud.

(l) Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report, the nature of fraud and amount involved. For reporting under this clause, the auditor may consider the following: (i) This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers
or employees are only covered. (ii) Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds. (iii) While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.

3. Whether the company has entered into any noncash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with? [Paragraph 3(xv)]

Ans. Relevant Provisions:

(a) Section 192 of the Act deals with restriction on noncash transactions involving directors or persons connected with them. The section prohibits the company from entering into following types of arrangements unless it meets the conditions laid out in the said section:

i. An arrangement by which a director of the company or its holding, subsidiary or associate company or a person connected with such director acquires or is to acquire assets for consideration other than cash, from the company.

ii. An arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

(b) Arrangements, as discussed herein above, can only be entered by the company on fulfillment of the conditions laid out in Section 192 of the Act which are as under:

i. The company should have obtained prior approval for such arrangement through a resolution of the company in general meeting.

ii. In case the concerned director or the person connected therewith, is also a director of its holding company, a similar approval should have been obtained by the holding company through a resolution at its general meeting.

(c) The reporting requirements under this clause are in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

(d) In other words, such transactions involving change in the assets or liabilities of a company but not involving "cash" or cash equivalents" as defined under Accounting Standard (AS) 3, “Cash Flow Statement” may be construed as non-cash transactions. At this point, it may be appropriate to also refer to the definition and discussion on “non-cash transactions” & “cash and cash equivalents”, as given in AS 3.

(e) There may be a situation where the acquisition of the asset takes place in one year and the corresponding liability is created in the financial statements, the corresponding settlement in
the following year. The said transaction will not be considered as non-cash transaction. Further, mergers under Court schemes would be entered into subject to requisite approvals of Court etc., would not be considered non-cash transactions.

(f) The term “person connected with the director” has not been defined in the Act, or the Rules thereunder. Instead, the term “to any other person in whom the director is interested” is defined in the Explanation to sub section (1) of section 185 of the Act, which is reproduced as under and may be used as the reference point for reporting under this clause.

“(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
(b) any firm in which any such director or relative is a partner;
(c) any private company of which any such director is a director or member;
(d) any body corporate at a general meeting of which not less than twenty-five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or (e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.”

(g) Section 2(77) of the Companies Act, 2013 read with Rule 4 of the Companies (Specification of Definition Details) Rules, 2014 defines the term “relative”. As per the aforesaid section 2(77), “Relative, with reference to any person, means anyone who is related to another, if –

(i) they are members of a Hindu Undivided Family;
(ii) they are husband and wife; or
(iii) one person is related to the other in such manner as may be prescribed” As per Rule 4 of the Companies (Specification of Definition Details) Rules, 2014, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely –

(i) Father, including step father
(ii) Mother, including step mother
(iii) Son, including step son
(iv) Son’s wife
(v) Daughter
(vi) Daughter’s husband
(vii) Brother, including step brother
The term “acquire” simply means to come into possession of something. A thing that cannot be sold cannot be acquired. Thus, an acquisition would necessarily involve existence of two parties and a transfer of rights and/or obligations in a thing. In the context of section 192 of the Act, this transfer is between the company and the director and/or a person connected with a director. Such “director” is not restricted to being a director of the concerned company, but extends to director of a holding company, subsidiary or associate of the company under question.

As provided in section 192, the acquisition by/from the company has to be that of an “asset”. Further, the term assets should be construed to have the same meaning as described in the Framework for Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India. The auditor would need to evaluate whether the subject matter of acquisition by/from the company satisfies the characteristic of an “asset”.

Audit Procedures and Reporting

For reporting on the first leg of the reporting clause, the starting point of the auditor’s procedures could be obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Act. The auditor would need to corroborate the management representation with sufficient appropriate audit evidence. A scrutiny of the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non cash transactions as well as persons connected with the Directors:

<table>
<thead>
<tr>
<th>Persons connected with Director</th>
<th>Acquisition by/ From Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form No. MBP 1, Notice of Interest by Director, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 184(1) and Rule 9(1)]</td>
<td>Form No. MBP 2, Register of Loans, Guarantee, Security and Acquisition Made by the Company, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 186(9) and Rule 12(1)]</td>
</tr>
<tr>
<td>Form No. MBP 4, Register of Contracts with Related Party and Contracts and Bodies etc. in which Directors are Interested, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 189(1) and Rule 16(1)]</td>
<td>Movements in the Fixed Asset Register</td>
</tr>
<tr>
<td>Minutes book of the General Meeting and Meetings of Directors</td>
<td></td>
</tr>
</tbody>
</table>
(k) The above documents and records would provide evidence of any such non-cash transactions that have actually taken place. The language of section 192(1) also uses the term “is to acquire” in the context of such transactions, indicating the existence of intention to acquire. The management may be requested to provide details of its intention to enter into transactions covered under section 192, after the date of the financial statements under audit. The minutes of the meetings of the Board of Directors and the Audit Committee may provide evidence of such intention. Besides, a scrutiny of the information for subsequent period as contained in the aforesaid records and documents may provide corroborative audit evidence of such intention having existed as at the date of the auditor’s report.

(l) Where the company has entered into/is to enter into any non-cash transactions as discussed above, the auditor would make a report to that effect under this clause. The second leg of the clause requires the auditor to report whether the Company has complied with the provisions of section 192 in this regard. Section 192(1) and (2) envisage the following compliances in respect of such transactions:

(i) The company should have obtained a prior approval for such arrangement by a resolution in the General Meeting.

(ii) If the concerned Director or connected person is a director of the company’s holding company, the latter too should have obtained a similar prior approval for the arrangement by a resolution at its General Meeting.

(iii) Notice for approval of the resolution should contain details of the arrangement along with the value of assets involved duly calculated by a registered valuer. The auditor should check compliance with Section 192(2) and verify the notice of the General Meeting that it includes particulars of arrangement along with the value of the assets involved such arrangements. The said value should be calculated by the register valuer.

(m) In case where the concerned director/connected person is also a director of the holding company, the auditor would need to check whether the holding company has complied with the requirements. For this purpose, the auditor would need to obtain a management representation letter from the holding company through the management of the auditee company.

Suggested paragraph on reporting:

According to the information and explanations given to us, the Company has entered into non-cash transactions with one of the directors/ person connected with the director during the year, by the acquisition of assets by assuming directly related liabilities, which in our opinion is covered under the provisions of Section 192 of the Act, and for which approval has not yet been obtained in a general meeting of the Company.

**************************************************************************************************************
© The Institute of Chartered Accountants of India
Key Aspects discussed in Guidance Note on Internal Financial Control over Financial Reporting

1. What is Internal Financial Control (IFC)? (Sec 134)

As per Section 134 of the Companies Act 2013, the term Internal Financial Controls means the policies and procedures adopted by the company for ensuring:

- Orderly and efficient conduct of its business, including adherence to Company's policies,
- Safeguarding of its assets,
- Prevention and detection of frauds and errors,
- Accuracy and completeness of the accounting records, and
- Timely preparation of reliable financial information.

2. What is Internal Controls over financial Reporting (ICFR)?

As per Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (September, 2015), "Internal Financial Controls Over Financial Reporting (ICFR) shall mean:

"A Process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles". A Company's internal financial control over financial reporting includes those policies and procedures:

Pertain to the maintenance of the records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company:

It provides reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and those receipts and expenditures of the company are being made only in accordance with authorizations of management and director of the company.

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effects of the financial statement.

3. Which provision of Companies Act requires such IFC and Reporting? Section 134:

In the case of a listed company, the Directors' Responsibility states that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.

Section 134:

In the case of a listed company, the Board of Directors are required to confirm about the adequacy and operating effectiveness of Internal Financial Controls. However as per Rule 8(5) of Companies
Section 143:
The auditor’s report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls

Section 177:
Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

Schedule IV
The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.

Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 –
The director’s report should contain details in respect of adequacy of internal financial controls with reference to the financial reporting.

4. To whom does this apply?
The guidance note clarifies that reporting on ICFR by auditors will be applicable to both listed and unlisted companies, including small and one person companies. This is in line with the requirements of section 143(3)(i) of the Companies Act, 2013.

Furthermore, it states that auditors will have to report on ICFR in respect of both stand alone and consolidated financial statements.

5. When does this apply and for financial statements of which period?
The guidance note clarifies that auditors will have to report whether a company has an adequate ICFR system in place and whether the same was operating effectively as at the balance sheet date. In practice, this will mean that when forming its audit opinion on ICFR, the auditor will surely test transactions during the financial year and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. If control issues or deficiencies are identified during the interim period and are remediated before the balance sheet date, then the auditor may still be able to express an unqualified opinion on the ICFR.

6. What is extent of reporting?
The auditor needs to obtain reasonable assurance to state whether an adequate internal financial controls system was maintained and whether such internal financial controls system operated effectively in the company in all material respects with respect to financial reporting only. The auditor’s opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.
Theoretical Questions

1. (a) The Balance Sheet of G Ltd. as at 31st March 18 is as under. Comment on the presentation in terms of Schedule III.

<table>
<thead>
<tr>
<th>Heading</th>
<th>Note No.</th>
<th>31st March, 18</th>
<th>31st March, 17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equity &amp; Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>1</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Reserves &amp; Surplus</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Employee stock option outstanding</td>
<td>3</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Share application money refundable</td>
<td>4</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Non-Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred tax liability (Arising from Indian Income Tax)</td>
<td>5</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Payables</td>
<td>6</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-Current Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets-Tangible</td>
<td>7</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>CWIP (including capital advances)</td>
<td>8</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade Receivables</td>
<td>9</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Deferred Tax Asset (Arising from Indian Income Tax)</td>
<td>10</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Debit balance of Statement of Profit and Loss</td>
<td></td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

(b) Z Ltd changed its employee remuneration policy from 1st of April 2017 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or encash it. As at 31st March 18 the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be
provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment.

(c) K Ltd. had 5 subsidiaries as at 31st March 2018 and the investments in subsidiaries are considered as long term and valued at cost. Two of the subsidiaries net worth eroded as at 31st March 18 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline' as the other three subsidiaries are doing exceptionally well. Comment.

(d) While adopting the accounts for the year, the Board of Directors of Sunrise Ltd. decided to consider the Interim Dividend declared @15% as final dividend and did not consider transfer of Profit to reserves.

2. MG & Co. Ltd. seeks your advice while preparing financial statements the general instructional to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and liabilities.

3. As an auditor, how would you deal with the following situations:

(a) Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2015-2016. Mr. Hanuman, a partner of the Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.

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

(c) Contravene Ltd. appointed CA Innocent as an auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.

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

4. (a) Astha Pvt. Ltd. has fully paid capital of ₹ 140 lakh. During the year, the company had borrowed ₹ 15 lakh each from a bank and a financial institution independently. It has the turnover (Net of excise ₹ 50 lakh which is credited to a separate account) of ₹ 475 lakh. Will Companies (Auditor’s Report) Order, 2016 be applicable to Astha Pvt. Ltd.?

(b) Under CARO, 2016, as a statutory auditor, how would you report on the following:

(i) A Term Loan was obtained from a bank for ₹ 80 lakh for acquiring R&D equipment, out of which ₹ 15 lakh was used to buy a car for use of the concerned director who was overlooking the R&D activities.
(ii) Physical verification of only 50% of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.

5. T Pvt. Ltd.'s paid up Capital & Reserves are less than ₹ 50 lakhs and it has no outstanding loan exceeding ₹ 25 lakhs from any bank or financial institution. Its sales are ₹ 6 crores before deducting Trade discount ₹ 10 lakhs and Sales returns ₹ 95 lakhs. The services rendered by the company amounted to ₹ 10 lakhs. The company contends that reporting under Companies Auditor’s Reports Order (CARO) is not applicable. Discuss.

Answers to Theoretical Questions

1. (a) Following Errors are noticed in presentation as per Schedule III:
   
   (i) Share Capital & Reserve & Surplus are to be reflected under the heading “Shareholders’ funds”, which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities yet it must be shown under head “shareholders' funds”. The heading “Shareholders’ funds” is missing in the balance sheet given in the question.
   
   (ii) Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head ‘Surplus’. The balance of ‘Reserves and Surplus’, after adjusting negative balance of surplus shall be shown under the head ‘Reserves and Surplus’ even if the resulting figure is in the negative.
   
   (iii) Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading “Reserves and Surplus”
   
   (iv) Share application money refundable shall be shown under the sub-heading “Other Current Liabilities”. As this is refundable and not pending for allotment, hence it is not a part of equity.
   
   (v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown. Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
   
   (vi) Under the main heading of Non-Current Assets, Fixed Assets are further classified as under:
   
   (a) Tangible assets
   
   (b) Intangible assets
   
   (c) Capital work in Progress
(d) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Fixed Assets as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading “Long term loans and advances” under the heading Non-Current Assets. Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, the words “Fixed assets” shall be substituted with the words “Property, Plant and Equipment”.

(e) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(f) Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, Trade Payables should be disclosed as follows:-

(A) total outstanding dues of micro enterprises and small enterprises; and

(B) total outstanding dues of creditors other than micro enterprises and small enterprises.”

(b) As per Para 11 of AS-15 on “Employee Benefits”, issued by the Institute of Chartered Accountants of India, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, Z Ltd will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the contention of the auditor is correct that full provision should be provided by the company.

(c) As per AS-13 “Accounting for Investments” issued by the Institute of Chartered Accountants of India, long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.
Keeping in view the above, K Ltd should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.

(d) **Declaration of Interim Dividend:** Section 123(3) of the Companies Act, 2013 provides that the Board of Directors of a company may declare interim dividend during any 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. The amount of dividend including interim dividend should be deposited in a separate bank account within five days from the declaration of such dividend for the compliance of Section 123(4) of the said Act.

Based on Section 2(35) of the said Act, it can be said that since interim dividend is also a dividend, companies should provide for depreciation as required by Section 123 before declaration of interim dividend. However, the first proviso to Section 123(1) 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 i.e. the company is not mandatorily required to transfer the profit to the reserves, it is an option available to the company to transfer such percentage.

In the instant case, the Board has decided to pay interim dividend @15% of the paid-up capital. Assuming that the company has complied with the depreciation requirement, the interim dividend can be declared without transferring such percentage of its profits as it may consider appropriate to the reserves of the company.

2. **General Instructions for Preparation of Balance Sheet:**

   (i) **General Instruction in respect of Current Assets:** An asset shall be classified as current when it satisfies any of the following criteria-

   (1) it is expected to be realized in, or is intended for sale or consumption in, the company’s normal operating cycle;  
   (2) it is held primarily for the purpose of being traded;  
   (3) it is expected to be realized within twelve months after the reporting date; or  
   (4) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

   (ii) **General Instruction in respect of Current Liabilities:** A liability shall be classified as current when it satisfies any of the following criteria-

   (1) it is expected to be settled in the company’s normal operating cycle;  
   (2) it is held primarily for the purpose of being traded;  
   (3) it is due to be settled within twelve months after the reporting date; or  
   (4) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at
3. (a) **Auditor Holding Securities of a Company**: As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.

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

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd. as per section 141(3)(d)(i), which is the holding company of Shiva Ltd., because Mr. Hanuman one of the partner is holding equity shares of its subsidiary.

(b) **According to Section 139(7) of the Companies Act, 2013**, the auditors of a government company shall be appointed or re-appointed by the Comptroller and Auditor General of India. As per section 2(45), a Government company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company as thus defined”.

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

Nick Ltd. is a subsidiary company of Ajanta Ltd. Hence Nick Ltd. is covered in the definition of a government company. Therefore, the Auditor of Nick Ltd. can be appointed only by C & AG.

Consequently, appointment of Mr. Prem is invalid and he should not give acceptance to the Directors of Nick Ltd.

(c) **Services not to be Rendered by the Auditor**: 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.

Further section 141(3)(i) of the Companies Act, 2013 also disqualify 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. A person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

In the given case, CA Innocent was appointed as an auditor of Contravene Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

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

In the given case Mr. Amar is disqualified to act as an auditor under section 141(3)(d)(ii) as he is indebted to M/s Chaudhary Finance Ltd. for more than ₹ 5,00,000. Also, according to section 141(3)(d)(ii) he cannot act as an auditor of any subsidiary of Chaudhary Finance Ltd. i.e. he is also disqualified to work in Charan Ltd. & Das Ltd. Therefore he has to vacate his office in Das Ltd. Even though it is a subsidiary of Chaudhary Finance Ltd.

Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd should appoint another auditor for the company.

4. (a) Applicability of CARO, 2016: The CARO, 2016 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.
In the case of Astha Pvt. Ltd., it has outstanding loan of ₹ 30 lakh (₹ 15 lakh + ₹ 15 lakh) collectively from bank and financial institution which is less than ₹ 1 crore rupees and turnover is ₹ 4.75 crore i.e. also less than ₹ 10 crore and not exceeding the limit. However, it has paid capital of ₹ 140 lakh i.e. more than ₹ 1 crore.

Thus, in view of rupees 140 lakh paid up capital which is exceeding the prescribed limit for exemption, CARO, 2016 will be applicable to Astha Pvt. Ltd.

(b) Reporting under CARO, 2016

(i) Utilisation of Term Loans: According to clause (ix) of Para 3 of CARO, 2016, the auditor is required to report “whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable”.

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car which has no relation with R&D equipment.

Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report as per Paragraph 3 clause ix of the CARO 2016, that out of the term loan taken for R&D equipment, ₹ 15 lakh was not utilised for the purpose of acquiring R&D equipment.

(ii) Physical Verification of Inventory: Clause (ii) of Para 3 of CARO, 2016 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

In the given case, the above requirement of CARO, 2016 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

5. Applicability of CARO, 2016: The CARO, 2016 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing
operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, paid up capital and reserves of T Pvt. Ltd. is less than ₹ 1 crore and has no loan outstanding exceeding ₹ one crore from any bank or financial institution. Further, its total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) is not exceeding rupees ten crore during the financial year as per the financial statements.

Thus CARO 2016 will not be applicable to T Pvt. Ltd.