

AUDITING
ASSIGNMENT ON-
CAPTER - 5
COMPANY AUDIT

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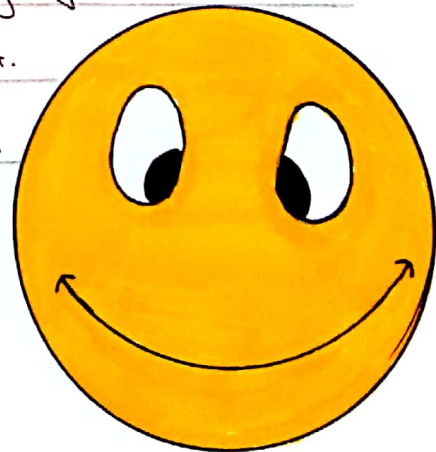
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Meaning of Auditor

The Companies Act does not define the term auditor. But it may be defined as any CA appointed qualified for the purpose of examining the accounts of a joint stock company and making a report there on to the shareholder every year at the annual general meeting of the company.

Qualification and disqualification of a Company auditor

Qualification of an auditor

The necessary qualification of an auditor who can audit the a/c of a limited company, are contained in Sec 226 of the Companies Act. These qualification are as follows:

1) He must be practicing CA within the meaning of the CA Act, 1949. A chartered accountant means a person who is a member of the Institute of Chartered Accountants of India.

2) A firm of auditor can be appointed as an auditor of a company in its firm name, but all the partners of such a firm must be CA. In such a case, any partner of such a firm may act as an auditor in the name of the firm.

3) A person, holding a Certificate under the restricted Auditor Certificates (Part B state) rules 1956, is also qualified to act as an auditor of a Company.

Disqualifications of an Auditor

The following persons are disqualified for appointment as auditor of a Company.

- 1) A body Corporate.
- 2) An officer or employee of the Company.
- 3) A person who is a partner or who is in the employment of any officer or employee of the Company.
- 4) A person who is indebted to the Company for an amount exceeding ₹ 1000 or who has given any guarantee of any third person to the Company for an amt exceeding ₹ 1000.

Appointment of a Company Auditor

The legal provisions relating to the appointment of the Company auditor may be discussed as follows :

1. Appointment of First Auditor

a) The first auditor of a Company shall be appointed by the board of directors within one month of the registration of the Company. The auditor, so appointed, shall hold office until the conclusion of the first annual general meeting.

b) Appointment of the first auditor should be made by passing a resolution by the board at its meeting.

c) If board of directors fails to make such appointment, the Company, in its first general meeting, shall appoint the first auditor. The first auditor so appointed shall hold office until the conclusion of the first annual general meeting.

2. Appointment of Subsequent Auditor

a) Every Company shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting and shall, within seven days of appointment, give intimation hereby to every auditor so appointed.

b) Re-appointment of a retiring auditor: ordinarily, the

retiring auditor shall - automatically be appointed at the annual general meeting. But in the following cases, the retiring auditor shall not be reappointed.

i) If he is not qualified for re-appointment.

ii) If he has given to the company a notice in writing of his unwillingness to be reappointed.

iii) If a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed.

iv) If a notice has been given to the company of an intended resolution to appoint some person or persons in the place of a retiring auditor.

3. Appointment by the Central government

If an auditor is not appointed or re-appointed at the annual general meeting, the company shall notify this fact to the central government within seven days thereafter, and the central government may appoint a person to fill the vacancy. If the company fails to intimate this fact within seven days, the

Company and every officer of the Company who is in default shall be punishable with fine which may extend to ₹ 500.

4. Appointment of auditor of a government Companies.

Under Sec 619 of the Companies Act, the auditor of a government Company shall be appointed or re-appointed by the Central government on the advice of the Comptroller and Auditor General of India. But while making appointment, effect shall be given to the provision relating to ceiling on Company audit as per Sec 224 (1-b) & (1-c)

5. Appointment of Auditors by Special Resolution

As per Sec 224 (4), in the case of a Company in which not less than 25 percent of the subscribed share capital is held whether singly or jointly by-

a) A public financial institution or a government Company or the Central government or any State government or

b) Any financial or any other institution established by the provision of a State act, in which a State government holds not less than 51% of the subscribed share capital, or

c) An nationalized bank or an insurance company carrying on general insurance business - the appointment or reappointment of the auditors shall be made by a special resolution.

6. Appointment in case of a casual vacancy

The casual vacancy, in general, means a vacancy in the office of the auditor resulting from accidental or fortuitous circumstances such as death, incapacity or disqualification of the auditor. Any casual vacancy can be filled up by the board of directors. An auditor appointed to a casual vacancy can hold office only till the conclusion of the next annual general meeting.

Removal of Auditors

An auditor may be removed before the expiry of the term for which he has been appointed. The first auditor appointed by the directors of the company may be removed before the expiry of his term of office and another person may be appointed in his place by the shareholders at a general meeting by

passing an ordinary resolution to that effect.

In any other case, an auditor may be removed from office before the expiry of his term by passing an ordinary resolution. But this can be done by the company after obtaining prior approval of the central government.

Removal of an Auditor

1. The first auditor, appointed by the board of directors, retires at the conclusion of the first annual general meeting.
2. The subsequent auditor, appointed by the shareholders at the annual general meeting, retires at the conclusion of the next annual general meeting since he is appointed only for one year.
3. However, an auditor who retires at an annual general meeting may be reappointed by the shareholders at the annual general meeting unless -
 - a) He is not qualified for reappointment or
 - b) He has given to the company a notice in writing of his unwillingness to be reappointed or.

c) A resolution is passed to the effect that the retiring auditor should not be reappointed.

4. It may be noted that, if on the retirement of an auditor on the conclusion of an annual general meeting, no new auditor is appointed by the shareholders, then, the retiring auditor will continue to be the auditor of the company for another term of one year.

Remuneration of an Auditor

The remuneration of the first auditor is fixed by the board of directors as he is appointed by it. If the auditor is appointed by the central government under certain special circumstances his remuneration is fixed by the central government. If the auditor is appointed by the shareholders at the general meeting, his remuneration is fixed by the company in the general meeting. If the remuneration of the auditor is not fixed by the company and if the company or the general meeting delegates the power of fixing his remuneration to someone else.

Rights and Powers of a Company Auditor

1. Right of access to books of accounts and vouchers

Under Sec 227(1) of the Companies Act every auditor of a company has a right of access, at all times, to the books of accounts and vouchers of the company, whether they are kept at the head office of the company or elsewhere.

2. Right to obtain information and explanation

The auditor has a right to ask the director and officers of the company, to give information and explanation which he may think necessary for the due discharge of his duty as auditor.

3. Right to visit the branches of the company

The company auditor has the right to visit the branches of the company to audit the accounts if no qualified auditor has been appointed to audit the accounts of the branch offices. If he is required to audit the a/c of the branches, then he has the right of access to all the book of a/c's vouchers etc of the branches at all times.

4. Right to receive notice and other communications of the general meetings and attend the same.

The company auditor has the right to receive notice of and attend every general meeting of the shareholders of the company irrespective of the fact whether the a/c are being discussed or not at such a meeting. He has also the right to speak at such meeting when the accounts are being discussed.

5. Right to make statements at the general meeting

He has the right to make any statements or explanations as desired by him at such a meeting in connection with the a/c audited by him but he is not bound to do so on his own account.

6. Right to correct any wrong statements

An auditor has a right to correct any wrong statement made by the directors relating to the accounts to be laid before the company in the general meeting.

7. Right to be indemnified.

He has a right to be indemnified out of the

assets of the company against any liability incurred by him in defending himself against any civil and criminal proceedings by the company, provided the judgement is in his favour or the court is of the opinion that the auditor acted honestly.

8. Right to seek legal and technical advice

He has the right to seek legal, expert or technical advice on the performance of his work but he must give his own opinion on the report and not that of the experts, lawyers.

9. Right to make representation.

When the auditor is asked to vacate his office before the expiry of his term, then he has the right to make written representation at the general meeting of the company and he has also the right to be heard at the meeting before the resolution removing him is passed.

10. Right to receive remuneration

He has the right to receive his remuneration provided he has completed the work assigned to him. It may be noted that, if the remuneration payable to the auditor is fixed

in the form of an annual fee, he is entitled to full year's fee, even if he is dismissed during the year.

11. Right to Sign the Audit Report

Only the person appointed as an auditor of the company or where a firm of auditors is appointed as auditor, only a partner of such a firm can 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.

12. Right to Report to the Shareholders of the Company

The auditor has a right to the shareholders of the company whether the books of accounts audited by him show the true and fair view of the financial position of the company.

Duties of a Company Auditor

a) Statutory duties

These are the duties of an auditor which are specifically provided in the companies act and hence they are called statutory duties. These duties of the auditor are as follows:

1. Duty to make a report to the members of the company

It is a most important duty of the auditor to make a report to the members of the company on the accounts audited by him. The report, so submitted, should contain the following:

- a) whether, in his opinion, the P&L ac exhibits a true and fair view of the profit or loss of the company
- b) whether in his opinion, the b/s is properly drawn up so as to exhibit a true and fair view of the state of affairs of the business of the company.
- c) whether he has obtained all the information and explanation, which, to the best of his knowledge and belief, were necessary for the purpose of his carrying out his audit.
- d) whether, in his opinion, proper books of account as required by law, have been kept by the company.
- e) whether, the accounts given the information required by the Companies Act and in the manner, so required.

2. Duty to make enquiry

under sec 227 (1A) of the Companies Act of 1965.

an auditor of a company should enquire

a) whether loan and advance made by the company on the basis of securities have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company or its member.

b) whether the transactions of the company which are represented merely by book entries are not prejudicial to the interest of the company.

c) where the company is not an investment company, whether the shares, debenture and the other securities of the company have been sold at a price less than their purchase price.

d) whether loan and advance made by the company have been shown as deposit

e) whether personal expenses have been charged to revenue account.

3. Duty to certify the Statutory report

It is the duty of the auditor to certify the

Correctness of the Statutory report after it has been certified as correct by not less than two directors so far as it relates to the following :

- a) The shares allotted by the company
- b) The cash received by the company on account of shares.
- c) The abstract of the receipts and payment of the company.

4. Duty to sign his report

It is the duty of the auditor to sign the report prepared by him. In the case of a firm of auditors, any partner of the firm should sign the audit report.

5. Duty to give a statement in prospectus

Under Sec 56(1) of the Companies Act, the prospectus issued by an existing company should contain a report or statement from the auditor regarding.

- a) Profit & losses
- b) Assets & liabilities of the company and its subsidiaries.
- c) Rate of dividend paid ^{by} the auditor of the company for each of the 5 financial years preceding the issue of the prospectus.

6. Duty to comply with the directives of the central government

Under sec 227(4-A) of the Companies Act the central government is empowered to issue necessary directions to the auditors of certain companies to give specific reports on certain matters of the companies. The central government issue directives to auditors of the companies which are engaged in one or more of the following activities:

- a) Manufacturing, mining or processing
- b) Supplying and rendering services
- c) Trading
- d) Business of financing, investment, chit fund, rights or mutual benefit societies.

7. Duty to certify the declaration of the solvency of the company

When a company goes into voluntary winding up and a declaration of the solvency of the company is made by its directors, to be given to the liquidator, as per sec 488(c) of the Companies Act, it is the duty of the auditor to certify the declaration of the solvency of the company.

8. Duty to assist investigators or inspectors

where the central government has appointed the investigations or inspectors to investigate the affairs of the company, it is the duty of the auditor to preserve and produce before such investigations all books and papers relating to the company and give them all possible assistance in connection with the investigation.

9. Duty to assist the central government in connection with prosecution

Under section 201 of the Companies Act, it is the duty of the auditor to give the central government all reasonable assistance in connection with the prosecution of directors, managing director or other officers of the company.

10. Duty to make a report on Public Deposits

Under sec 58(A) of the Companies Act, the auditor of a non banking company should enquire whether or not such a company has furnished information about the deposit accepted by it from the public to the reserve bank of India, and whether the directives issued by RBI regarding acceptance of public deposit have been completed with by the company or not.

B. General Duties

The auditor has some other duties which are required to be discharged by him in his capacity as an auditor. These duties have been recognized by the courts. They are also called as legal duties or duties under Company law. They are

1. Duty to exercise reasonable care and skill

The auditor must exercise reasonable care and skill in the discharge of his duties. Since he holds himself out as an expert, he must be honest. He must not certify what he does not believe to be true and he must take reasonable care and caution before he believes that what he certifies is true.

2. Duty to check the accuracy of accounts

The auditor must check the accuracy of the books of accounts and see that they show the true and fair view of the affairs of the company.

3. Duty to satisfy himself about reserves

It is the duty of the auditor to satisfy himself that the reserves mentioned in the books of the company

on fact exist. He should personally inspect the securities and ensure that they are on safe custody.

4. Duty to scrutinize debentures

It is the duty of the auditor to scrutinize debentures in detail and examine properly the rules of the Debenture Trust Deed.

5. Duty to verify investments

It is the duty of the auditor to verify investment himself while certifying such investments.

6. Duty to report to the shareholders

The auditor must report all material facts and about the violation of the provisions of the Companies Act to the shareholders.

7. Duty to verify the assets

The auditor must verify personally all the assets of the company.

8. Duty to check the stock

It is the duty of the auditor to check the stock and account properly.

Liabilities of a Company Auditor

The company auditor is appointed under the Companies Act. So, his liabilities are determined by the Companies Act. The liabilities of Company Auditor can be grouped under two heads.

They are - Civil Liability

- Criminal Liability

a) Civil Liability

Liability of an auditor to pay damages is known as civil liability. The civil liabilities of an auditor may be grouped under two heads. They are:

1. Civil Liability for negligence

An auditor of a company is appointed by the Shareholders. As such he becomes an agent of the Shareholders. As an agent, he must safeguard the interests of the Shareholders and the company. To safeguard the interests of the Shareholders and the company, he must exercise reasonable care and skill in the performance of his duties. If he fails to do so, and as a consequence thereof, the principal suffers any loss, the auditor will be held liable to make good and loss.

The auditor can be held liable for negligence only if the following conditions are fulfilled.

- a) There has been negligence in the performance of his duty.
- b) The loss or damages is the result of his negligence.
- c) The loss was suffered by the client to whom he owed a duty.

a. Civil liability for negligence

Negligence means improper performance of a lawful act or negligence means a breach of trust or duty imposed by law. If an auditor of a company does something wrongfully in the performance of his duties, resulting in financial loss to the company, he is guilty of negligence.

b) Criminal liability

The criminal liabilities of an auditor may arise under the Companies Act, 1956, the Indian Penal code, the Income Tax Act 1961, and the Chartered accountants act of 1949.

1. Criminal liability of an auditor under the Companies act of 1956

Under this act an auditor is held criminally

liable in the following cases:

- > For misstatement in prospectus
- > For fraudulently inducing persons to invest money
- > For non-compliance with section 227 and 229 of the Companies Act (Section 233)
- > For failure to assist investigation (Section 240)
- > For failure to assist prosecution of guilty officers (Sec 242)
- > For failure to return property, books or papers (Sec 477)
- > For falsification of books (Sec 539)
- > Prosecution under Section 545

2. Criminal liability of an Auditor under the Indian Penal Code

Under sec 197 of the Indian Penal Code, if an auditor issues or signs any certificate, which by law is admissible in evidence, knowing or believing that such certificate is false in any material point, he becomes punishable in the same manner as if he gives false evidence.

3. Criminal liabilities of an Auditor under the Income Tax Act

1961

The auditor of a company can act as an authorized

representative and appear before the Income Tax authorities in connection with the proceedings under the Income Tax Act. As such, an auditor may become criminally liable under certain circumstances.

→ under Sec (288) 288 of the Income Tax Act, 1961, if an auditor has been convicted of an offence in connection with taxation proceedings, he will be disqualified from representing an assessee for a certain period.

→ under Sec 277 of the Income Tax Act, if an auditor submits knowingly any false statement in the form of a/c for the preparation of Income tax return, he becomes liable for imprisonment for a period of 12 years.

4. Criminal Liability of an Auditor under the Chartered a/c's a/c

under Part III of Part Schedule of the Chartered accountants Act 1949, a member of the Institute will be deemed to be guilty of professional misconduct.

Audit Report

The term report has been defined by Lancaster as a

"Statement of collected and considered facts so drawn up so as to give clear and concise information to person who are not already in possession of a full facts of the subject matter of the report".

Characteristics of Audit report

1. It is a statement of facts collected and considered by the auditor in clear and concise words.
2. It is the medium through which the auditor express his opinion on the financial state of affairs of the company.
3. It is the end product of audit, as it summarized the results of the audit work conducted by the auditor.
4. The audit report may be short or long.
5. It may be a clean report or a qualified report.
6. It may be in the form of a letter or mere statements.
7. It is duly signed by the auditor and attached to the balance sheet of the company.

Importance of Audit report

An audit report is a very important document.

The importance of an audit report is due to the following reasons:

1. An audit report is a statutory requirement in the case of Company audit.
2. An audit report is the end product of audit. It summarizes the results of the audit work done by the auditor.
3. It is the medium through which an auditor expresses his opinion on the state of affairs of the business.
4. It gives satisfaction to the shareholders that the accounts are properly maintained and are showing a true and fair view of the financial position of the business.
5. It is an evidence of the auditor's work.
6. It is a tangible proof of the financial state of affairs of the Company.

REFERENCE

Auditing (B.Com VI Sem)

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