



Company Audit

Anuj Jindal

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Table of Contents

Chapter-7: Company Audit	4
Meaning of Company Audit	4
Qualification of Company Auditor	4
Disqualification of Auditor	5
Appointment of Auditors	7
Appointment of Auditor in Government Company	7
Appointment of Auditor in Non-Government Company	9
Re-appointment	11
Rotation of Auditors.....	11
Applicability.....	11
Manner of rotation	12
Ceiling on the number of Audits	13
Remuneration of an Auditor	14
Removal of an Auditor	15
Rights/Powers of an Auditor.....	16
Duties of Company Auditor	19
Statutory Duties	19
Duties under common law.....	21
Other Duties.....	22
Liabilities of Company Auditor.....	22
Civil Liability	23
Liabilities under Companies Act.....	24
Liability under Income Tax Act.....	25
Liability for Professional Misconduct.....	25
Liability Towards Third Parties.....	25

Chapter-7: Company Audit

Meaning of Company Audit

Let us first recall, **what is an Audit?**

Audit is the **systematic examinations of financial statements of an entity** for an objective **of express an opinion** whether financial statements are **giving true and fair results or not.**

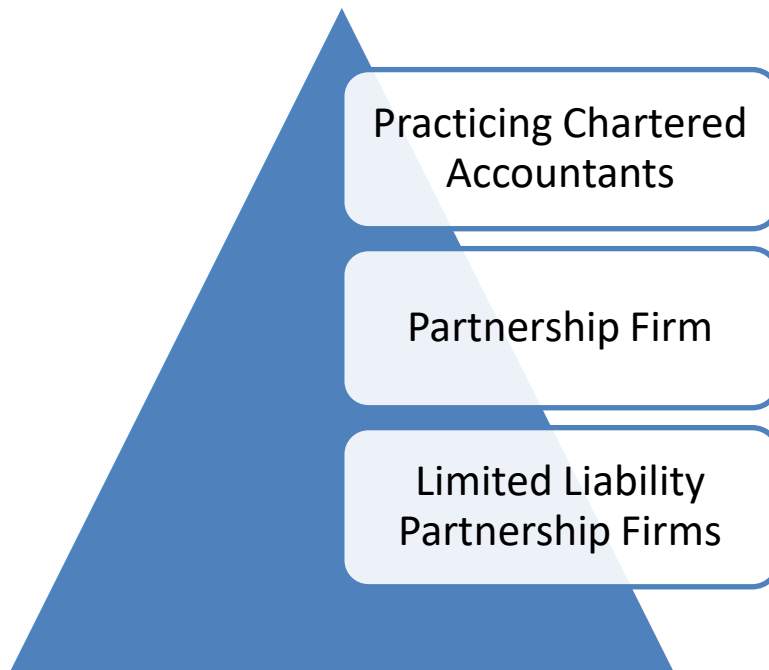
Key points

- **Systematic Examination**
- **Expressing an Opinion**
- **Financial Statements**
- **True and Fair results.**

If the concerning entity for which audit is done is Company registered under the **Companies Act 2013 (In Indian scenario)** then it shall be known as company audit.

Qualification of Company Auditor

- **The Companies Act, 2013 provides that following persons are competent to be appointed as auditors of a company:**



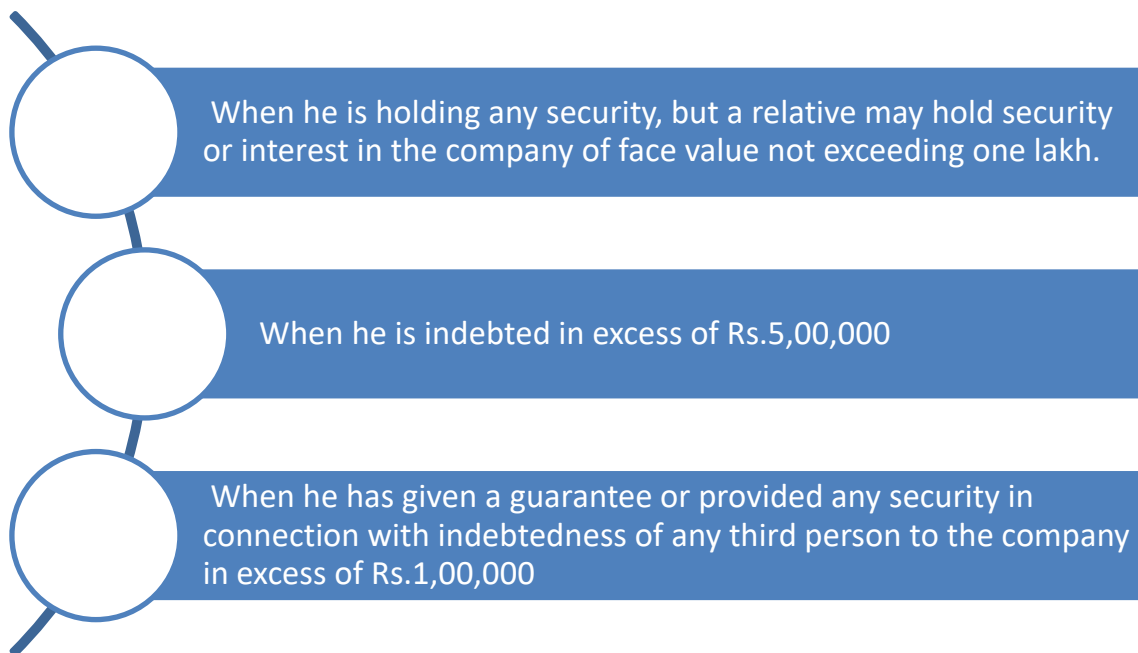
- 1. Practicing Chartered Accountants:** A person shall be qualified for being appointed as auditors of a company only if he/she is a chartered accountant within the meaning of the Chartered Accountants Act, 1949 and holds a valid Certificate of Practice.
- 2. Partnership Firm:** In case of a firm, if majority of the partners practicing in India are qualified for appointment as auditor, it may be appointed by its firm name to be the auditor of a company.
- 3. Limited Liability Partnership as (LLP) Firms:** An LLP firm can be appointed as statutory auditor of a company provided that only chartered accountant partners will be authorised to act and sign on behalf of the limited liability firm.

Disqualification of Auditor

The Companies Act, 2013, following persons shall not be eligible as auditor of the company:

- (a) A body corporate, except Limited Liability Partnership.
- (b) An officer or employee of the company.
- (c) A person who is a partner or who is in the employment as an officer or employee of the company.

(d) A person **himself or his relative or partner of a company or holding or subsidiary company or associate company** is disqualified in the following circumstances:



(e) A person or a firm who has **business relationship with the company**, in any form be it subsidiary, holding, associate etc is disqualified.

(f) The business relationship shall be any transactions enter for a commercial purpose **except**:

- Commercial transactions which are professional **services** that is **permitted** to be rendered by an auditor.
- Commercial transactions which are **in ordinary course of business** of the company at **arm's length price** (The price at which a buyer and seller would freely agree to transact as if they were unrelated, so that there is no conflict of interest in the transaction). Example- like sale of products or services to the auditor, as customer, in the ordinary course of business by companies engaged in the business of telecommunications, airlines, hotels etc.

(f) A **person who's relative is a director** or is in the employment of the company as director or key managerial personnel.

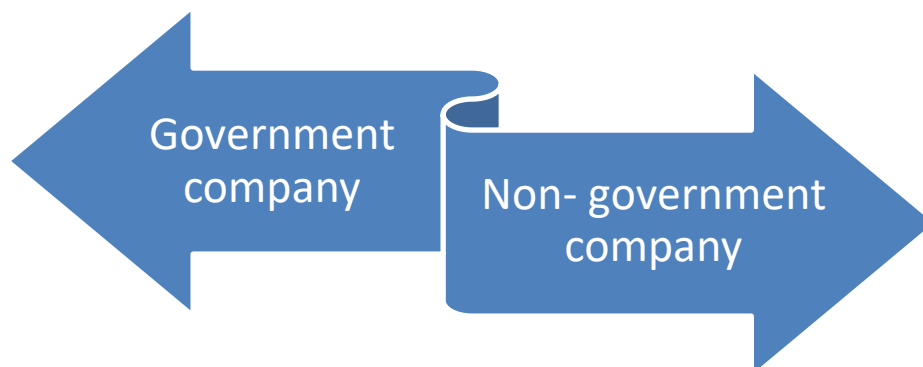
(g) A person doing **audit for more than 20 companies** at the date of appointment or reappointment.

(h) A person who has been **convicted by a court** of an offence for doing fraud and **a period of 10 years** has not elapsed from the date of such conviction.

(i) Any person who on the date of appointment is **engaged in consulting and specialized services** to the company as mentioned in the Companies Act, 2013.

Note: Where a person appointed as auditor of the company incurs any of the disqualification mentioned in the Companies Act, 2013 after his appointment, he shall vacate his office as such auditor and such vacancy shall be casual a vacancy in the office of the auditor.

Appointment of Auditors



Appointment of Auditor in Government Company

Meaning of government Company

- Companies Act, 2013 defines a Government Company, "**as a company in which not less than 51% of the paid-up share capital** is held by the Central or State Government or Governments or partly by the Central government and partly by one or more State governments."



Appointment of first auditor

- He shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of registration of the company.
- In case of failure to do so, Board of Directors of the company shall appoint first auditor within next 30 days.
- In case of failure of the Board to appoint the first auditor, it shall inform Members of the company who shall appoint first auditor within 60 days at an Extraordinary General Meeting.

Appointment of subsequent auditor

- The Comptroller and Auditor General of India shall appoint subsequent auditor of Government companies within 180 days from the commencement of the financial year.
- He shall hold office till the conclusion of the Annual General Meeting.

Appointment in case of casual vacancy

- Appointment of auditor due to casual vacancy in Government Company is filled by the Comptroller and Auditor General of India within 30 days.
- If he fails to do so, the Board of Directors shall fill within next 30 days.

Appointment of Auditor in Non-Government Company

Appointment of First Auditor

Shall be appointed by Board of Directors

- Within 30 days from the registration of company

In case of failure to do so

- It shall inform the members of the company. The Members shall appoint the auditor within 90 days at an Extraordinary General Meeting.

Note: Appointed first auditor shall hold office till the conclusion of the first Annual General Meeting.

Appointment of Subsequent Auditor

- ❖ Every company shall appoint an individual or a firm as auditor of the company at the first Annual General Meeting.
- ❖ The appointed auditor shall hold the office till the conclusion of sixth Annual General Meeting (5 years).
- ❖ The Company shall place the matter relating to such appointment at every Annual General Meeting for formal consent by members.

- ❖ Before appointment is made, the written consent of the auditor and a certificate from the auditor that he is eligible for appointment shall be obtained.
- ❖ The company shall inform the appointed auditor and file a notice of appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

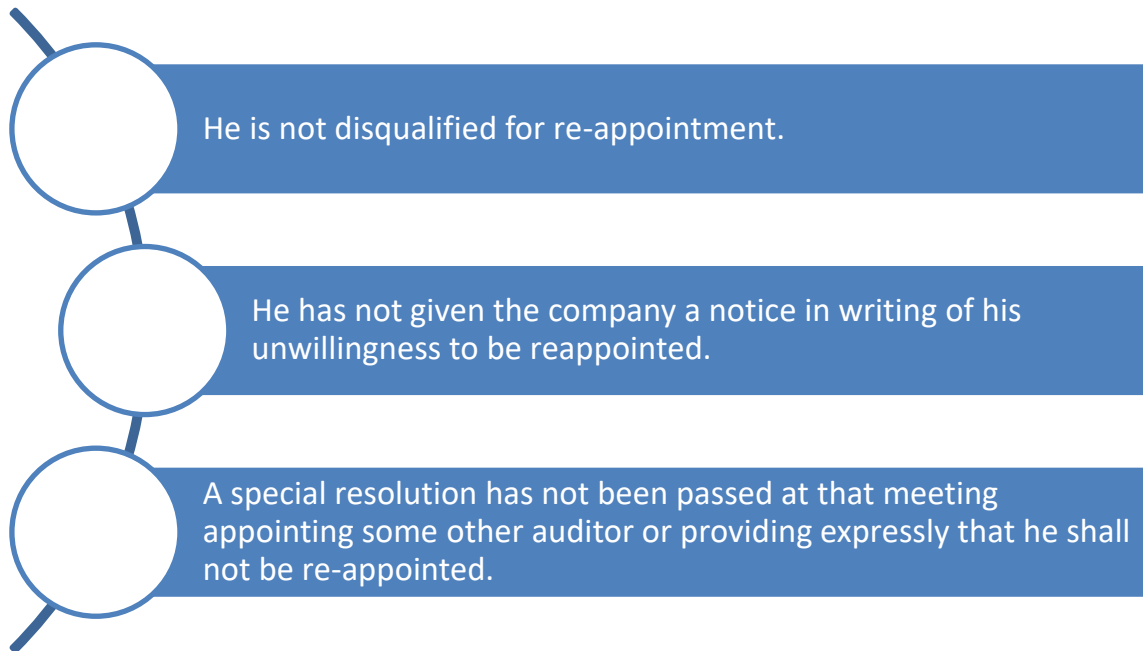
Appointment in case of Casual vacancy

Causal vacancy arises due to death or insanity or insolvency of an auditor. If an auditor is disqualified after his appointment, he shall vacate his office as auditor. Such vacation shall be deemed to be a casual vacancy in the office of the auditor.

- ❖ Appointment of auditors in case of casual vacancy shall be done by the Board of Directors within a period of 30 days.
- ❖ If vacancy is due to resignation of an auditor, such appointment shall also be approved by the company at a General Meeting convened within 3 months of the recommendation of the Board.
- ❖ The auditor shall hold office till the conclusion of the next Annual General Meeting.

Re-appointment

- Subject to the provisions of the Act, a retiring auditor may be re-appointed at an annual general meeting if:



Where at any annual general meeting, **no auditor is appointed or re-appointed the existing auditor shall continue to be the auditor of the company.**

Rotation of Auditors

Rotation of Auditor is appointing a new auditor when an appointed individual or audit firm completes their respective tenure.

Applicability

- The following classes of companies **excluding one person companies and small companies have** been prescribed for the purpose of rotation of auditors:

All listed companies

All unlisted public companies having paid up share capital of 10 crore or more

All private limited companies having paid up share capital of 20 crore or more

All companies having public borrowings from financial institutions, banks or public deposits of 50 crores or more

Manner of rotation

In case of an individual as an auditor	In case of a firm as an auditor
No individual shall be appointed or reappointed as auditor for more than one term of 5 consecutive years.	No audit firm shall be appointed or reappointed as auditor for more than 2 terms of 5 consecutive years.
An individual auditor who has completed his term of 5 consecutive years, shall not be eligible for re- appointment as auditor in the same company for 5 years from the completion of his term.	An audit firm which has completed its 2 terms of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms.

Restriction on other audit firm(s) having common partners.

If 2 or more audit firms have common partners(s), and one of these firms has completed its 2 terms of five consecutive years, **none of such audit firms shall be eligible for reappointment as auditor in the same company for 5 years.**

Example: Firm 1 has partners A, B, C and firm 2 has partners B, C, D. So here common partners are B and C. Firm 1 did audit of XYZ ltd for 10 years (2 consecutive period). Then, both firm 1 and 2 cannot be appointed as auditor for next 5 years in the company.

Time period for compliance for existing companies

Every company which is required to comply with these provisions, shall comply **within three years** from the date of commencement of this Act.

Subject to the provisions of this Act, members of a company may provide that:

- (a) The audit firm appointed by it, the auditing partner and his team shall be rotated at such **intervals** as may be resolved by members, or
- (b) the audit shall be **conducted by more than one auditor.**

Ceiling on the number of Audits

- There is a ceiling on the number of companies of which a person or a firm could be the auditor. The specified number of companies in the **case of an auditor or firm of auditors is as follows:**

In case of any person

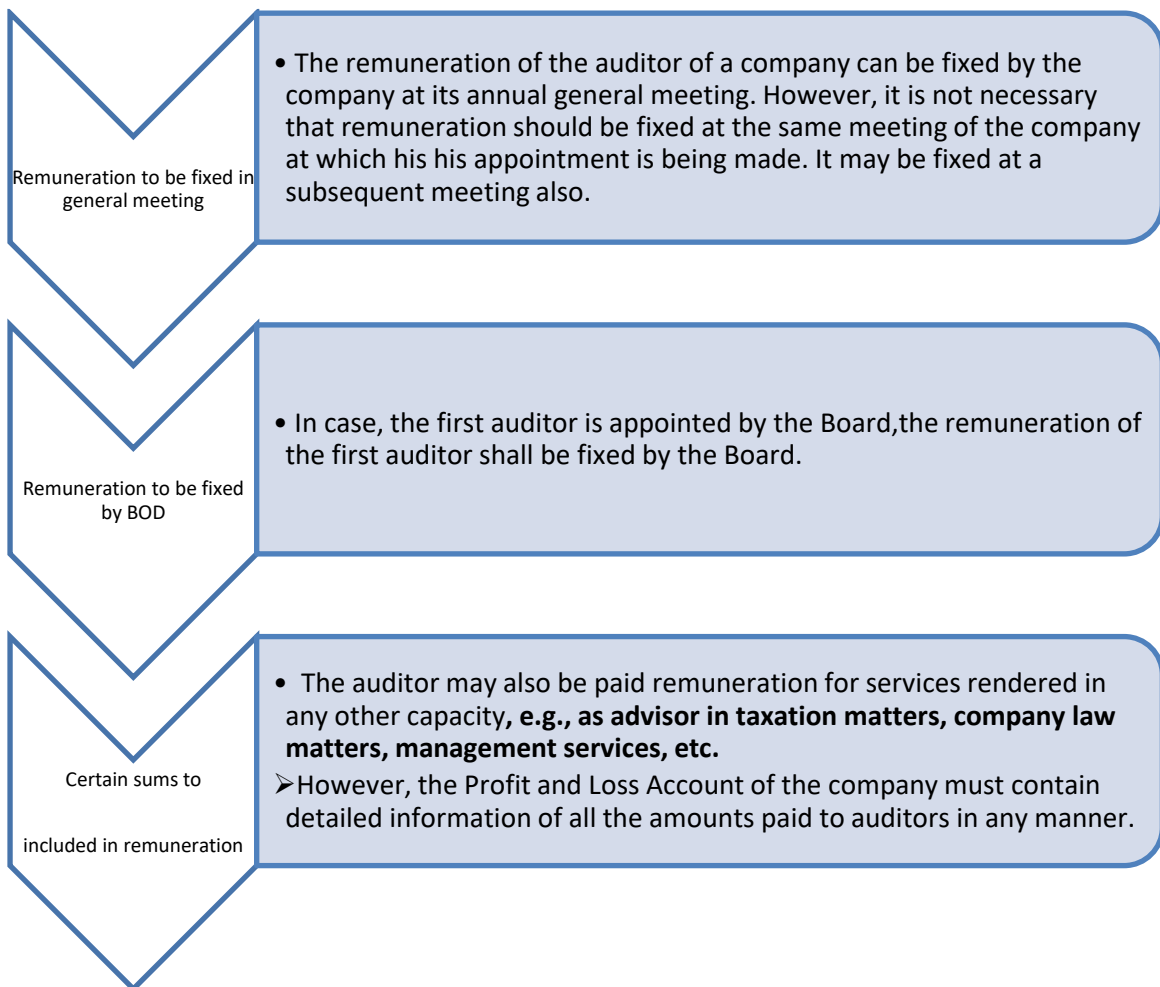
- The maximum number of audits stands at 20 companies which includes public and private companies having paid up capital of 100 crores or more.
- 20 companies audit shall exclude one person company, small company, dormant company, private company with paid up capital less than Rs.100 crore.

In case of partnership firm

- The maximum number of audits stands at 20 companies per partner of the firm.
- However, if any partner is in full-time employment elsewhere, such partner is not to be taken into account for the purpose maximum number of companies that the firm can audit.

Remuneration of an Auditor

The decision regarding remuneration of an auditor varies depending upon his appointment.



Removal of an Auditor

First Auditor

- Who have been appointed by Board of Directors can be removed by members in the general meeting without the approval of the Central Government.
- It is not necessary that the auditor shall complete his term of appointment.

In other cases

- Any auditor may be removed from office before the expiry of his/her term by passing a special resolution.
- However, prior approval of the Central Government shall be sought before removing the auditor in the general meeting.

Rights/Powers of an Auditor

The statutory rights are the various rights conferred upon the auditor by the Companies Act, 2013. These rights **cannot be limited, abridged, or curtailed in any way**. Any resolution limiting the powers of the auditor or any such provision in the Articles of Association will be **void**.



Right of Access to Books, Accounts and Vouchers

- ❖ Every auditor shall always have a right of access **to books, accounts and vouchers of the company** whether kept at head office or elsewhere.
- ❖ **Voucher includes all documents, correspondence, agreements, etc, which support any transaction** or data disclosed in financial statements, directly or indirectly.
- ❖ **Books include financial statutory and statistical books.** Auditors may also refer to quantitative records relating to production, sales, stores, etc.

- ❖ At all times means an auditor can inspect books, accounts, and vouchers at any time during the period he acts as auditor of company. However, all times implies **only normal business hours.**

Right to Obtain Information and Explanation

- ❖ The auditor shall be entitled to get from the officer of the company, such information and explanation as the auditors thinks necessary **for performance of his duties.**
- ❖ In case any information or explanation is **not given to him he should mention this fact in his audit report.**

Right to Visit Branch Office

- ❖ The auditor is entitled to visit branch offices of the company if he deems it necessary to do so for the **performance of his duties as auditor.**
- ❖ The auditor shall have the right of access to the books, accounts and vouchers of the company **maintained at the branch offices.**
- ❖ **For example,** in case of banking company having foreign branches, it would be sufficient if the auditor is allowed to access the books and account of the branch as have been transmitted to the principal office of the company in India.

Right to Sign the Audit Report

- ❖ **Only the person appointed as auditor** of the company or where a firm is so appointed, only the partner in the firm practicing an India, **may sign the Auditor's Report** and/or sign/authenticate any other document.

Right to Receive Notices and to Attend General Meeting

- ❖ The auditor has a right to receive all notice of any general meeting of a company as are sent to the members of the company.
- ❖ The auditor **can also attend any general meeting like a member.**
- ❖ However, **he can speak only on the matters concerning as an auditor.**

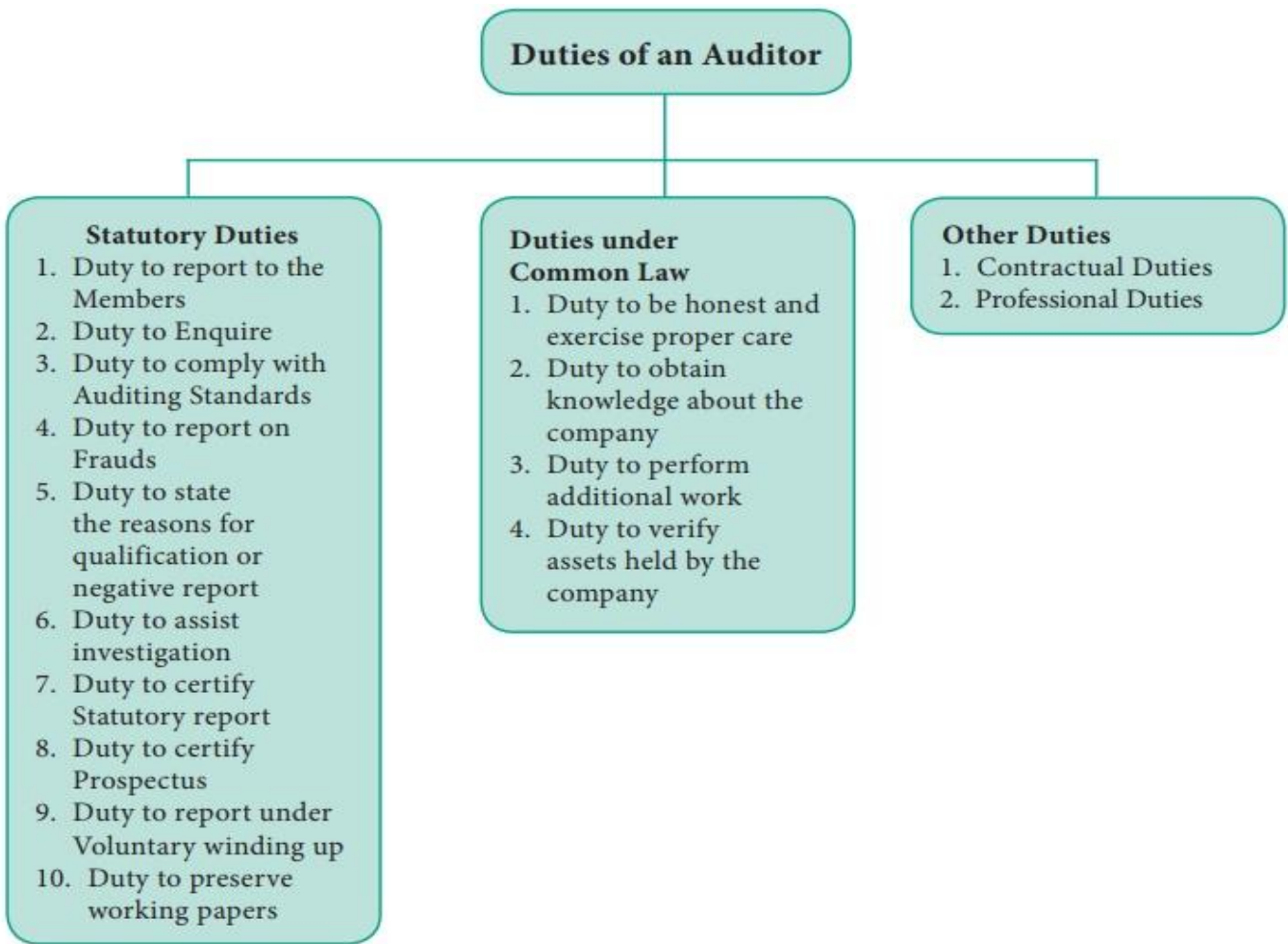
Right to Receive Remuneration

- ❖ Auditors has statutory right to receive remuneration which cannot be limited either by articles or resolution of the members.

Other Rights

- ❖ The auditor of a company is entitled to seek legal and technical advice, which is required in the performance of conduct of audit/ discharge of his duties.
- ❖ The auditor is the officer of the company for many purposes. As an officer, he has the right to be indemnified (compensated) out of the assets of the company against any liabilities incurred by him in defending himself against any Civil/Criminal proceeding by the company if he is held not guilty by law.

Duties of Company Auditor



Statutory Duties

Duty to report to the Members:

The auditor shall make a report to the members of the company on accounts and financial statements examined by him.

The report shall state:

- ❖ Whether he has sought and obtained all necessary information and explanations.
- ❖ Whether proper books of accounts have been kept.
- ❖ Whether company's Balance Sheet and Profit and Loss account agree with books of accounts and returns.

Duty to Enquire:

It is the duty to inquire into the following matters:

- ❖ Whether loans and advances made by the company based on security have been **properly secured** and whether the terms on which they have been made are favourable to the company or its members or not.
- ❖ Whether loans and advances made by the company have been **shown as deposits.**
- ❖ Whether personal expenses have been charged to revenue account.
- ❖ Whether it is stated in the books and documents of the company that any shares have been allotted for cash, whether **cash has been received in respect of such allotment,** and if no cash has been so received, whether the position as stated in the account books and the balance sheet is correct, regular, and not misleading.

Duty to comply with auditing standards:

- ❖ **Every auditor shall comply with the auditing standards issued by the Accounting Standards board.**

Duty to report on Frauds:

- ❖ When an auditor suspects an offence involving fraud is being committed by officers or employees of the company, he shall **immediately report the matter to the Central Government.**
- ❖ **For example,** if books of account show the creditors of Rs. 5,00,000 and through personal confirmation from creditors, it is found out that it is of Rs. 10,00,000, then it indicates fraud on part of the company and must be reported to the central government.

Duty to state the reasons for qualified or negative report:

- ❖ In case of **negative or qualified report,** the reasons must be stated in the report.
- ❖ The qualified Audit report is the report that **issue by auditors to the financial statements when he found material misstatements in them.**
- ❖ **For example,** the opening balance of the entity contains many inventories that could not be verified, he shall report the same in his report.

Duty to assist investigation:

- ❖ It is the important duty of the auditor to assist the investigator to investigate the affairs of the company.
- ❖ **Further, it is the duty of the auditor,**
 - To **provide and preserve the necessary documents** which are in his custody to the investigator, and

- To assist the investigator by providing all assistance in connection with the investigation.

Duty to certify Statutory Report:

The auditor must certify statutory report as correct to the extent of -

- ❖ Shares allotted by the company,
- ❖ Cash received in respect of such shares, and
- ❖ An abstract of receipts and payments of the company.

Duty to certify Prospectus:

- ❖ It is the duty of auditor to certify a report showing statement of profits or losses and assets and liabilities of the company and its subsidiaries.
- ❖ The report shall also include rates of dividend paid by the company for each of five financial years preceding the issue of prospectus.

Duty to report under voluntary winding up:

- ❖ When the company proposes for voluntary winding up, directors of the company must make a declaration of solvency.
- ❖ The auditor must certify a report upon the solvency based on the profit and loss Account and balance sheet.

Duty to preserve Working Papers:

- ❖ It is the duty of an auditor to preserve and produce all books and papers relating to the company which are in his custody and to assist the inspector appointed by the government for investigation.
- ❖ It is important to note that working papers is the property of auditor and not the client.
- ❖ Client cannot demand the same from the auditor.

Duties under common law

Duty to be honest and exercise proper care:

- ❖ The auditor should be straightforward, honest, and tactful and must not be influenced by others in discharge of his duties.
- ❖ He should be careful and cautious in performing his duties.
- ❖ For example, auditor must keep in mind that it is independent from the organisation and should give decisions unbiasedly.

Duty to obtain knowledge about the company:

- ❖ Before conducting audit, he should obtain detailed knowledge about the activities and affairs of the company as without knowledge of the same, audit cannot be conducted efficiently.

- ❖ **For example**, he can enquire about the internal check and internal control system maintained by the organisation and accordingly decide whether to conduct test check or not.

Duty to perform additional work:

- ❖ The auditor besides performing the statutory duties is bound to perform additional work **by passing a resolution** in the general meeting or making a provision in the Articles of Association of the company.
- ❖ **For example**, as advisor in taxation matters, company law matters, management services, etc.

Duty to verify assets held by the company:

- ❖ It is the duty of the auditor to verify assets of the company.
- ❖ **For example**, he can physically count the cash by himself, check the land & buildings whether they exist or not.

Other Duties

Contractual Duties:

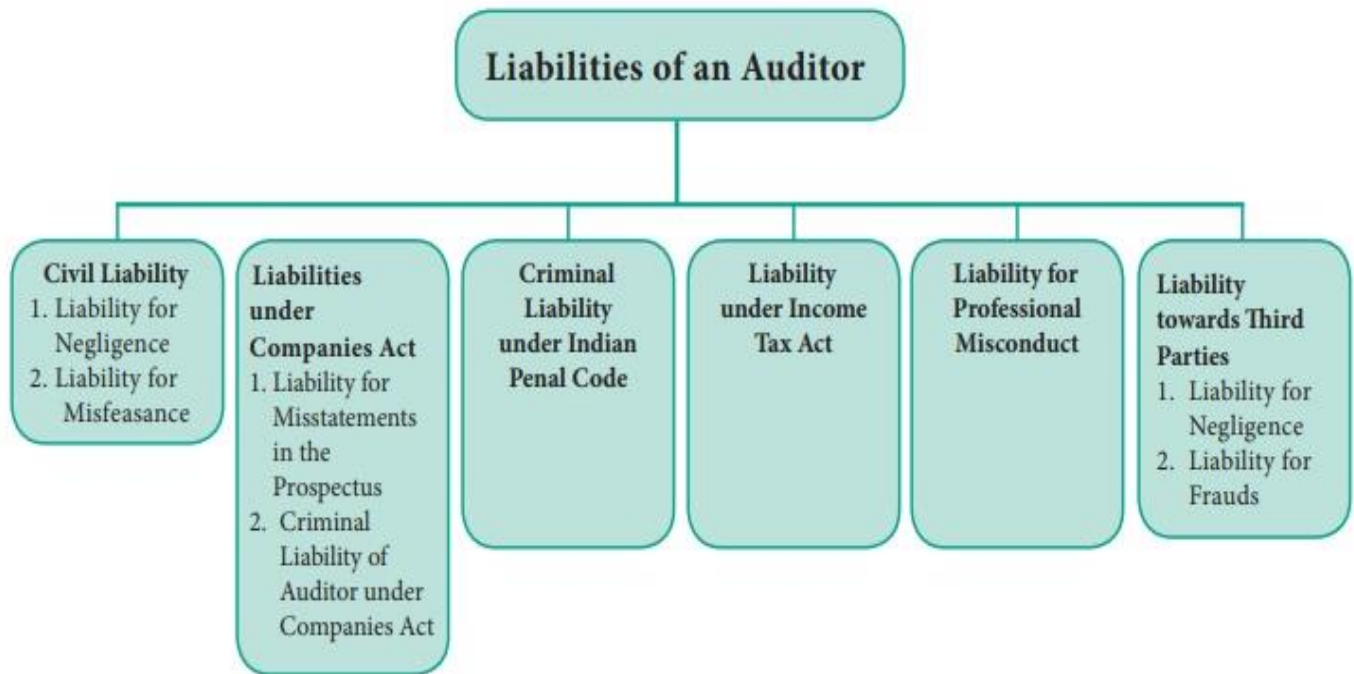
- ❖ The auditor's duty will depend upon the terms and conditions of his appointment between him and the party who appointed him.

Professional Duties:

- ❖ The auditor **must observe the ethics** given by the Institute of Chartered Accountants of India.
- ❖ He should correspond with the previous auditor before accepting the assignment.

Liabilities of Company Auditor

- ❖ The liability of auditor based on the work done by him as professional accountant and carry out his work due care, caution, and diligence. **The nature of liabilities of an auditor is discussed below:**



Civil Liability

Liability for Negligence:

Negligence means breach of duty.

An auditor is an agent of the shareholders as he is acting on their behalf. He must perform his professional duties.

- ❖ He should take reasonable care and skill in the performance of his duties.
- ❖ If he fails to do so, liability for negligence arises. An auditor will be held liable if the client has suffered loss due to his negligence.
- ❖ It should be noted that an auditor will not be liable to compensate the loss or damage if his negligence is not proved.

Liability for Misfeasance:

Misfeasance means breach of trust.

- ❖ If an auditor does something wrongfully in the performance of his duties resulting in a monetary loss to the company, he is guilty of misfeasance.
- ❖ In such a case, the company can recover damages from the auditor or from any officer for breach of trust or misfeasance of the company.

Liabilities under Companies Act

The following are the liabilities of an auditor under the provisions of the Companies Act.

Liability for Misstatements in the Prospectus:

- ❖ An auditor shall be held liable to compensate every person who subscribes for shares or debentures of a company by believing the prospectus containing an untrue statement made by an auditor.
- ❖ **For example,** his consent in writing is included in the prospectus issued by the companies, inviting public to subscribe in share or debentures. If the report is found to be misleading and a person has sustained a loss or damage because of subscription to the shares or debentures he can file suit against the auditor.

The auditor may escape from liability if he proves that:

- The prospectus is issued **without his knowledge or consent.**
- He **withdrew his consent,** in writing **before delivery of the prospectus** for registration.

Criminal Liability of Auditor under Companies Act:

Untrue statement in Prospectus

- The auditor is liable when he authorizes a false or untrue prospectus.

Failure to assist investigation:

- When Central Government appoints an Inspector to investigate the affairs of the company, it is the duty of the auditor to produce all books, documents and to aid the inspectors.

Failure to assist prosecution of guilty officers:

- An auditor is required to assist prosecution when Central Government takes any action against the report submitted by the Inspector.
- If he fails to do so, **he is found guilty and is punishable.**

Failure to return property, books, or papers:

- **When a company is wound up,** **the auditor is supposed to be present** and subject himself to a private examination by the court and is also liable to return to the court any property, books or papers relating to the company.
- If the auditor does not comply, he may be imprisoned.

Penalty for falsification of books:

- An auditor when destroys, mutilates, alters, or falsifies or secrets any books of account or document belonging to the company.

Prosecution of auditor:

- While winding up of a company by the Tribunal, if it appears to the Tribunal that an auditor of the company has been **guilty of an offence**, it shall be the duty of the auditor to give all assistance in connection with the prosecution.

Penalty for deliberate act of commission or omission:

- If an auditor **deliberately** makes a statement in any report, certificate, balance sheet, prospectus, etc which is **false or which contains omission of material facts**. He shall be held guilty and punished.

Criminal Liability under Indian Penal Code

- If any person issues or signs any certificate relating to any fact which is false, he is punishable as if he gave false evidence.
- According to the Indian Penal Code, the auditor is **similarly liable for falsification of any books, materials, papers that belongs to the company.**

Liability under Income Tax Act

- An auditor may also be charged in case of wrong certification of account.
- A Chartered Accountant can represent his clients before the Income Tax Authorities. However, if he is guilty of misconduct, he can be **disqualified from practicing**.

Liability for Professional Misconduct

- The Chartered Accountant Act, 1949 mentions number of acts and omissions that comprise professional misconduct in relation to audit practice.
- **The council of ICAI may remove the auditor's name for five years or more if he finds guilty of professional misconduct.**

Liability Towards Third Parties

- There are number of persons who rely upon the financial statements audited by the auditor and enter transactions with the company without further enquiry **viz.**

creditors, bankers, tax authorities, prospective shareholders, etc. All these are third parties.

Liability for Negligence:

- It has been held in some court cases that auditor is not liable to third parties, as there is no contract between auditor and third parties.
- He owes no duty towards them.

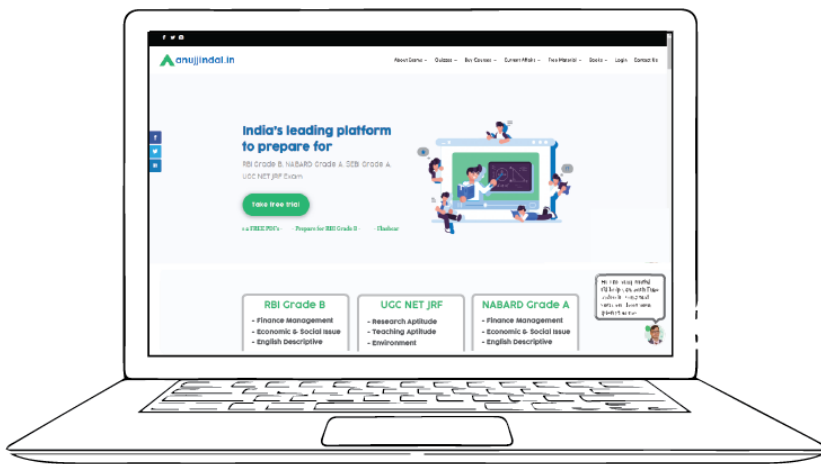
Liability for Frauds:

- In certain court cases it was held that, third parties can hold the auditor liable if there is fraud on the part of auditor even if there is no contractual relationship between auditor and third parties.
- But it must be proved that auditor did not act honestly, and he knew about it.

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“HALL OF FAME”

RBI



AIR 03 RBI : Muhammad Ali

AIR 06 RBI : Aditya Sood

AIR 10 RBI : Sameer

AIR 11 RBI : Abhishek

550+ Students cleared RBI Phase 1
300+ Students clear RBI Phase 2
48 Students got selected in RBI

SEBI



AIR 01 : Rajendra S

600+ Students cleared Phase 1

300+ Students cleared Phase 2

60+ Students selected in SEBI

NABARD



1100+ Students cleared Phase 1

250+ Students cleared Phase 2

30 Students selected in NABARD

UGC NET JRF



260+ Students selected in UGC NET JRF