

# **AUDITING**

**Audit Programme:** before commencing the audit he should plan his work so that is over without delay. For this purpose the auditor chalks out a detailed programme explaining the procedure to be followed for audit. It explains the work to be done by the audit staff. an audit programme is defined as “a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements, and giving the estimated time required’.

Hence an audit programme is a statement giving instructions and guidance to the audit staff as to the audit procedure. It arranges and distributes the work among the audit staff.

## **ADVANTAGES:**

1. It provides the audit staff clear instructions about their duties.
2. It promotes division of work in a well organized manner.
3. It helps the auditor to monitor the progress of the work.
4. It will be easier to fix responsibilities for omissions and commissions.
5. It serves as a valuable evidence for the work done.
6. It serves as a guide for future audit.
7. It ensures that audit process in a systematic manner.
8. It eliminates inefficiency and saves time.
9. Incase if any audit assistant goes on leave, his work can be easily continued by others.
10. It avoids duplication of work.

## **Disadvantages of Audit Programme.**

1. The audit work becomes mechanical.
2. It kills the creativity of the audit staff.
3. Chances of work not done properly/ high as the scope is to be completed within a scheduled time.
4. A rigid programme may not be suitable for all kinds of business.

The above disadvantages can be minimized if the audit programme is made more flexible and audit staff encourages to go beyond the work mentioned in the audit programme. The auditors should also periodically review the programme in the light of experiences gained in the previous year. He should impress upon the audit staff. The audit programee is only guidance and they should use their initiatives, intelligence and comman sense at all times during the course of the audit.

## **Audit Working Papers:**

Audit working papers are those papers which contain essential facts about accounts, which are being audited. Its defined as the file of analysis, summaries, comments and correspondence build up by the auditor during the course of audit.

The auditor maintains papers as supporting evidence to the audit work. The institute of chartered accountants of India states that “an auditor is expected to maintain evidence of work done by him and his staff”.

Usually, audit working papers contains a copy of the trial balances, schedule of debtors and creditors, reconciliation statements important correspondence etc.

**Purpose of maintaining working paper:**

1. They show the extent to which accounting principles and auditing standards have adhered to.
2. They provide the required support for the auditors report.
3. They also reveal the efficiency with which the audit work was done.
4. They can be used as evidence in the court to defend himself against negligence in his duty.
5. They help the auditor in finalizing his report quickly.
6. They help the auditor to understand the efficiency of the accounting system, internal check system etc.

Working papers should be clear complete, and contain the necessary information so that they may be of maximum utility. They should be properly organized, documented and signed. In this regard its said hat “an auditor is often judged by the quality of the working paper prepared by him under his guidance”.

working papers are confidential documents hence he should not disclose the facts to others. Doing so results in professional misconduct. Working papers should be preserved properly because they are important documents.

**OWNERSHIP OF WORKING PAPERS:**

The auditor who collects information through working papers for his audit work. Usually claims that he is the owner of the working papers. On the other hand the company claims that the auditor was appointed by and he only acts as its agent. Hence, all the documents that the auditor had collected should belong to the company several cases have been referred to the courts regarding the ownership in one of the cases it was decided that the working papers belong to the auditor because he was an independent professional and not an agent of the client. In another case also, it was held that the working papers belong to the auditor.

## **INTERNAL CONTROL**

**Definition:**

Internal Control is defined as “the whole system of controls, financial and otherwise established by the management in the conduct of a business including internal check internal audit and other forms of control.

**Objective advantages of Internal Control:**

1. From the clients point of view.
  - a. Internal control system provides authentic and reliable data useful to take business decisions.
  - b. It safeguards the physical and non-physical assets in the form of records, documentation etc.
  - c. It promotes operational efficiency, by preventing waste, duplication of work and inefficient use of resources.
  - d. A good system of internal control provides that the company follows the procedures and rules as required by the law.

2. From auditors point of view.  
An auditor evaluates a system of control before commencing an audit work his work becomes easier if the control system is efficient. He can also decide whether detail verification is necessary or not.

### **Disadvantages of Internal Control:**

1. It involves expenditure which may not be affordable by the small organizations.
2. Internal control is concerned with routine transactions many times unusual transactions may be over looked.
3. The system of internal control may be weakened due to inefficiency in handling of the system.
4. There are chances of diverse objectives among employees in the departments and staff in charge of internal control.
5. Management may manipulate the operation of internal control system.

### **Elements, features characteristics principles of a good Internal Control System:**

An effective internal control system should have the following factors:

1. **Competent and trust worthy staff:** people in charge of internal control system must be reliable and highly competent about the work. Lack of knowledge and dishonesty will spoil the efficiency of the system.
2. **Records of financial and other organizational plans:** A good internal control system must have good documentation system. Filing, recording, classifying, etc will help in this regard.
3. **Segregation of duties:** normally, there should be a separate department for internal control this reduces frauds, bias etc. normally, a clerk in charge of accounting function should not be in charge of assets also.
4. **Supervision:** proper reviewing of the operations of the company regularly makes the control system effective.
5. **Authorization:** all transactions must be properly authorized. In other words, the authority of each person should be well defined.
6. **Sound practices:** the company should have well established procedures, policies, delegations organizational manuals etc.
7. **Internal Audit:** it's a part of internal control and it should be independent of internal check.
8. **Accounting Controls:** proper accounting information systems should be established so that the information relating to accounts is properly collected, recorded and accounts prepared.

### **Scope of Internal Control or Areas of Internal Control:**

1. **General financial Control:** It's concerned with control over all finance functions i.e., planning, acquiring and investing funds and management of profits. It deals with accounting supervision recording etc of the finance department.
2. **Cash Control:** it's concerned with proper control over receipts payments and balance of cash. The control system must ensure that misappropriation of cash is prevented.
3. **Control over wages:** this includes maintenance of time records, wage records, and payment to workers. The main area of concern in this regard is the check payment to wages for the work not done and misappropriations of cash.

4. **Control over purchases:** the system of internal control regarding purchases should be developed in such a manner that purchasing accounting, handling and issuing of goods are properly controlled.

**Difference between Internal and Independent Audit (External Audit):**

<b>Internal</b>	<b>Independent.</b>
1. An internal auditor is a regular employee of the company.	1. He is a professional auditor appointed by the company who is not an employee.
2. His duties, rights and responsibilities are determined by management.	2. The scope of audit work liabilities, duties etc are explained by concerned statutes.
3. He is appointed by the management.	3. He is appointed either by shareholders or by govt.,
4. It's not compulsory.	4. It is compulsory for all companies.
5. Internal auditor acts as an advisor to the management.	5. He is independent of the management.
6. To become an internal auditor professional qualification is not necessary.	6. An independent auditor must have professional qualification as per the act.
7. Internal Auditor ensures that the system of accounting is efficient.	7. the internal auditor comment on the true and fair view of business.
8. An internal auditor reports to the management.	8. The Internal Auditor reports to the shareholders.
9. Internal audit is a continuous process.	9. It's a periodic process.

**Difference between internal checks and internal audit:**

<b>Internal Check</b>	<b>Internal Audit.</b>
1. It is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another.	1. It is independent appraisal of operation and records of the company.
2. The purpose of IC is to prevent minimize possibilities of errors and frauds.	2. The purpose is to detect errors and frauds that are already committed.
3. IC doesn't require separate staff. It represents only the arrangement of duties.	3. It requires separate staff employed only for this purpose.
4. IC is a continuous process.	4. The Internal auditor has to report periodically about various inefficiencies and suggest improvements.
5. IC begins along with the recording of transactions.	5. It begins when the accounting process ends.
6. It is devices of doing the work.	6. It is a device for monitoring the work.

7. Scope of Internal Check is limited especially to the accounting department.	7. The scope of internal audit goes on beyond accounting department.
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## **Audit under Computerized Environment.**

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The process of account has undergone rapid changes in the recent years. The recording of business transaction has changed from Manual System to Computerized system. Computers are used for processing all kinds of accounting information. Useful to the management in its function of decision making. Most of the companies follow computerized accounting system to record, process and present accounting transactions. An auditor should see how efficient is the accounting information system is. It should be remembered that a computer does not take decision on its own, but only facilitate the process of decision making. Hence, the efficiency of accounting information system depends upon the knowledge of people related to it regarding computerized accounting.

### **Limitations or Problems associated with the computerized accounts.**

1. In case of computerized accounts the auditor may not go for in depth auditing. In other words, he may not go to the original data to vouch and verify.
2. Knowledge of computer is a major deficiency in our country.
3. Each type of business has its own method of computerized auditing. This makes the auditor's work more difficult.
4. Documentation is completely different in case of computerized accounting which requires complete knowledge of input and output document.

Its therefore necessary that an auditor needs to be familiar himself with computerized accounting system and its environment. He has to review the system of internal control prevailing in existence, in recording, transmitting and processing of the data.

### **Internal Control System Under Computerized Audit:**

The auditor should study the internal control system existing in a business where computerized accounting is followed. He should verify allocation of duties, systems of authorization etc. Its necessary to identify and decide the extent to which the internal control is reliable. It should be understood that computerization of accounts does not eliminate errors and frauds. Its advisable that he management should consult the auditor while installing the system of computerized accounting. This helps the auditor to satisfy himself as to its adequacy from the point of view of audit work. The control systems may be of the following types:

#### **a) Organizational Controls:**

It is necessary to have an effective control system at various levels of organization. Eg: A programmer can always manipulate facts if he desires to do so, if the organization has a weak control system.

Its advisable to divide the work in such a manner that functions like programming, system design and analysis, testing, operating etc are assigned to different people. It is always necessary that the programmer does not have access to the data files.

#### **b) Control Over Documentation, Testing etc:**

This includes preparation of flow chart, instruction to operations etc. the control should be in such a manner that no alteration is allowed in programmes without authorization. For new programming and changing the existing programme a proper procedure should be laid out.

**c) Input Control:**

Quality of output depends upon the quality of input. It must be ensured that only authorized, accurate, and complete input data are fed into the system. Errors in these areas results in unreliable output.

control over creation of original documents to overcome the entry errors or error and frauds at the input level. Companies can develop a system of indentifying such errors at the entry level only before original documents are forwarded to data processing centre. A senior officer should review the documents to ensure their correctness.

**d) Control over handling and movement of Original Documents:**

To prevent loss of document either at data processing centre of while transferring them to the following controls are suggested:

- i) Documents should be sent in a well defined process or routing system.
- ii) The document sourced from one department should be consecutively numbered.
- iii) It should be verified whether number of documents sent agree with the number of documents processed.

## **COMPANY AUDIT**

### **Appointment of an Auditor**

According to Section 224 of the Companies Act, every company whether private or public must appoint an Auditor or auditors to audit the final accounts.

**The provisions relating to the appointment of auditor are as follows:**

**1. 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.

**2. Annual General Meeting:**

The auditor or auditors are appointed in the annual general meeting under the following circumstances:

- 1) If the board of directors fail to appoint an auditor, the shareholders shall make an appointment in the annual general meeting.
- 2) 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.
- 3) The company has to give intimation to the auditor so appointed within seven days of his appointment.

- 4) The auditor so appointed shall within 30 days 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.

In every annual general meeting the appointment of the company's auditor is made by the simple majority of votes by the present members.

### **3. 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).

### **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. A public financial institution or a government company or the central government or any state government or
- b. 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
- c. A nationalized bank or an insurance company carrying on general insurance business.

In the above mentioned circumstances, the appointment of an auditor shall be made by passing a special resolution (that is 75% or more of the members present should agree for the resolution). If not, it shall be deemed that the appointment has not been made and the central government will get the right under section 224(3) of the Companies Act to make an appointment.

### **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.

In other cases, that is, whether auditors are appointed by the board of directors in the annual general meeting or by the central government, the retiring auditors are compulsorily reappointed, unless

1. He is not qualified for reappointment.
2. He has given a notice in writing to the company of his unwillingness, to be reappointed
3. Where a notice has been given or an intended resolution to appoint some other person in the place of the retiring auditor and by reason of death, in capacity or disqualification of that person or of all the persons as the case may be, the resolution cannot be proceeded with or
4. A resolution has been passed at that meeting, appointing somebody instead of providing expressly that he shall not be reappointed. This is as per section 224(2) of the Companies Act.

### **Ceiling on Number of Audits**

In 1974, a group of young chartered accountants, academicians and other sections of the public argued that the opportunities of professional practice are concentrated in the hands of a few well established and leading chartered accountants of the country. They demanded this monopoly be liquidated in the general interest of the profession thereby providing an opportunity to young chartered accountants also to earn their living. Therefore, the Companies Act was amended in 1974, by introducing section 224 (1- B). This came into effect from February 01, 1975 to ensure a more equitable distribution of audit work among all the practicing chartered accountants and to avoid the concentration of audit work in few leading firms of chartered accountants.

Therefore, according to section 224( 1-B) of the Companies Act, no individual and no partner of the firm of auditors shall hold office as auditors of more than 20 companies of which not more than 10 be companies with paid up share capital of Rs.25 lakhs or more.

### **Filling of Casual Vacancies [Section 224(6)]**

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

### **Qualification of 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 Restriction 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.

1. A body corporate.
2. An officer or an employee of the company.
3. A person who is a partner in the business.
4. 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.**

1. 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.

2. 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.
3. 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.

#### **The procedure so laid down is as follows( Removal )**

- a. Special notice of intention to make such resolutions to remove the existing auditor must be given to the company by the shareholder not less than 14 days before the annual general meeting.
- b. On receipt of such a notice, the company must forthwith send a copy to the retiring auditor.
- c. The retiring auditor has the right to send a representation to the company which he can ask the company to send to the shareholders.
- d. If a copy of the representation is not sent to the members, either because it was received too late to be thus sent, or because of the default of the company, the auditor may insist that the representation shall be read out in the meeting.
- e. The auditor, who is proposed to be removed, has the right to attend the general meeting where his removal is to be discussed. He also has the right to speak at such a meeting.
- f. As a matter of professional conduct, the auditor so appointed in place of another should communicate with the retiring auditor in writing before accepting the appointment. If he does not do that, he may be held liable for disciplinary action as per the regulations of the Institute of Chartered Accountants of India.

#### **Remuneration of an Auditor.**

1. The general rule is that the appointing authority is authorized to fix the remuneration of an auditor as per Section 224(8)
2. 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.
3. Similarly, if an auditor is appointed to fill a casual vacancy the remuneration will be fixed by the board of directors.
4. When an auditor is appointed by the Central Government the remuneration will also be fixed by the Central Government.
5. If the auditor is appointed at the annual general meeting, the remuneration is also fixed at the annual general meeting.
6. Remuneration includes the sum paid by the company in respect of the auditor's expenses.
7. 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.
8. 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 shareholders is not needed for the same.
9. Any remuneration paid for services other than routine audit work should be explained in the Profit and Loss account separately as under:
  - i. Remuneration as an Auditor of the company.

- ii. In the capacity of an adviser in respect of:
  - a. Taxation representation.
  - b. Company Law matters
  - c. Management Services.
  - d. Internal Auditing
  - e. Other professional services and
  - f. For travelling and out of pocket expenses.

## **Rights, Duties and Liabilities of a Company Auditor**

### **Rights of Company Auditors.**

According to Section 227(7) of the Companies Act, a company auditor has the following rights.

1. **Right of Access to Books of Accounts:**

As per Section 227(1) of the Companies Act every auditor of the company has the right to access at all times to the books of accounts and vouchers of the company, whether kept at the head office of the company or elsewhere.

Under section 209(1) (d), a company auditor has the right to examine the cost records also which are required to be maintained by certain companies relating to production sales, stores etc.

2. **Right to Obtain Information and Explanations:**

An auditor can call for any information or explanation from different officers of the company which he may think necessary for the performance of his duties.

Under section 221, apart from the auditor's right to obtain information and explanation it is the duty of every officer of the company to furnish without delay the information to the company auditor.

The power is so wide; the decision as to what information and explanation is left entirely to the discretion of the auditor. If the directors or officers of the company refuse to supply some information on the ground that in their opinion it is not necessary to furnish it, then the auditor has the right to mention that in his audit report.

3. **Right to Receive Notices and Other Communication Relating to General Meetings and to attend them.**

According to section 231, of the companies act an auditor of a company has the right to receive notices and other communications relating to the general meetings in the same way as that of the members of the company.

Similarly an auditor also has the right to attend any annual general meeting and also to be heard at those meetings which he attends and which concerns him as an auditor.

The auditor also has the right to make a statement or explanation with regard to the accounts he has audited. But he auditor is not expected to answer questions in the general meeting.

4. **Right to Visit Branches.**

According to section 228 of the companies act the auditor of the company has the right to visit the branch office or offices of the company.

He can also audit such accounts of the offices of the company provided that there is not qualified auditor to audit the accounts of the branch office or offices of the company, in such cases, the auditor has the right to access at all times to the books of accounts and vouchers that the company maintains at branch office or offices.

Moreover section 226 of the companies act provides that in case of the company gets the branch accounts audited by some of the local auditors, even the auditor has access at all times, to the books, accounts and vouchers of the company and he can also visit the branches, if he feels necessary.

**5. Right to Correct Any Wrong Statement.**

The company auditor is required to make a report to the members of the company on the accounts examined by him of the final accounts and the related documents which are laid down before the company in the general meeting.

Similarly, the auditor can advise the directors to amend their system of maintaining accounts. If the suggestions are not carried out, he has the right to refer the matter to the members and also to report that in the audit report.

**6. Right to sign the Audit Report**

As per section 229 of the companies act only the person appointed as auditor of the company or where a firm is so appointed, only a partner in the firm practicing in India, may sign the audit report or authenticate any other document of the company required by law to be signed.

**7. Right to Being Indemnified.**

Under Section 633 of the Companies Act, an auditor is considered to be an officer of the company and he has the 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 if it is proved that the auditor has acted honestly or the judgment is delivered in his favour.

**8. Right to seek Legal and Technical Advice.**

The company auditor has the full right to seek the opinion of the experts and to take their legal and technical advice so as to discharge his duties efficiently.

**9. Right to Receive Remuneration.**

As per Section 224(8) of the Companies Act, the company auditor has the right to receive remuneration provided he has completed the work which he has undertaken to do so.

**10. Right to have legal, technical of expert advice:**

..... **Relating to the business in order to perform his work satisfactorily.**

**11. Right to speak at the general meeting:**

He need not answer any question at the general meeting unless he is asked to do so by the chairman of the meeting .

**12. Right to report to the members of the company:**

**.if the accounts audited by him show an unsatisfactory state of affairs**

## **Duties of Company Auditor.**

The various duties of the company auditor are as follows:

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

**A company auditor shall enquire:**

- a. Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms of which they have been made are not prejudicial to the interests of the company or its members.
- b. Whether the transactions which are not supported by any fact or evidence, though recorded in the books are not prejudicial to the interests of the company.
- c. Whether personal expenses have been charged to the revenue account.
- d. Whether it has stated in the books of accounts of the company that any shares have been allotted for cash and whether cash has actually been received in respect of such

allotment, and if no cash has actually been received, whether the position as stated in the account books and the Balance Sheet is correct and regular.

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

Under Section 227(2,3,4&5) of the Companies Act, the auditor shall report to the shareholders about the accounts examined by him. The report so mentioned shall contain the following.

- a. Whether in his opinion, the Profit and Loss Account referred to in his report exhibits a true and fair view of the profit or loss.
- b. Whether in his opinion, the Balance Sheet referred to in his report is properly drawn up, so as to exhibit a true and fair view of the state of affairs of the business according to the best of his information and explanations given to him and as shown by the books of accounts.
- 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 audit.
- d. Whether in his opinion, proper books of accounts as required by law have been kept by the company and proper returns adequate for the purpose of his audit have been received from branches he visited or not.
- e. Whether report on branch accounts audited under section 28 by a person other than the company's auditor has been forwarded to him as required by clause (c) sub section (3) of that section and how he had dealt with the same in preparing the auditor's report.
- f. Whether the company's Balance Sheet and Profit and Loss Accounts dealt with by the report are in agreement with the books of accounts and returns.

If the answer to any of the above mentioned questions is in the negative, the auditor should submit his report accordingly.

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

It is the duty of the auditor to comply with the various directives issued to the auditor of the joint stock companies from time to time to give specific reports on the financial accounts of the companies.

For example in 1975 it was made compulsory for some of the specified companies which are engaged in any of the below mentioned activities to conduct cost audit, that is, those companies engaged in

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

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

As per section 229 of the companies act 1956, it is the statutory duty of the company auditor to sign the report prepared by him. Only a partner practicing in a firm in India can sign the audit report for and on behalf of a partnership firm practicing as chartered accountants.

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

As per section 56(1) of the companies act, the prospectus issued by an existing company shall contain a report from the auditor of the company regarding

- a. Profits and losses during the previous year.
- b. Assets and liabilities of the company and its subsidiaries and
- c. The rate of dividend paid by the company in respect of each class of shares in the company for each of the five financial years preceding the issue of prospectus.

So it is the statutory duty of the company auditor to submit his report containing the above mentioned points.

6. **Duty to Certify the Statutory Report.**

According to section 165(4) the auditor of the company has to certify the statutory report regarding the shares allotted by the company, the cash received in respect of shares, and

the receipts and payments of the company. The statutory report should also be certified as correct by two directors, one of whom shall be managing director.

Every company shall within a period of not less than one month and not more than 6 months from the date which the company is entitled to commence business has to conduct a general meeting of the members of the company which is known as the statutory meeting.

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

When a company goes into voluntary winding up, then a declaration of solvency is to be made by the directors of the company. Under section 488(1) of the Companies Act, this declaration is to be accompanied by the report of the auditor of the company under the section 488(2) of the companies act. So it is the duty of the auditor to make such reports.

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

Under section 240(6) (b), it is the duty of an auditor to preserve and produce to the inspector or any other person authorized by him in this behalf with the previous approval of the central government, all books and papers of or relating to the company or as the case may be, of relating to the other body corporate which are in their custody or power and other wise to give to the inspector all the assistance in connection with the investigation which they are reasonably able to give.

9. **Duty to perform the contract**

It is the duty of the auditor to discharge the duties according to the terms of contract between the auditor and the party who has appointed him. It is to be remembered that the scope of statutory duties of a company auditor cannot in any way be curtailed. But on the other hand, the scope of duties of the auditor can be enlarged by passing a resolution at the annual general meeting making a provision in the Articles of Association of the company. If so, it is the duty of the auditor to perform the additional work.

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

The auditor is appointed in the capacity of an expert, therefore, he must act honestly and exercises care and caution in the performance of his duties. The auditor can never give ignorance as an excuse for defense. So the auditor must prove that in the course of his audit work, he has employed skills that would reasonably be applied by any other auditor.

## **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:

#### 1. **Civil Liability of an Auditor for negligence.**

The liability of an auditor to pay damages are known as Civil Liabilities. Every auditor in the performance of his job is expected to exercise reasonable care and skill as per the circumstances, because the shareholders of the company appoint the auditor as their agent and therefore, he must exercise reasonable degree of skill and care in the performance of his duties. If not, the auditor will have to face the consequences.

Therefore, we can conclude that an auditor can be held liable for negligence of his duty if it is proved that

- a. 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.
- b. There happens to be a loss or damage as a result of his negligence and
- c. 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.

1. Loss without negligence and
2. Negligence without loss.

#### **a. Liability of the Auditor for Mis-statements in the Prospectus.**

As per section 65 of the companies act 1956, an auditor may be held liable for damages suffered by those persons who subscribed to the shares or debentures of a company or debentures of a company proposing in the faith of the prospectus, which included auditor's report containing some untrue statements or facts. 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, for the damages sustained directly resulted from those untrue statements. For the purpose of this clause, even those statements shall be taken to be untrue which are misleading in form and the context in which they are included.

But the auditor can escape from his liability if he is able to prove:

- i. That he withdrew his consent in writing before the delivery of the copy of the prospectus for registration.
- ii. That he withdrew his consent in writing from such a prospectus on coming to know of the untrue statement by giving a reasonable public notice before the allotment of shares.
- iii. That he was competent to make the statement and that he has reasonable grounds to believe up to the time of allotment of the shares, that the statement was true or he relied upon the opinion of an expert whose name he has quoted in his certificate.

#### **b. Civil Liability of an Auditor for Misfeasance.**

By misfeasance we mean 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.

As per section 543 of the companies act. The liquidator can bring the suit in the name of the company against the auditor, that is "in the course o winding up of a company, it appears that any officer, including eh auditor or any other person associated with the promotion or the management of the company has misapplied or retained wrongfully, any property of the company or is guilty of breach of duty, he can be held liable for the damages caused to the company"

But section 633 grants relief to directors, officers, and auditors of the company against liability in respect of negligence, default, breach of duty, misfeasance or breach of trust.

But for getting any relief there under, it must be proved by the person concerned.

- a. That he has acted honestly.

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

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

The auditor of a company becomes criminally liable for various offences during the course of his audit. Criminal liability of an auditor will arise when he is found to be guilty of willful non compliance under the provisions of law. Under the criminal liabilities, he may be imprisoned, fined or punished with both as per the companies act, income tax act, and the Indian Penal Code. Criminal liability of an auditor arises from errors in the performance of audit.

The auditor can be held criminally liable under:

1. The Companies Act.
2. The Income Tax Act.
3. The Chartered Accountant Act

### **a) Criminal Liabilities under the Companies Act.**

#### **i. 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

#### **ii. 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 6months or fine up to Rs.2000 or both. For persistent default a further fine at Rs. 200 per day may also be charged.

#### **iii. 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 6months or fine of Rs 500 or both.

#### **iv. 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.

#### **v. 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.

#### **vi. 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.

#### **vii. 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.

**viii. 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.

1. Which is false in any material, particularly knowing it to be false.
2. Which omits any material fact knowing it to be material.

The punishment on conviction is imprisonment for a term which may extend up to 2 years and shall also be fined.

**ix. Section 629**

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

**Conclusion.**

If the Articles of Association or any special agreement between the company auditor and the company contains any provision which exempts the auditor from any of the above legal liabilities for negligence, defaults, misfeasance, breach of trust, breach of duty etc it shall be considered void. However, according to section 633 the company can indemnify such officers including the company auditor for any of the losses suffered by him.

**b) Criminal Liabilities under the Income Tax Act.**

A qualified chartered accountant or the auditor of the company can act as authorized representative and may attend the Income Tax Authority or the Appellate Tribunal in connection with the proceedings under the Income Tax Act.

**a. 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.

**b. 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.

**c. 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.

**c) Criminal Liabilities of an Auditor under the Chartered Accountants Act 1949.**

1. 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.

2. According to Part III of the first schedule of Chartered Accountants Act 1949 a member of the institute whether in practice or not, shall be deemed to be guilty of professional misconduct if he:
  - a. Includes in any statement return or form to be submitted to the council any particulars knowing them to be false.
  - b. Not being a fellow styles himself as fellow
  - c. Does not supply the information called for or does not comply with the requirements asked for by the council or any of its committees.

### **3. Auditors Liabilities to Third Parties.**

Besides the client, the creditors, bankers, prospective share holders, tax authorities etc depend fully upon the final accounts certified by the auditor and do different dealings with the company.

The liability of an auditor towards third parties can be discussed under 2 circumstances.

#### **a. For Frauds.**

If in case there is any fraud on the part of the company's auditor, the third parties can however hold him liable. This 3<sup>rd</sup> party can sue the auditor if the report of the auditor is of such a nature, as amounts to fraud, even in there is no contractual obligation between the auditor and the 3<sup>rd</sup> party.

It was decided in the case of Derry Vs Peek (1882) that the auditor can be held liable to 3<sup>rd</sup> parties only when the following facts are proved against him.

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

#### **b. For Negligence.**

An auditor in general is not liable to 3<sup>rd</sup> parties for negligence of duty as no contractual obligation exists between the auditor and the 3<sup>rd</sup> party. As he is not appointed by them, he owes no duty towards them and hence there is no question of any type of liability.

