

Accounts and Audit

UNIT I: ACCOUNTS OF COMPANIES

Question 1

The Board of directors of Bharat Ltd. has a practical problem. The registered office of the company is situated in a classified backward area of Maharashtra. The Board wants to keep its books of account at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the company. Advise.

Answer

According to section 128(1) of the Companies Act, 2013, every company is required to prepare and keep the books of accounts and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The proviso to section 128(1) further provides that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place. Further company may keep such books of accounts or other relevant papers in electronic mode as per the Rule 3 of the *Companies (Accounts) Rules, 2014*.

Therefore, the Board of Bharat Ltd. is empowered to keep its books of account at its corporate office in Mumbai by following the above procedure.

Question 2

Mr. White is working as Chief Accountant in White Metal Limited. The Board of Directors of the said company propose to charge him with the duty of ensuring compliance with the provisions of the Companies Act, 2013 so that books of account can be properly maintained and Balance Sheet and Profit and Loss Account can be prepared as per the provisions of law. Draft a "Board Resolution" for the said purpose. Also point out the consequences in case of default; when such a resolution is passed.

Answer

Board Resolution for charging Mr. White, Chief Accountant, with the duty of Compliance with the requirements of Sections 128 and 129 of the Companies Act, 2013.

"Resolved that Mr. White, Chief Accountant of the company be and is hereby charged with the duty of seeing that the requirements of Sections 128 and 129 of the Companies Act, 2013 are duly and fully complied with.

Resolved further that the said Mr. White is hereby entrusted with the authority to do such Acts or deeds as may be necessary or expedient for the purpose of discharging his above referred duties."

Consequences of contravention: Section 128(6) provides that if the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person of a company charged by the Board with the duty of complying with the provisions of this section, contravenes such provisions, such managing director, whole-time director in charge of finance, Chief Financial officer or such other person of the company shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both. Hence, Mr. White is liable for punishment as referred above.

Question 3

Advise:

XYZ Ltd. wants to maintain its books of account on cash basis.

Answer

The Companies Act, 2013 vide section 128(1) now requires every company to prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The second part of the section clearly states that the books of accounts must be maintained on accrual basis and according to the double entry system of accounting.

No exception has been given by the Act to any class or classes of companies from the above requirement. Hence, it is clear that XYZ Ltd. cannot maintain its books of accounts on cash basis.

Question 4

- (i) Define the expression "Accounting Standards" within the meaning of Companies Act, 2013.
- (ii) XYZ Limited did not prepare its Balance Sheet as at 31st March, 2015 and the Profit and

Loss Account for the year ended on that date in conformity with some of the mandatory Accounting Standards issued by the Institute of Chartered Accountants of India. You are required to state with reference to the provisions of the Companies Act, 2013, the responsibilities of directors and statutory auditor of the company in this regard.

Answer

- (i) As per sub-section (2) of Section 2 of the Companies Act, 2013, the expression "accounting standards" means the standards of accounting or any addendum thereto for companies or class of companies referred to in section 133.

As per Section 133, the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 as may be prescribed by the Central Government in consultation with and after examination of the recommendations made by the National Financial Reporting Authority established under section 132 of the said Act.

According to proviso to section 133 inserted by the MCA vide 2nd Order dated 29th March 2016, until the National Financial Reporting Authority is constituted under section 132 of the Companies Act, 2013, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by National Advisory Committee on Accounting Standards Constituted under section 210A of the Companies Act, 1956.

- (ii) Sub-section (1) of section 129 of this Act states that financial statement of the company shall comply with the accounting standards notified under section 133. As per sub – section (5), where the Financial Statements of the company do not comply with the accounting standards, such companies shall disclose in its financial statements, the following, namely:
- (a) the deviation from the accounting standards;
 - (b) the reasons for such deviation; and
 - (c) the financial effect, if any, arising due to such deviation.

Apart from the above consequence on non compliance, section 129(7) further provides that if a company contravenes the provisions of section 129 (which requires compliance with accounting standards), the managing director, whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Moreover, the Board of directors is also required under section 134 of the Companies Act, 2013 to include a Directors Responsibility Statement indicating therein that in the preparation of the financial statements the applicable accounting standards had been followed along with proper explanation relating to material departures, if any. If such person (as above referred) fails to take all reasonable steps to secure compliance by the company, as respects any accounts laid before the company in general meeting, with the provisions of this section and with the other requirements of this Act as to the matters to be stated in the accounts, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to 1 year, or with fine not less than Rs. 50,000 but which may extend to ₹ 5,00,000 or with both.

Responsibilities of auditors:

As per section 143(3) (e) of the Companies Act, 2013, the statutory auditor's responsibility is to state in his report, whether in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in section 133 of the Companies Act, 2013.

Question 5

State giving reasons whether the following are true or false under the provisions of the Companies Act, 2013? The Board of Directors of ABC Ltd. wants to circulate unaudited accounts before the Annual General Meeting of the shareholders of the Company.

Answer

False. Section 129(2) of the Companies Act, 2013 provides that at every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year. Further section 134(7) provides that signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of:

- (a) any notes annexed to or forming part of such financial statement;
- (b) the auditor's report; and
- (c) the Board's report.

It, therefore, follows that unaudited accounts cannot be sent to members or unaudited accounts cannot be filed with the Registrar of Companies.

Question 6

The Board of Directors of Vishwakarma Electronics Limited consists of Mr. Ghanshyam, Mr. Hyder (Directors) and Mr. Indersen (Managing Director). The company has also employed a full time Secretary.

The Profit and Loss Account and Balance Sheet of the company were signed by Mr. Ghanshyam and Mr. Hyder. Examine whether the authentication of financial statements of the company was in accordance with the provisions of the Companies Act, 2013?

Answer

Under section 134(1) of the Companies Act, 2013 the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by at least:

- (a) The chairperson of the company where he is authorised by the Board; or
- (b) Two directors out of which one shall be managing director and the Chief Executive Officer, if he is a director in the company, and
- (c) the Chief Financial Officer and the company secretary of the company, wherever they are appointed.

In the instant case, the Balance Sheet and Profit and Loss Account have been signed by Mr. Ghanshyam and Mr. Hyder, the directors. In view of Section 134(1) of the Companies Act, 2013, Mr. Indersen, the Managing Director should be one of the two signing directors. Since the company has also employed a full time Secretary, he should also sign the Balance Sheet and Profit and Loss Account.

Question 7

The Companies Act, 2013 has prescribed an additional duty on the Board of Directors to include in the Board's Report a 'Directors' Responsibility Statement'. Explain briefly the details to be furnished in the said statement.

Answer

Section 134(3)(c) of the Companies Act, 2013 provides that there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include a number of statements as prescribed in the sub section including Directors' Responsibility Statement.

Further section 134(5) states that the Directors Responsibility Statement shall state that:

- (i) In the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- (ii) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;
- (iii) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- (iv) that the directors had prepared the annual accounts on a going concern basis; and

- (v) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively; and
- (vi) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

Question 8

The Annual General Meeting of Robertson Ltd., for laying the Annual Accounts thereat for the year ended 31st March, 2014 was not held, as the accounts were not ready. In this context:

- (i) *Advise the company regarding compliance of the provisions of section 137 of the Companies Act, 2013 for filing of copies of financial statements with the Registrar of Companies.*
- (ii) *Will it make any difference in case the Annual Accounts were duly laid before the Annual General Meeting held on 27th September, 2014 but the same were not adopted by the shareholders?*

Answer

Under section 137(1) of the Companies Act, 2013, a copy of the financial statements, including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the Registrar within thirty days of the date of annual general meeting in such manner, with such fees or additional fees as may be prescribed within the time specified. Every company shall file the financial statements with the Registrar together with *Form AOC-4*.

Provided that where the financial statements under sub-section (1) are not adopted at annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents under sub-section (1) shall be filed with the Registrar within thirty days of the date of annual general meeting and the Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose.

Further under section 137(2) of the Companies Act, 2013 where the annual general meeting of a company for any year has not been held, the financial statements along with the documents required to be attached under sub-section (1), duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held and in such manner, with such fees or additional fees as may be prescribed within the time specified.

Accordingly,

- (i) In the present case though Annual General Meeting was not held, it ought to be held by 30th September, 2014 under sections 96 of the Companies Act, 2013.

Therefore, under the provisions of section 137(2) the financial statements along with the documents required to be attached under this Act, duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held i.e. by 30th October 2014 alongwith such fees or additional fees as may be prescribed.

- (ii) Since the Annual General Meeting has been held in time on 27th September 2014, the unadopted financial statements along with the required documents under sub-section (1) of section 137 shall be filed with the Registrar within thirty days of the date of annual general meeting and the Registrar shall take them in his records as provisional till the financial statements are filed with him after its adoption in the adjourned annual general meeting for that purpose.

Question 9

Explain the concept of 'CSR' (Corporate Social Responsibility) as introduced by the Companies Act, 2013. Examining the provisions of the Act, answer the following:

- (i) *Which companies are required to constitute CSR Committee?*
- (ii) *Which companies are excluded from the requirements of the provisions of the Act in relation to CSR committee?*
- (iii) *What is the minimum contribution the companies are required to make towards CSR?*

Answer

Concept of Corporate Social Responsibility, CSR Committee & Minimum Contribution (Sections 135 of the Companies Act, 2013)

Corporate Social Responsibility (CSR): CSR implies a concept, whereby companies decide voluntarily to contribute to a better society and a cleaner environment — a concept, whereby the companies integrate social and other useful concerns in their business operations for the betterment of its stakeholders and society in general in a voluntary way.

According to section 135 of the Companies Act, 2013:

- (i) **Company which is required to constitute CSR committee:**
 - (A) Every company including its holding or subsidiary, and a foreign company defined under section 2(42) of the Companies Act, 2013 having its branch office or project office in India, having
 - (1) net worth of rupees 500 crore or more, or
 - (2) turnover of rupees 1000 crore or more or
 - (3) a net profit of rupees 5 crore or moreduring any financial year shall constitute a Corporate Social Responsibility Committee of the Board.

- (B) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.
 - (C) However, the net worth, turnover or net profit of a foreign company shall be computed in accordance with balance sheet and profit and loss account of such company as prepared in accordance with the provisions of section 381(1)(a) and section 198 of the Act.
- (ii) **Companies excluded from the requirements of the provisions of the Act in relation to CSR Committee:**
- Every company which ceases to be a company as per section 135(1) of the Act for three consecutive financial years –
- (1) shall not be required to constitute a CSR Committee, and
 - (2) is not required to comply with the provisions as per section 135.
- (iii) **Required minimum contribution of the Companies towards CSR:**
- (A) The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR Policy.
 - (B) The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.
 - (C) If the company fails to spend such amount, the Board shall, in its report, specify the reasons for not spending the amount.
 - (D) Companies may build CSR capacities of their own personnel as well as those of their implementing agencies through Institutions with established track records of at least three financial years. However, such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.

Question 10

Mr. Bhagvath, recently acquired 76% of the equity shares of M/s Renowned Company Ltd., in the hope of earning good dividend income. Unfortunately the existing Board of Directors have been avoiding declaration of dividend due to alleged inadequacy of profits. Unconvinced, Mr. Bhagvath seeks permission of the Company to allow him to examine the Books of Accounts, which is summarily rejected by the Company. Examine and advise the provisions relating to inspection of Books of Accounts and remedy available.

Answer

Inspection of Books of Accounts of the Company (Section 128 of the Companies Act, 2013)-

Mr. Bhagvath has no right to carry out an inspection of the books of accounts of the company despite the fact that he holds 76% of the equity shares of M/s Renowned Company Ltd. According to sections 128(3) and 206 of the Companies Act, 2013, following persons have the right to carry out the inspection of the books of accounts of the company.

- (i) Directors of the Company [Section 128(3) of the Companies Act, 2013]
- (ii) Registrar of Companies [Section 206 of the Companies Act, 2013]
- (iii) Such officer of Government as may be authorised by the Central Government in this behalf (Section 206 of the Companies Act, 2013).
- (iv) Such officers of SEBI as may be authorised by SEBI [Section 206 read with Section 24 of the Companies Act, 2013].

Since Mr. Bhagvath does not fall in any of above mentioned categories, he is not eligible to carry out the inspection.

[Note: According to Regulation 89(ii) of the Table F of the Schedule I of the Companies Act, 2013, a member shall have right of inspecting any account or book or document of the company only if conferred by law or authorized by the Board or by the company in general meeting]

Question 11

ABC Limited has on its Board, four Directors viz. W, X, Y and Z. In addition, the company has Mr. D as the Managing Director. The company also has a full time Company Secretary, Mr. Wise, on its rolls. The financial statements of the company for the year ended 31st March, 2015 were authenticated by two of the directors, Mr. X and Y under their signatures.

Referring to the provisions of the Companies Act, 2013:

- (i) *Examine the validity of the authentication of the Balance Sheet and Statement of Profit & Loss and the Board's Report.*
- (ii) *What would be your answer in case the company is a One Person Company (OPC) and has only one Director, who has authenticated the Balance Sheet and Statement of Profit & Loss and the Board's Report?*

Answer

In accordance with the provisions of the Companies Act, 2013, as contained under section 134 (1), the financial statements, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by at least:

- (1) The Chairperson of the company where he is authorized by the Board; or
- (2) Two directors out of which one shall be the managing director and
- (3) The other Chief Executive Officer, if he is a director in the company
- (4) The Chief Financial Officer and the Company Secretary of the company, wherever they are appointed.

In case of a One Person Company, the financial statements shall be signed by only one director, for submission to the auditor for his report thereon.

The Board's report and annexures thereto shall be signed by its Chairperson of the company, if he is authorized by the Board and where he is not so authorized, shall be signed by at least two directors one of whom shall be a managing director or by the director where there is one director.

- (i) *In the given case, the Balance Sheet and Profit & Loss Account have been signed by Mr. X and Mr. Y, the directors. In view of the provisions of Section 134 (1), the Managing Director Mr. D should be one of the two signatories. Since the company has also employed a full time Secretary, he should also sign the Balance Sheet and Profit & Loss Account. Therefore, authentication done by two directors is not valid.*
- (ii) *In case of OPC, the financial statements should be signed by one director and hence, the authentication is in order.*

Question 12

DJA Company Limited, incorporated under the provisions of the Companies Act, 2013, has two subsidiaries – AJD Limited and AMR Limited. All the three companies have prepared their financial statements for the year ended 31st March, 2015. Examining the provisions of the Companies Act, 2013, answer the following:

- (i) *In what manner the subsidiaries – AJD Limited and AMR Limited shall prepare their Balance Sheet and Profit & Loss Account?*
- (ii) *What would be your answer in case the DJA Limited – the holding company, is not required to prepare consolidated financial statements under the Indian Accounting Standards?*
- (iii) *What shall be your answer in case one of the subsidiary company's financial statements do not comply with the Accounting Standards?*
- (iv) *To what extent is the Central Government empowered to exempt a company from preparing the financial statements in compliance with the Indian Accounting Standards?*

Answer

- (i) *In accordance with the provisions of the Companies Act, 2013, as contained under section 129(3) and (4):*

Where a company has one or more subsidiaries, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. The consolidated financial statements shall also be laid before the AGM of the company along with the laying of its own financial statement. The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiaries in Form AOC-1. For the purpose of consolidated financial statements, 'subsidiaries' shall include associate company and joint venture.

- (ii) According to Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, for a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III to the Act. The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements.*
- (iii) If the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements the following viz.*
 - (a) The deviation from the accounting standards,*
 - (b) The reasons for such deviation, and*
 - (c) The financial effects, if any, arising out of such deviation.*
- (iv) The Central Government may, on its own or on any application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this Section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest. Any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.*

Question 13

Explain the law laid down under the Companies Act, 2013 in respect of filing of annual financial statements with Registrar of companies in the following two situations who is liable for the default.

- (i) Where financial statements of the company are filed with the ROC after 10 months from its due date;*
- (ii) Where financial statements are not at all filed by the company with the ROC?*

Answer

- (i) *Under section 403 of the Companies Act, 2013, any document may be filed within 270 days from the date by which it should have been filed under the Act. Any such document be also filed after 270 days on payment of fee and additional fee as may be prescribed, and the company and its officers who are in default shall be liable for the penalty or punishment provided under the Act.*

Accordingly, in the present case, the financial statement has been filed after 270 days. Thus, the company may file the same on payment of fee and additional fee after 10 months. The company and its officers may approach ROC for compounding the offence, to avoid any prosecution by ROC for such failure or default.

- (ii) *Under section 137 (3) of the Companies Act, 2013, if a company fails to file the financial statement, the company and the Managing director and the Chief Financial officer, if any, and in their absence, any other director who is charged by the Board with the responsibility of complying with the extent provisions, and in the absence of any such director, all the directors of the company, shall be punishable.*

UNIT II: AUDIT AND AUDITORS**Question 14**

State the procedure for the following, explaining the relevant provisions of the Companies Act, 2013:

- (i) *Appointment of First Auditor, when the Board of directors did not appoint the First Auditor within one month from the date of registration of the company.*
- (ii) *Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.*

Answer

- (i) Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days of the registration of the company.

Section 139 (6) continues to provide further that if the Board of Directors fails to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

From the above provisions of law if the Board of Directors fails to appoint the first auditors within the stipulated 30 days, it shall take the following steps:

- a. Inform the members of the Company;

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- b. Immediately take steps to convene an extra ordinary general meeting not later than 90 days;
 - c. Members shall at that extra ordinary meeting appoint the first auditors of the company;
 - d. The first auditors so appointed shall hold office upto the conclusion of the first AGM of the company.
- (ii) Section 140 of the Companies Act, 2013 prescribes certain procedure for removal of auditors. Under section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner. From this sub section it is clear that the approval of the Central Government shall be taken first and thereafter the special resolution of the company should be passed.

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Therefore, in terms of section 140 (1) of the Companies Act, 2013 read with rule 7 of the *Companies (Audit & Auditors) Rules, 2014* the following steps should be taken for the removal of an auditor before the completion of his term:

- a. The application to the Central Government for removal of auditor shall made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the *Companies (Registration Offices and Fees) Rules, 2014*
- b. The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
- c. The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

Question 15

Explain how the auditor will be appointed in the following cases:

- (i) *A Government Company within the meaning of section 394 of the Companies Act, 2013.*
- (ii) *The Auditor of the company (other than government company) has resigned on 31st December, 2013, while the Financial year of the company ends on 31st March, 2014.*
- (iii) *A company, whose shareholders include the following:*
 - (a) *Bank of Baroda (A Nationalized Bank) holding 12% of the subscribed capital in the company.*
 - (b) *National Insurance Company Limited (carrying on General Insurance Business) holding 10% of the subscribed capital in the company.*

- (c) *Maharashtra State Financial Corporation (A Public Financial Institution) holding 8% of the subscribed capital in the company.*

Answer

- (i) The appointment and re-appointment of auditor of a Government Company or a government controlled company is governed by the provisions of section 139 of the Companies Act, 2013 which are summarized as under:

The first auditor shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General of India shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

- (ii) The situation as stated in the question relates to the creation of a casual vacancy in the office of an auditor due to resignation of the auditor before the AGM in case of a company other government company. Under section 139 (8)(i) any casual vacancy in the office of an auditor arising as a result of his resignation, such vacancy can be filled by the Board of Directors within thirty days thereof and in addition the appointment of the new auditor shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
- (iii) The Companies Act, 2013 categorizes companies into government companies and non Government Companies and lists down the provisions relating to appointment, of auditors as per this classification. Hence, in the given case as the total shareholding of the three institutions adds up to 30% of the subscribed capital of the company it is not a government company also not a deemed Government company. Hence, the provisions applicable to non-government companies in relation to the appointment of auditors shall apply.

Question 16

Prakash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2014. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2014 for personal reasons. The Board of directors seeks your advice for filling up the vacancy by appointment of Mr. Albert as auditor. Advise as per the provisions of the Companies Act, 2013.

Also suggest the procedure to be adopted in case Mr. Albert is proposed to be removed from his office before the expiry of his term.

Answer

Under section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

Therefore, in the present case, as the auditor has resigned, the casual vacancy so created can be filled up by the Board appointing Mr. Albert. However, the appointment of Mr. Albert must be approved by the company by passing of an ordinary resolution at a general meeting of the company which must be convened by the Board within 3 months of the recommendation of the Board.

Mr. Albert will be entitled to hold office till the conclusion of the next Annual General Meeting.

Under section 140(1) of the Companies Act, 2013, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner:

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Therefore, in terms of section 140 (1) of the Companies Act, 2013 read with rule 7 of *the Companies (Audit & Auditors) Rules, 2014*, the following steps should be taken for the removal of an auditor before the completion of his term:

- a. The application to the Central Government for removal of auditor shall made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the *Companies (Registration Offices and Fees) Rules, 2014*
- b. The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
- c. The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

Question 17

One-fourth of the subscribed capital of AMC Limited was held by the Government of Rajasthan. Mr. Neeraj a qualified Chartered Accountant was appointed as an auditor of the Company at the Annual General Meeting held on 30th April, 2014 by an ordinary resolution. Mr. Sanjay, a shareholder of the Company objects to the manner of appointment of Mr. Neeraj on the ground of violation of the Companies Act 2013. Decide, whether the objection of Mr. Sanjay is tenable? Also examine the consequences of the above appointment under the said Act.

Answer

As per the section 2(45) of the Companies Act, 2013, the holding of 25% shares of AMC Ltd. by the government of Rajasthan does not make it a government company. Hence, it will be treated as a non-government company.

Under section 139 of the Companies Act, 2013, the appointment of an auditor by a company vests generally with the members of the company except in the case of the first auditors and in the filling up of the casual vacancy not caused by the resignation of the auditor, in which case, the power to appoint the auditor vests with the Board of Directors. The appointment by the members is by way of an ordinary resolution only and no exceptions have been made in the Act whereby a special resolution is required for the appointment of the auditors.

Therefore, the contention of Mr Sanjay is not tenable. The appointment is valid under the Companies Act, 2013.

Question 18

Examine the validity of the following with reference to the provisions of the Companies Act, 2013:-

- (i) *EF Limited appointed a individual firm, Naresh & Company, Chartered Accountants, as Auditors of the company at the Annual General Meeting held on 30th September, 2014. Mrs. Kamala, wife of Mr. Naresh, invested in the equity shares face value of Rs. 1 lakh of EF Limited on 15th October, 2014. But Naresh & Company continues to function as statutory auditors of the company.*
- (ii) *Mr. Suresh, a Chartered Accountant, was appointed by the Board of Directors of AB Limited as the First Auditor. The company in General Meeting removed Mr. Suresh without seeking the approval of the Central Government and appointed Mr. Gupta as Auditor in his place.*

Answer

- (i) **Disqualification of auditor:** According to section 141(3)(d)(i) of the Companies Act, 2013, a person who, or his relative or partner holds any security of the company or its subsidiary or of its holding or associate company a subsidiary of such holding company, which carries voting rights, such person cannot be appointed as auditor of the company. Provided that the relative of such person may hold security or interest in the company of face value not exceeding 1 lakh rupees as prescribed under the *Companies (Audit and Auditors) Rules, 2014*.

In the case Mr. Naresh, Chartered Accountants, did not hold any such security. But Mrs. Kamala, his wife held equity shares of EF Limited of face value Rs. 1 lakh, which is within the specified limit.

Further Section 141(4) provides that if an auditor becomes subject, after his appointment, to any of the disqualifications specified in sub-section 3 of section 141, he shall be deemed to have vacated his office of auditor. Hence, Naresh & Company can continue to

function as auditors of the Company even after 15th October 2014 i.e. after the investment made by his wife in the equity shares of EF Limited.

- (ii) **Removal of first auditor:** Section 140(1) stipulates that any auditor appointed under section 139 may be removed from office before the expiry of his term by passing special resolution in general meeting, after obtaining the previous approval of the Central Government in that behalf.

Provided that before taking any action under subsection (1) of Section 140, the auditor concerned shall be given a reasonable opportunity of being heard.

The first auditors appointed by Board of Directors can be removed in accordance with the provision of Section 140(1) of the Companies Act, 2013. Hence the removal of the first auditor appointed by the Board without seeking approval of the Central Government is invalid. The company contravened the provision of the Act.

Question 19

The auditors of a company refuses to make their report on the annual accounts of a company before it is signed on behalf of the Board of directors. Advise the company.

Answer

The auditor is right. Theoretically, accounts are presented to auditors only after they are approved by the Board and signed by authorized persons. The auditor is only expected to submit his report on the accounts presented to him for audit after conducting an examination of the necessary documents, analyzing relevant information and test checking accounting records in order to be able to form an opinion of the financial statements presented to him. In practice, the checking of accounts is already completed before accounts are approved by the Board. Auditor informally approves the draft account with notes etc., before the accounts are approved by the Board. However, auditor signs the accounts only after these are approved by Board and signed by persons authorized by Board of the company.

Question 20

On recommendation of the Board of Directors of DJA Company Limited, Mr. R is appointed at the company's Annual General Meeting held on 1st October, 2014 as the company's auditor for a period of 10 years. A resolution to this effect was passed unanimously with no vote against the resolution. Explaining the provisions of the Companies Act, 2013 relating to the appointment and re-appointment of auditors:

- (i) *Examine the validity of the above resolution.*
- (ii) *What shall be your answer in case an audit firm R & Associate is appointed as the company's auditor ?*

Answer**Appointment of Auditor [Section 139 of the Companies Act, 2013 and the *Companies (Audit and Auditors) Rules, 2014*]:**

Section 139(2) of the Companies Act, 2013, provides that listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or re-appoint-

- (1) an individual as auditor for more than one term of five consecutive years; and
- (2) an audit firm as auditor for more than two terms of five consecutive years.

The *Companies (Audit and Auditors) Rules, 2014* has prescribed the following classes of companies for the purposes of section 139(2):

- (1) all unlisted public companies having paid up share capital of rupees 10 crore or more;
- (2) all private limited companies having paid up share capital of rupees 20 crore or more;
- (3) all companies having paid up share capital of below threshold limit mentioned in (1) and (2) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crores or more.

- (i) In the above question, on recommendation of the Board of Directors of DJA Company Limited, Mr. R is appointed at the company's Annual General Meeting held on 1st October, 2014 as the company's auditor for a period of 10 years. As per the above provisions of the Companies Act, 2013, the appointment of Mr. R as auditor of the company for 10 years is not valid because an individual shall not be appointed as auditor for more than one term of five consecutive years. The said resolution is not valid.

[Note: As the question does not specify the status of the company whether listed or unlisted; amount of paid up share capital, public borrowings from financial institutions, banks or public deposits are not known; it is assumed that DJA Company Limited is a listed company or within the prescribed classes of companies specified under the above said Rules].

- (ii) An audit firm can be appointed as an auditor for two terms of five consecutive years. This means that a firm can be appointed for five years and thereafter may be appointed/ reappointed for further five years. The total period for which a firm can be appointed is 10 years. A firm cannot be appointed as auditor for ten years by a single resolution.

Thus, the appointment of R & Associate as the company's auditor for ten years by a single resolution is not valid.

Question 21

PQR Limited is an unlisted Public company having paid up share capital of ₹ 80 crores during the preceding financial year 2014-15. The turnover of the company was ₹ 110 crores for the same period. Referring to the provisions of the Companies Act, 2013, answer the following:

- (i) *Is it mandatory for the above company to appoint an internal auditor for the financial year 2015-16?*
- (ii) *What are the qualifications of the Internal Auditor?*

Answer

- (i) Class of companies required to appoint Internal Auditor: Section 138 of the Companies Act, 2013 and the *Companies (Accounts) Rules, 2014* prescribes the class of companies required to appoint Internal Auditor. According to it, following class of companies shall be required to appoint an internal auditor or a firm of internal auditors.
 - 1. Every listed company;
 - 2. Every unlisted public company having –
 - (a) Paid up share capital of 50 crore rupees or more during the preceding financial year; or
 - (b) Turnover of 200 crore rupees or more during the preceding financial year; or
 - (c) Outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year; or
 - (d) Outstanding deposits of 25 crore rupees or more at any point of time during the preceding financial year; and
 - 3. Every private company having –
 - (a) Turnover of 200 crore rupees or more during the preceding financial year; or
 - (b) Outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year.

As per the facts given in the question, PQR Limited is an unlisted public company with the paid up share capital of ₹ 80 crores during the preceding financial year with the turnover of ₹ 110 crores. Since PQR Limited fulfills one of the criteria with paid up share capital of more than 50 crore rupees during the preceding financial year, it is mandatory for the PQR Limited to appoint an internal auditor for the financial year 2015-16.

- (ii) As per the section 138(1), an internal auditor shall either be a Chartered Accountant (engaged in practice or not) or a Cost Accountant, or such other professional as may be decided by the Board. Even an employee of the company may also be appointed as an Internal auditor of the company as per the Rule 13 of the *Companies (Accounts) Rules, 2014*.

Question 22

List out three matters on which an Auditor of a company has to express his views and comments in his report as per the Companies (Audit and Auditors) Rules, 2014.

Answer

The *Companies (Audit and Auditors) Rules, 2014*, provides that the auditor's report shall also include their views and comments on the following matters namely :

- (1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

Question 23

The auditor of Organic Foods Ltd., accepted the Certificate from Mr. Rohan who is the manager, a person of knowledge, competence and high reputation, as to the value of the stock in trade. The valuation of stock referred to above was found to be grossly overstated for several years in the balance sheets of the company. As a result of the over valuation, dividends were paid out of capital. The auditor did not examine the books of account very minutely. If they had done so and compared the amount of stock at the beginning of the year, with the purchases and sales during the year, they would have noticed the over valuation. The company subsequently went into liquidation and the auditors were sued to make good the loss caused by the wrongful payment of dividends based on the balance sheets figures. Based on the above facts, you are required to decide, with reference to the provisions of the Companies Act, 2013 and the decided case laws, the following issues:

- (i) *Whether the Auditors of the company will be liable for the loss caused to the company by the wrongful payment of dividends based on the Balance sheets duly audited by the Auditors.*
- (ii) *What are the statutory duties of the Auditors in this regard?*

Answer

The problem given in question is mainly relates to the duties of the auditors. Section 143 of the Companies Act, 2013 provides that the main duty of the auditor is to make a report to the members of the company on the accounts examined by him and the balance sheet and the profit and loss account of the company and on every document which is annexed to the balance sheet or profit and loss account laid before the company in general meeting. The auditor owes a duty to the members to state whether

the accounts give a true and fair view of the affairs of the company at the end of the financial year and of the profit and loss account of the year.

The duty of an auditor is to give information in direct and express terms (Crichton's Oil Co. Re (1902) 2ch 86) and not merely to arouse inquiry. If he discovers that any illegal or improper payments or any other papers have been made, his duty will be to make it public by reporting. The auditor occupies a fiduciary position in relation to the shareholders and in auditing the accounts maintained by the directors, he must act in the best interest of the shareholders who are in the position of beneficiaries.

But there is a limitation relating the duties to be performed by the auditor. An auditor is not bound to be a detective and is not expected to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog but not bloodhound. He is justified in believing tried servants of the company in whom confidence was placed by the company. He is entitled to assume that they are honest and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion, he should probe it to the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious and careful.

This question is related to case of Kingston Cotton Mill Co. Re (No. 2) (1896) 2 ch 279. In this case it was held that, the auditors were not liable. It is not auditor's duty to take stock. There are many matters in which he may rely on the honesty and accuracy of others. Further auditors do not guarantee the discovery of all frauds.

However, it is possible to hold a different view by stating that the auditor cannot escape from his responsibility by relying on the stock valuation certified by Mr. Rohan who is the manager. Though, it is not the duty of auditor to examine the books of accounts very minutely, they are supposed to examine the quantity of stock at the beginning of year with the purchases & sales and arriving at the figures of closing stock which would have become clear that there was overvaluation of stock. Thus, the auditor of the company will be responsible for the violations and shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend up to ₹ 5 lakhs as per provisions of Section 147(2) of the Act.