


# COMPANY AUDIT




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# *APPOINTMENT OF A COMPANY AUDITOR*


## WHO CAN APPOINT AN AUDITOR?




- Appointment by directors



- Appointment by shareholders



- Appointment by the Central Government



- Appointment by the Comptroller and Auditor General

# *APPOINTMENT OF A COMPANY AUDITOR*

## *Under Sn 224 of the Company's Act*

- Appointment by Board of Directors:

- The first auditor of a newly floated company is appointed by the board of directors, **within one month of registration** of the company. Such an auditor or auditors shall hold office till the conclusion of the first annual general meeting.
- The directors are also empowered to fill a **casual vacancy of an auditor** if it is not caused by resignation. The auditor so appointed shall hold office till the conclusion of the next annual general meeting. But in case, if the vacancy is caused by the resignation of an auditor, it shall only be filled by the company in its annual general meeting.

# ..... Appointment of a Company Auditor

## 2. Annual General Meeting: (By Shareholders)

- ✓ The auditor or auditors are appointed in the annual general meeting under the following circumstances:
- ✓ If the board of directors fail to appoint an auditor, the **shareholders** shall make an appointment in the annual general meeting.
- ✓ Every company shall at each annual general meeting appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.
- ✓ The company has to give intimation to the auditor so appointed within seven days of his appointment.
- ✓ The auditor so appointed shall within 30days of the receipt of intimation from the company regarding his appointment, has to inform the registrar of the company in writing whether he has accepted or refused the appointment.

# ..... Appointment of a Company Auditor

## Central Government:

- According to section 224 (3), if the auditor has not been appointed in the annual general meeting, the company has to inform **within seven days** to the **Regional Director** to whom the Central Government's power to appoint an auditor in such an event has been delegated under section 637.
- The said application must disclose in sufficient **detail the reasons** why the company could not appoint the auditor at its general meeting. In the case of default, the company and every officer of the company who is in default **shall be punishable with a fine which may extend to Rs.500 as per section 224(4).**
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# ..... Appointment of a Company Auditor

- **Appointment of Auditor by Special Resolution.**
- In 1974, Companies Act 1974 was amended by adding sub section A to section 224. After that, in some cases, the appointment of auditors or auditor requires special resolution. That is in case of a company, in which not less than **25% of the subscribed share capital is singly or jointly held by.**
- A public financial institution or a government company or the central government or any state government or
- Any financial or other institution established by any provincial or state Act in which a state government holds not less than 51% of the subscribed share capital or
- A nationalized bank or an insurance company carrying on general insurance business.

## ..... Appointment of a Company Auditor

- Filling of Casual Vacancies [Section 224(6)]

- ✓ A vacancy caused by the **resignation of an auditor** shall only be filled by the members in the annual general meeting.
- ✓ If a casual arises for any other reason (that is, death, insanity or insolvency) it can only be filled by the **board of directors**.
- ✓ An auditor appointed to fill up the **casual vacancy shall hold office until the conclusion of the next annual general meeting of the company**.

## APPOINTMENT BY THE COMPTROLLER AND AUDITOR GENERAL



In case of Government Companies, the Comptroller and Auditor General appoints or re-appoints the auditor.



# RE-APPOINTMENT OF AN AUDITOR

The retiring auditor shall **NOT** be re-appointed in the following

1. Not qualified

2. Unwilling

3. Passing of a special resolution

4. Appointment of some other person

5. Unable to comply with the ceiling on no. of audits

# *Reappointment of Company Auditor*

## **Compulsory Reappointment.**

Section 619 of the Companies Act specifies that in the case of **government companies**, the appointment or reappointment of an auditor by the central government can be made only on the advice of the **comptroller and Auditor General of India**.

## *Qualification of an Auditor*

According to Section 226(1) and 226(2) of the Companies Act, the prescribed qualifications of an auditor are as follows:

1. A person who is a **chartered accountant** within the meaning of the Chartered Accountant's Act 1949. (Section 26(1))
2. A person who holds a **certificate under the Restricted Auditors Certificate Rules 1956** is also qualified to act as an auditor of a company. Such persons are also known as **certified auditors** and are always subject to rules made in this behalf by the central government [section 226(2)]

The central government is empowered to frame rules relating to granting renewals, suspension or cancellation of such certificates.

# *Disqualification of a Company Auditor.*

- ✓ According to section 226(3) of the Companies Act, the following persons shall not be appointed as auditors of a company.
- ✓ A body corporate.
- ✓ An officer or an employee of the company.
- ✓ A person who is a partner in the business.
- ✓ A person who is indebted to the company for an amount exceeding more than Rs.1000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs.1000/-.
- ✓ If an auditor, after his appointment becomes a subject of any of the above mentioned disqualifications, he shall be deemed to have vacated his office forthwith.

## *Removal of an Auditor.*

- The first auditors appointed by the directors prior to the **first annual general meeting** of the company may be removed by the **members** in the annual general meeting even if their tenure of office has not expired.
- The general meeting may in their place, appoint any other person, notice for whose nomination has been given by any member not less than **14 days before the date of the meeting.**
- In any other case, the **auditor may be removed from office before the expiry of his term by the company in the annual general meeting after obtaining the previous approval of the central government** in this behalf. This provision is as per section 224(7) of the Companies Act.
- But section 225 of the Companies Act makes **special provisions** in this respect, in order to safeguard the interests of an independent auditor against unfair and unjust removal at the hands of an unscrupulous management.

# Remuneration of an Auditor.

- The general rule is that the **appointing authority** is authorized to fix the remuneration of an auditor as per Section 224(8)
- In the case of a new company where the auditors are appointed by the **board** of directors, the remuneration will be fixed by the **board of directors**.
- Similarly, if an auditor is **appointed to fill a casual vacancy the remuneration will be fixed by the** board of directors.
- When an auditor is appointed by the **Central Government** the remuneration will also be fixed by the **Central Government**.
- If the auditor is appointed at the **annual general meeting**, the remuneration is also fixed at the annual general meeting.
- Remuneration includes the sum paid by the company in respect of the auditor's expenses.
- Where the auditor is **reappointed** in the next annual general meeting, the amount **fixed in the previous year** is considered for the current year also, if nothing more is specifically provided as remuneration in the current annual general meeting.
- A part from the routine audit work, if a chartered accountant is entrusted with the work of taxation, writing up of the account books and other professional services then the auditors and the board of directors can **fix up the remuneration mutually for the additional work**. Moreover, the sanction of the share holders is not needed for the same.

## *Rights of Company Auditors.*

- ✓ **Right of Access the Books of Accounts:**
- ✓ **Right to Obtain Information and Explanations:**
- ✓ **Right to Receive Notices and Other Communication Relating to General Meetings and to attend them**
- ✓ **Right to Visit Branches.**
- ✓ **Right to Correct Any Wrong Statement.**
- ✓ **Right to sign the Audit Report**
- ✓ **Right to Being Indemnified.**
- ✓ **Right to seek Legal and Technical Advice.**
- ✓ **Right to Receive Remuneration.**
- ✓ **Right to have legal, technical of expert advice:**
- ✓ **Right to speak at the general meeting:**
- ✓ **Right to report to the members of the company:**

# *Duties of Company Auditor*

**1. To make special enquiries and investigation:** in connection with the following matters under section 227(1-A) of the Companies Amendment Act 1965.

- ✓ loans and advances
- ✓ security
- ✓ transactions -not supported by any fact or evidence
- ✓ personal expenses have been charged to the revenue account.
- ✓ shares have been allotted for cash and whether cash has actually been received

**2. Duty to make a Report to the Shareholders.**

- ✓ the Profit and Loss Account
- ✓ Balance Sheet
- ✓ the information and explanation
- ✓ proper books of accounts as required by law
- ✓ report on branch accounts audited



# .....*Duties of Company Auditor*

## **3. Duty to comply with the Directives of the Central Government.**

- ✓ Manufacturing, mining or processing.
- ✓ Supplying and rendering services
- ✓ Trading
- ✓ Business of financial investments, chit funds, nidhi or mutual benefit societies.

## **4. Duty to sign the Audit Report.**

## **5. Duty to give a Statement in the Prospectus.**

Profits and losses during the previous year.

Assets and liabilities of the company and its subsidiaries and

The rate of dividend paid by the company in respect of each class of shares

## **6. Duty to Certify the Statutory Report.** (after 1 month, before 6 months)

shares allotted by the company, the cash received in respect of shares, and the receipts and payments of the company..... Directors Sign , Managing Directors sign.....

## .....*Duties of Company Auditor*

**7. Duty to make a declaration of Solvency, if the company Goes into Voluntary Winding up.**

**8. Duty to produce information and to assist the investigation, if any investigation is conducted regarding the working of the company.**

**9. Duty to perform the contract**(according to the terms of contract between the auditor and the party who has appointed him).

**10. Duty to care and caution.:**

- ✓ A. Appointed in the capacity of an expert,
- ✓ B. Act honestly
- ✓ C. Exercises care and caution in the performance of his duties.
- ✓ D. The auditor can never give ignorance as an excuse for defense.

# *The Liabilities of a Company Auditor.*

## **Classification of Liabilities**

### **1. Civil Liabilities:**

- A) Civil Liabilities for Negligence'
- B) Civil Liabilities for Mis- statements in Prospectus
- C) Civil Liabilities for Misfeasance

### **2. Criminal Liabilities:**

- A) The Companies Act.
- B) The Income Tax Act.
- C) The Chartered Accountant Act

# .....The Liabilities of a Company Auditor.

## • A. Civil Liability of an Auditor for negligence.

- ✓ There has been a negligence in the performance of his duty and it may be due to the absence of **requisite professional skills** or failure to exercise it.
- ✓ There happens to be a **loss or damage** as a result of his negligence and
- ✓ The loss was **suffered by his client.**

However, the court has the power to grant relief, wholly or partly to an auditor. We can also present the situation as given below.

- ✓ Loss without negligence and
- ✓ Negligence without loss.

## • B. Liability of the Auditor for Mis-statements in the Prospectus.

If Prospectus issued with auditors consent

- The auditor and every person who has authorized the issue of the prospectus shall be punishable with imprisonment for a term which may extent of 2years or with fine, which may extend to Rs. 5000 or with both

# .....*The Liabilities of a Company Auditor.*

## • C. Civil Liability of an Auditor for Misfeasance.

**Breach of trust or duty imposed by law for negligence** in the performance of duties, which results in some **loss or damage** to the company. If an **auditor does something wrong** in the performance of his duties resulting in financial loss to the company he is guilty of misfeasance.

### **Relief:**

- ✓ That he has acted honestly.
- ✓ That he has acted reasonably and
- ✓ That having regard to all the circumstances of the case, he ought fairly to be excused.

# *Criminal Liabilities of a Company Auditor.*

## The auditor can be held criminally liable under:

- The Companies Act.
- The Income Tax Act.
- The Chartered Accountant Act

## Criminal Liability under the Company's Act:

### • Section 233

- If the auditor does not comply with the requirement of section 227 and 229 as to **make of his report, of signing or authenticating any document and** if such default on his part is willful, he shall be punishable with fine which may extend to Rs. 1000

### • Section 240

- If the auditor of a company **doesn't give the required assistance to an inspector appointed by the central government to investigate into the affairs of the company,** the auditor of the company is punishable with imprisonment up to 6 months or fine up to Rs. 2000 or both. For persistent default a further fine at Rs. 200 per day may also be charged.

# *Criminal Liabilities of a Company Auditor.*

## Section 242

- ✓ When on the basis of the report submitted by an inspector, the central government takes action and prosecutes any person connected with the affairs of the company is required to **assist the prosecution**. If he does not do so, he is guilty of contempt of court and punishable to the extent of imprisonment for 6 months or fine of Rs 500 or both.

## Section 477

- ✓ When the **company is wound up**, the auditor is subjected to a **private examination by the court and is also liable to return to the court any books and documents of the company in his possession**. If he does not appear before the court he can be arrested.

## Section 478

- ✓ On an **application from the official liquidator, the auditor of a company is liquidation can be publicly examined in high court**. Notes of the examination shall be taken down in writing and that should be signed by the auditor which may thereafter be used as evidence against him in any other civil or criminal proceedings.

# .....*Criminal Liabilities of a Company Auditor.*

## Section 539

- ✓ **If an auditor destroys, mutilates, alters, falsified or secretes** or is a party to the destruction mutilation alteration or falsification or secreting of any books papers or securities or makes or is a party to the making of any false or fraudulent entry in any register books of accounts or documents belonging to the company, he shall be punishable with imprisonment for a term which may extend to 7years and also be fined.

## Section 545

- ✓ The **court may direct the liquidator** of a company in winding up to prosecute the auditor if he is found guilty of **any criminal offence** in relation to the company.

## Section 628

- ✓ An auditor is also liable to criminal prosecution, if he in any return, certificate, balance sheet, prospectus, statement or any other document required by or for the purpose of the act makes a statement.
- ✓ **Which is false in any material, particularly knowing it to be false.**
- ✓ **Which omits any material fact knowing it to be material.**
- ✓ The punishment on conviction is imprisonment for a term which may extend up to 2years and shall also be fined.

## Section 629

- ✓ **If any person including an auditor intentionally gives false evidence** upon nay examination up on oath or solemn affirmation authorized under the act or in any affidavit, deposition or solemn affirmation in or abut he winding up of any company under he act, he shall be punishable with imprisonment for a term which may extend to seven years and shall be liable to fine also.



# *Criminal Liabilities of a Company Auditor.*

## Criminal Liabilities under the Income Tax Act.

- Section 288

- This section provides that if a person who is convicted of an offence in connection with taxation proceedings will be disqualified from representing an assessee. The commissioner of Income Tax has been empowered to determine the period of such disqualification.
- **If the council of the Institute of Chartered Accountants of India finds that any chartered accountant is guilty in his professional misconduct, default in taxation etc.** the institute can also declare him disqualified for certain specified period.

- Section 277

- As per this section 2 years imprisonment may be imposed on the auditor if he **auditor submits knowingly any false statements in the form of accounts for the preparation of income tax returns.**

- Section 278

- As per this section any **person who induces in any manner** any other person to make and deliver to the income tax authorities, **some false statements** or declaration relating to chargeable income tax, highlighting the fundamental principle of criminal law that any person who aids, counsels or procures the commission of an offence is liable to be punishable with rigorous imprisonment for a minimum period of 3 months and maximum of 3 years with fine. In case the amount of tax to be evaded is in excess of Rs. 100000 the minimum and maximum period of rigorous imprisonment will be 6 months and 7 years maximum with fine.

# .....*Criminal Liabilities of a Company Auditor.*

## Criminal Liabilities of an Auditor under the Chartered Accountants Act 1949.

✓ If a person not being a chartered accountant within the meaning of Chartered Accountants Act of 1949 acts as an auditor of a company and signs any documents, then he may be held liable for criminal prosecution under section 29 of the chartered accountants act 1949. The punishment for this is fine which may extend to Rs.1000 on first conviction and with imprisonment extending to 6months or fine amounting to Rs.5000 or both on any subsequent conviction.

### • **3. Auditors Liabilities to Third Parties. (For Fraud and Negligence)**

- ✓ That the statement or balance sheet signed by the auditor was materially untrue
- ✓ That the statement or the Balance Sheet was made an intention that a 3<sup>rd</sup> party should act on it.
- ✓ That the auditor knew that the statement of balance sheet was **untrue**.
- ✓ That the 3<sup>rd</sup> party acted upon such a statement and consequently suffered a loss.
- ✓ That the auditor **gave his consent** for the inclusion of such a statement in the prospectus.

Thank You