

## **UNIT-IV**

**SUBJECT CODE:CCM52**

### **COMPANY AUDITORS**

Company auditors – Qualification and Disqualification of an auditor – Appointment and Removal of auditor – Powers and Duties of Auditors – Liabilities of an Auditor.

#### **Meaning of Auditors**

Company Auditor is an individual appointed for preparing an independent audit report of the company. They can be either appointed by the company's Board of Directors, Shareholders, Central Government of Comptroller and Auditor General of India (C&AG) accordingly. An Individual must have expert knowledge and a practicing certificate from the Indian Institute of Chartered Accounts for becoming a company auditor.

It is mandatory for the companies to get their financial statements audited for every financial year for which Companies Act 2013, states all the provisions associate to company's audit in Sec 139 to Sec 142, Whereas; Sec 128 to Sec 132 reported the provisions linked with the accounts of the company.

#### **Qualities of an Auditor:**

The Auditor must possess the following qualifications and qualities:

1. Only the qualified chartered accountant can be appointed as auditor of a limited company.
2. The auditor must have thorough knowledge of principles and practice of all aspects of accountancy. He must be familiar with all systems of accountancy in use.
3. He should have adequate knowledge of financial management, industrial administration and business organization.
4. He must have thorough knowledge of audit case laws as per the various cases decide by the courts in and outside India.
5. He should be able to understand the technical details of business whose accounts he is going to audit.
6. An auditor must be honest i.e. He must certify that he does not believe to be true and he must take reasonable care and skill before he believes what he certifies is true.
7. He must act impartially and not influenced by others, directly or indirectly while discharging his duties.
8. He should be hard working, systematic and methodical.
9. He must have capacity to hear arguments of others.
10. He should have adequate skills and courage to write audit report correctly clearly and

concisely.

11. He should not disclose the secrets of his client

### **Disqualification of Auditors**

#### **Disqualification of Auditors [Section 141 of Company Act, 2013]**

Following persons are not qualified for the appointment as auditor of a company

- A \_\_\_\_\_ Body \_\_\_\_\_ Corporate.
- An \_\_\_\_\_ Officer \_\_\_\_\_ or \_\_\_\_\_ Employee \_\_\_\_\_ of \_\_\_\_\_ the \_\_\_\_\_ company.
- A Partner or Employee of an Officer or Employee of the company.
- A person who, or his relative, or his partner is holding any security in the company or subsidiary company or holding company or associate company or subsidiary of such holding company.

(Note – Security means an instrument which carries voting rights.)

- A person who, or his relative, or his partner is indebted, in excess of such amount as may be prescribed (the sum prescribed is Rs. 5 lakhs) the company or subsidiary company or holding company or associate company or subsidiary of such holding company.
- A person who, 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 prescribed amount (Rs. 1 lakh) the company or subsidiary company or holding company or associate company or subsidiary \_\_\_\_\_ of \_\_\_\_\_ such \_\_\_\_\_ holding \_\_\_\_\_ company.
- A person or a firm who, whether directly or indirectly, has business relationship of such nature as may be prescribed with the company or subsidiary company or holding company or associate company or subsidiary of such holding company.
- A person whose relative is a director or is in the employment of the company as a director or key \_\_\_\_\_ managerial \_\_\_\_\_ personnel.
- A person who is in the employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies.
- A person who has been convicted by a court of an offence involving fraud & a period of 10 years has not been elapsed from the date of such conviction.

**141(4):** An auditor, who after his appointment becomes subject to any of above disqualifications, shall be deemed to have vacated his office as an auditor.

The list of disqualifications makes the position of an auditor as independent as possible.

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## Appointment of Company Auditor

### Appointment of first auditor[ Section 139(6) of Companies Act, 2013]

1. As per section 139(6), first auditor will be appointment.
2. The first auditor shall appointed by the board of directors within one month of the date of registration of the company.
3. The first auditor so appointed shall hold office until the conclusion of the first Annual General Meeting.
4. Appointment of first auditor should be by valid resolution at the board meeting. Merely naming in the Article of Association will not be recognized as appointment under the act.
5. In case the board does not exercise its power in this regard, the board shall inform members of the company who shall appoint the first auditor within 90 days at an extraordinary general meeting.

### Appointment of an Auditor

**Appointment of Auditor in case of Sole proprietor:** The appointment of Auditor in case of sole trader is done by the owner of the business. In case of sole traders the auditor generally acts as an accountant who also prepares accounts besides checking their accuracy. As He is appointed by an individual he must get clear instructions from his client in writing as to what he is expected to do. His work and its scope will depend upon the agreement with his client since the appointment of an auditors not under any statute, therefore the rights and the duties will depend upon the agreement.

### Appointment of Auditor in case of partnership:

The Auditor of a partnership firm is made by the mutual consent of all the partners

**APPOINTMENT OF COMPANIES AUDITORS:** The provisions regarding appointment of the auditor

are contained in section 139 of Companies Act 2013

### 1.Appointment of auditor by members [sec 139(1)]:

- a. A company shall appoint an individual or a firm as an Auditor at the first annual general meeting and each subsequent sixth annual general meeting.
- b. Such auditors shall hold office till conclusion of sixth annual general meeting.
- c. Such appointment shall be placed before the members at each annual general meeting for ratification.

**2.Period for which the appointment is made [sec 139(2)]:**

- a. An individual can be appointed for a term no more than five years.
- b. An audit firm can be appointed for a consecutive term not more than two terms of five years.
- c. An individual or a firm which has completed its term shall not be eligible for reappointment as auditor in the same company for five years from the completion of term.

**3.Appointment of auditor of Government companies (sec 139 (5)):**

The comptroller and Auditor general shall in respect of financial year appoint an auditor duly qualified within 180 days from the commencement of financial year who shall hold office till conclusion of annual general meeting.

**4.Appointment of First Auditor by Board of Directors [sec139 (6)]:**

The first auditor of a company other than government company shall be appointed by the board of directors within 30 days of registration of company. If the board fails to appoint first auditor it shall inform the members of company who shall appoint auditor within 90 days at extra ordinary general meeting who shall hold the office till conclusion of first annual general meeting.

**5.Appointment of First Auditor of Government Company [sec 139 (7)]:**

The first Auditor of a Government Company shall be appointed by Comptroller and Auditor general within 60 days of registration of company. In case of its failure to appoint first auditor, then board of directors shall appoint auditor within next 30 days. The company shall inform the members if the board fails to appoint first auditor who shall appoint the auditor within 60 days at extra ordinary general meeting who shall the office till conclusion of the first general meeting.

**6.Casual vacancy of an Auditor [sec 139 (8)]:**

- a. The casual vacancy of auditor, except in case of Government Company, shall be filled by the board of directors within 30 days but if it arises as a result of resignation of the auditor it shall be approved by company at general meeting convened within 3 months o recommendation of board. Such auditor shall hold office till conclusion of next annual general meeting.
- b. Casual vacancy in case of Government Company shall be filled by Comptroller and Auditor General within 30 days if he fails to fill the vacancy, the board shall fill the vacancy within next 30 days.

**Reappointment of a retiring auditor [sec 139 (9)]:**

Such an auditor can be reappointed at annual general meeting if.

- a. He is not disqualified for reappointment.
- b. He has not given notice to company of his unwillingness.
- c. A special resolution has not been passed at annual general meeting appointing some other person or providing expressly that he shall not be reappointed.

All the above is subject to the provisions of sec 139 (1)

### **QUALIFICATIONS OF AN AUDITOR:**

- 1. A person shall be eligible for the appointment of an auditor of a company only if he is a chartered accountant.
- 2. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of firm.

### **Disqualifications of an Auditor:**

The following persons shall not be eligible for the appointment as an auditor of a company:

- 1. An officer or employee of the company.
- 2. A person who is a partner, or who is in employment or an officer or employee of the company.
- 3. A person or a firm who, whether directly or indirectly has business relationship with the company, or subsidiary of such holding company or associate company of such nature as may be prescribed.
- 4. A person whose relative is director or is in the employment of the company as director or key managerial personnel.
- 5. A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies.
- 6. A person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.

### **REMUNERATION OF AN AUDITOR (SEC 142)**

- 1. The remuneration of the Auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.
- 2. The Remuneration under sub section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the facility extended to him but does not include any remuneration paid to him by any other services rendered by him at the request of the company.

### **REMOVAL, RESIGNATION OF AN AUDITOR**

1. The Auditor appointed under section 139 may be removed from his office before expiry of his term only by a special resolution of the company after obtaining the previous approval of the central Government.

2. The Auditor who resigns from the company shall file within a period of thirty days from the date of resignation, a statement in a prescribed form with the company and registrar, the auditor shall also file such statement with the comptroller and auditor –general indicating the reasons and other facts as may be relevant with regard to his resignation.

### **Rights of an Auditor**

1. **Right to Access books of accounts:** Every auditor of a company has right to free and complete access at all the times to the books, accounts and vouchers of the company

2. **Right to obtain the information and explanation:** An auditor is authorized to obtain such information and explanation as the auditor may think necessary for the performance of his duty as auditor.

3. **Right to receive notice:** All notices of the company and other communications relating to any general meeting of the company shall be forwarded to the auditor of the company. He is also authorized to attend the meetings and make any statement or explanation with regard to the accounts audited by him.

4. **Right to sign audit report:** only the person appointed as auditor of the company, where a firm so appointed only a partner in the firm practicing in India, may sign the auditor's report or authenticate any other document of the company required law to be signed or authenticated by auditor.

5. **Right to seek legal and technical advice:** The auditor of a company is entitled to seek the legal and technical advice which may be needed in the performance of his duties.

6. **Right to remuneration:** on completion of his work an auditor is entitled to his remuneration.

7. **Right to be indemnified:** for many purposes, an auditor is considered to be an officer of the company. An officer has a right to be indemnified out of the assets of the company against any liability.

### **DUTIES OF AN AUDITOR:** Duties under section 143 (1):

a. The auditor has a duty to enquire whether loans and advances made by the company have been properly secured whether the terms and the conditions thereof are prejudicial to the interest of the company or its members.

b. Duty to enquire whether assets of the company being shares or debentures and other securities have been sold at a price less than at which these were purchased.

c. Whether any shares have been allotted for cash, whether cash actually received and whether the position in the account books and balance sheet is correct, regular and not misleading.

**Duties under section 143 (2):**

The auditor has the duty to report the members of the company, the accounts examined by him and every financial statement to be laid before the company in the general meeting. The auditor shall state in his report to the best of his information and knowledge, the said accounts and financial statements whether give a true and fair view or not, of the state of company's affairs

**Duties under section 143(3):**

1. He has the duty to sought and obtain all information and explanation which are necessary for his audit.
2. He has a duty to ensure that the books of accounts as required by law have been kept by the company.
3. He has a duty to see whether the company has adequate internal financial control systems in place and their operative effectiveness.
4. He has a duty to ensure whether the company's balance sheet and profit and loss account dealt within the report or in agreement with the books of account and returns.

**LIABILITIES OF AN AUDITOR:**

The liabilities of an auditor can be summed under following heads:

1. Civil liabilities
2. Criminal Liabilities

**1. Civil Liabilities:**

**(I) Liability for Negligence:** The liability of an auditor arises where it is proved that his client has suffered a loss due to his professional negligence. The auditor may be held personally liable, if it is proved, that had he exercised reasonable care and skill, he must have discovered the discrepancy. In a case it was held that if an auditor fails to show as much skill and diligence as is

expected of a man of ordinary prudence, he must suffer the consequences.

**(ii) Liability for misfeasance:** According to section (340), the court may assess damages against delinquent director and other officers of the company, including an auditor for misfeasance or breach of trust. In case of an auditor who also comes within the definition of officer in section 2 (59) for purpose of the section, if he is guilty of neglect of duty or misfeasance, so as to cause loss of company in any way, proceedings may be taken under this

section against him either independently or other officers or jointly with them. This section provides a simple way to the company to recover damages where an auditor or any other officer of the company is guilty of misfeasance. The time limit for bringing an action is 5 years.

## **2. Criminal Liabilities:**

### **i) Mis-statement in prospectus section 34:**

Where an auditor makes false statement with material particulars in returns, reports, prospectus or other statements knowingly it to be false or omits any material facts knowing them to be false, he shall be punishable with imprisonment for a minimum term of 6 months extendable to 10 years.

**ii) Non compliance by auditor with section 143 and 145:** If the auditor does not comply with section 143 and 145 regarding making his report or signing or authentication of any document and makes willful neglect on his part he shall be punishable with imprisonment up to 1 year and with fine not less than twenty thousand extendable to five lakhs. In case an auditor knowingly or willfully with the intension to deceive the company or Shareholders or creditors or tax authorities, he shall be punishable with imprisonment up to 1 year and fine not less than 1 lakh extendable up to twenty five lakhs.

### **iii) Failure to assist in the investigation section 217 (6):**

Where the central Government appoints an inspector to investigate the affairs of the company, it is the duty of the auditor to preserve and produce to the inspector all books and papers relating to the company. If an auditor fails to assist the inspector in investigation he shall be punishable with imprisonment up to 1 year and with fine not less than twenty five thousand extendable to 1 lakh

### **iv) Penalty for falsification of books section 336:**

Any officer including auditor of a company which is being wound up, with an intention to defraud or deceive any person, destroys, mutilates, alters, falsifies any books, papers or securities. He shall be punishable with imprisonment for a term not less than 3 years extendable to 5 years and with fine not less than 1 lakh extendable to three lakhs.

### **V) Penalty for deliberate act of commission or omission section 448:**

If any officer including auditor of the company deliberately make a statement in any return, report, certificate, balance sheet, prospectus etc. which false or which contains omission of material facts he shall be punishable with imprisonment for a term not less than 6 months extendable to 10 years and fine not less than amount involved in fraud extendable to 3 times of such amount



## **Rights & Powers of Auditor**

1. Right of access to Books of account & Vouchers [Sec. 143(1)]
2. Right to obtain information & explanation [Sec. 143(1)]
3. Right to visit branch offices & access to branch account
4. Right to receive notice & attend general meeting
5. Right to make representation
6. Right to report to members
7. Right to sign audit report
8. Right of seeking opinion of an expert
9. Right to receive remuneration

### **Right of access to Books of account & Vouchers**

The auditor has a right to access, at all times the books of accounts & vouchers of the company, whether kept at head office or elsewhere. It is an absolute right & is not subject to any restriction, exception or qualification.

The term book includes all types of books such as financial statutory or statistical books. The right of access at all times implies that an auditor can inspect the books, accounts & vouchers of the company during the normal business hours of the audit.

### **Right to obtain information & explanation**

An auditor of the company is entitled to required from the officers, of the company such information & explanation as he may think necessary for the performance of his duties as an auditor. The auditor is bound to state in his report whether he has obtained all the information & explanations which to the best of his knowledge & belief were necessary for the purpose of the audit.

### **Right to visit branch offices & access to branch account**

Where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor is entitled to visit the branches, if he deemed it necessary to do so for the performance of his duties as an auditor.

However, the auditor does not have right to visit foreign branches of a banking company & it will be adequate if he is allowed access to such copies of extracts from the books or accounts of the branch as have been sent to the principal office in India.

### **Right to receive notice & attend general meeting**

The auditor has the right of receiving all the notices & other communications relating to any general meeting of a company which any member of the company is entitled to have. He is entitled to attend any general meeting & to be heard at any general meeting which he attend on any part of the business which concerns him as an auditor.

However, the auditor has no obligation to attend such meetings. Also, this right does not extend to board meeting.

### **Right to make representation**

The retiring auditor is entitled to receive a copy of the special notice intending to remove him or proposing to appoint any other person as auditor. The retiring auditor has a right to make his representation in writing & request that the same is circulated among the members. In case the same could not be circulated, the auditor may require that the representation shall be read out at the general meeting.

### **Right to report to members**

The auditor has right as well as duty to make a report to the members on the accounts examined by him & to state whether in his opinion & to the best of his information & explanation given to him. Auditor has to state whether the financial statements give a true & fair view of the state of affairs of the business of the company.

### **Right to sign audit report**

The auditor has right as well as duty to sign the audit report & the balance sheet & the profit & loss account including all the documents attached or annexed therewith.

### **Right of seeking opinion of an expert**

In respect of any special technical matters, the auditor is entitled to consult & take the opinion of an expert. He is also entitled to take legal advice so as to discharge his duties efficiently.

### **Right to receive remuneration**

The auditor has an inherent right to receive remunerations for auditing the accounts of the company, though such rights accrue only after he has completed the work.

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### **Duties of Auditor**

1. Report to members [Sec.143(2)]
2. Examination of accounts
3. Reporting on true & fair view
4. Duty as to Enquiry [Sec.143(1)]
5. Report as to additional matters
6. Duty to sign report
7. Duty as to statutory report
8. Duty as to prospectus [Sec.56]
9. Duty to assist investigation

### **Report to members [Sec.143(2)]**

The auditor is required to make a report to the members of the company.

- On the accounts examined by him.
- On the balance sheet & profit & loss account.
- On every other document declared by the act.

His report must state whether in his opinion & to the best of his information & according to the explanations given to him the said accounts give a true & fair view in case of balance sheet, of the state of company's affairs as at end of the financial year, & in the case of the profit & loss account for its financial year.

### **Examination of accounts**

The auditor has to state in his report

- Whether he has obtained all the information & explanations which to the best of his knowledge & belief were necessary for the purpose of audit.
- Whether in his opinion proper book of accounts as required by law has been kept by the company & proper returns adequate for the purpose of audit have been received from the branches not visited by him.
- Whether any branch audit report under section 228 forwarded to him & how he has dealt with the same in preparing auditors report.
- Whether the company's balance sheet & profit & loss account dealt with the report are in agreement with the book of account & returns.
- Whether in his opinion the balance sheet & Profit & loss account comply with the accounting standards.
- If any adverse effect on the functioning of the company is observed it needs to be comment in bold & italic font.
- Whether any director is disqualified from being appointed as director under sec. 274 (i) (g)
- Whether cess payable under sec. 441A has been paid & if not the details of the amount of cess.

### **Reporting on true & fair view**

The primary duty of the auditor is to express his opinion whether the balance sheet shows true & fair view of the state of company's affair as at the end of the financial year.

Schedule VI refers only to the minimum disclosure requirement, if certain information has a material bearing on the representation made in the financial statements, it must be disclosed even if there is no legal requirement for its disclosure under schedule VI.

Before expressing his opinion on the truth & fairness of the financial statement, the auditor must ensure

- They are drawn up according to exact legal requirements.

- They show the financial position & profit & loss without any distortion.
- They do not contain any misstatement as to income or expenses.
- They have generally accepted principles of accounting have consistently been followed in drawing up financial statements.
- All necessary information is made available to shareholders as to the true financial position of the company.

### **Duty as to Enquiry**

It is the duty of the auditor to enquire

- Whether loans & advances made by the company on the basis of security have been properly secured & whether the terms on which they have been made are not prejudicial to the interest of the company.
- Whether the transactions are represented merely by book entries are not prejudicial to the interest of the company.
- Whether the company is not an investment company or a banking company, whether so many of the assets of the company have been sold at a price less than at which they were purchased by the company.
- Whether loans & advances made by the company have been shown as deposits.
- Whether personal expenses have been charged to revenue account.
- Whether the position is stated in books of accounts & balance sheet is correct, regular & misleading.

The auditor is not required to report on the matters specified under this section 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 enquiries, he is not required to report that he is so satisfied.

### **Report as to additional matters**

In exercise of this power, the Central Government has issued Companies ( Auditor's Report ) Order CARO,2003. The auditor has to make a statement on each of the matters specified in the order.

### **Duty to sign report**

It is the duty of the auditor to sign the auditor's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor. In case of a firm, only a partner of the firm practicing in India can sign the report.

Duty as to statutory report: It is the duty of the auditor to certify as correct that part of the statutory report that relates to a. The shares allotted by the company. b. Cash received in respect of such share & c. Receipt & payments of the company.

### **Duty as to statutory report**

It is the duty of the auditor to certify as correct that part of the statutory report that relates to

- The shares allotted by the company.

- Cash received in respect of such share
- Receipt & payments of the company.

### **Duty as to prospectus**

Section 56 deals with matters to be stated & the reports that is to be set out in the prospectus. It is the duty of the auditor to certify this report for the purposes of the prospectus.

### **Duty to assist investigation**

Where any investigation has conducted, it is the duty of auditor.

- To preserve & to produce all books & papers relating to the company to inspector.
  - Give to the inspector all assistance in the connection with investigation.
- It may be noted that no limitation can be placed upon the duties of the auditor under section 227, either by the articles of the company or by any resolution of the members.

### **Scope of Duties of Auditor**

The scope of duties of an auditor depends upon the nature of the business carried on by the concern. The duties & the responsibilities can be briefly summarized as follows:

- To verify that the statements of account are drawn up on the basis of the books of the business. However, the auditor is not liable for facts which are concealed & kept out of books which he cannot verify in the ordinary course of the exercise of reasonable care & diligence.
- To verify that the statements of the account exhibit a true & fair state of affairs of the business.
- To confirm that the management has not exceeded the financial administrative power vested in it by the articles or by any specific resolution of shareholders passed at a general meeting.
- To investigate matters in regard to which his suspicion is aroused as to the result of a certain action on the part of the servants of the company.
- To perform his duties by exercising reasonable skill & care. He should not rely on the certificate of the management for those items which he can verify directly.