

## The Company Audit- I

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### Question 1

*Discuss - Advantages and disadvantages of Joint Audit. (5 Marks, November, 2014)*

*Or*

*Explain the concept of joint audit. Discuss its advantages and disadvantages.*

*(8 Marks, May, 2011)*

### Answer

**Joint Audit:** The practices of appointing chartered accountants as joint auditors is quite widespread in big companies and corporations, joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work.

When more than one auditor is appointed to audit large entities, such auditors are called joint auditors. Joint auditors have a collective responsibility to report on the financial statements. SA 299, "Joint Audit" deals with duties, rights and professional responsibilities of joint auditors. Advantages and disadvantages of joint audit are as follows-

#### Advantages of Joint Audit

- (i) Pooling and sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower work load.
- (iv) Better quality of work performance.
- (v) Improved service to the client.
- (vi) Displacement of the auditor of the company taken over in a take-over often obviated.
- (vii) In respect of multinational companies, the work can be spread using the expertise if the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance.

### Disadvantages of Joint Audit

- (i) The fees being shared.
- (ii) Psychological problem where firms of different standing are associated in the joint audit.
- (iii) General superiority complexes of some auditors.
- (iv) Problems of coordination of the work.
- (v) Areas of work of common concern being neglected.
- (vi) Uncertainty about the liability for the work done.
- (vii) Lack of clear definition of responsibility.

### Question 2

*State with reasons (in short) whether the following statements are correct or incorrect:*

- (a) *Emphasis of Matter paragraph in the Auditor's Report is a substitute of Disclaimer of Opinion.*
- (b) *It is the responsibility of the Auditor to ensure that Statement of Profit and Loss and Balance Sheet of the company shall comply with the Accounting Standards.*
- (c) *The Auditor shall express an unqualified opinion if the Auditor is unable to obtain sufficient audit evidence regarding the opening balances.*
- (d) *The first Auditor is generally appointed by the company at a General Meeting.*

*(2 Marks each, November, 2014)*

### Answer

- (a) **Incorrect:** As per SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", the inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. Whereas the auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive. Therefore, an Emphasis of Matter paragraph is not a substitute for the auditor expressing a disclaimer of opinion.
- (b) **Incorrect:** It is the responsibility of the company to ensure that statement of profit and loss and balance sheet of the company comply with the accounting standards. However, according to section 143 of the Companies Act, 2013, it is the duty of the auditor to report whether, in his opinion, the financial statements comply with the accounting standards.
- (c) **Incorrect:** As per SA 510 "Initial Audit Engagements—Opening Balances", if the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate.

- (d) **Incorrect:** As per Section 139(6) of the Companies Act, 2013, the first auditor(s) of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

### Question 3

*State the matters to be specified in the Auditor's Report in terms of provisions of Section 227(3) of the Companies Act, 1956. (6 Marks, November, 2014)*

### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

### Question 4

*Write a short note on Companies not covered under Companies (Auditor's Report) Order, 2003. (4 Marks, November, 2014)*

### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

### Question 5

*What is Modified Reports? Discuss disclosure pattern when the auditor includes an Emphasis of Matter paragraph in the Auditor's Report. (5 Marks, May, 2014)*

### Answer

**Modified Reports:** As per SA 705 "Modifications to the Opinion in the Independent Auditor's Report", an auditor's report is considered to be modified when it includes-

(i) Matters That Do Not Affect the Auditor's Opinion

- ✓ emphasis of matter
- ✓ Other Matter

(ii) Matters That Do Affect the Auditor's Opinion

- ✓ qualified opinion
- ✓ disclaimer of opinion
- ✓ adverse opinion

Therefore, Modified Reports can be of two types (a) Matters that affect auditor's opinion (b) Matters that do not affect auditor's opinion.

The auditor shall modify the opinion in the auditor's report when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Further, as per SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", the inclusion of an Emphasis of Matter paragraph in the

auditor's report does not affect the auditor's opinion. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include it immediately after the Opinion paragraph in the auditor's report;
- (ii) Use the heading "Emphasis of Matter", or other appropriate heading;
- (iii) Include in the paragraph a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
- (iv) Indicate that the auditor's opinion is not modified in respect of the matter emphasised.

Examples:

- ❖ An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- ❖ Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- ❖ A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

#### Question 6

*State with reasons (in short) whether the following statements are correct or incorrect:*

- (a) *The Revised Schedule VI is applicable only to Public Limited Companies from the Financial Year 2012-13.*
- (b) *Companies (Auditor's Report) Order, 2003 shall not apply to a Private Limited Company whose paid up capital and reserves are not more than rupees fifty lakhs.*
- (c) *The Board of Directors can fill the casual vacancy caused by the resignation of an auditor, who shall hold office until the conclusion of the next annual general meeting.*

*(2 Marks each, May, 2014)*

#### Answer

- (a) This question is redundant in view of the provisions of the Companies Act, 2013.
- (b) This question is redundant in view of the provisions of the Companies Act, 2013.
- (c) **Incorrect:** As per section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall be filled by the Board of Directors within 30 days. However, 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 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

#### Question 7

*Write a short note on Introductory Paragraph in the Auditor's Report. (4 Marks, May, 2014)*

## Answer

**Introductory Paragraph:** As per SA 700, "Forming an Opinion and Reporting on Financial Statements", the introductory paragraph in the auditor's report shall-

- (i) Identify the entity whose financial statements have been audited;
- (ii) State that the financial statements have been audited;
- (iii) Identify the title of each statement that comprises the financial statements;
- (iv) Refer to the summary of significant accounting policies and other explanatory information; and
- (v) Specify the date or period covered by each financial statement comprising the financial statements.

## Question 8

*State with reason (in short) whether the following statements are correct or incorrect.*

- (a) *Rajat, an auditor recovers his fees on progressive basis is said to be indebted to company.*
- (b) *The first auditor of PQR Ltd., a Government company was appointed by the board of directors of company.*
- (c) *Mr. 'R', a practicing Chartered Accountant, is appointed as a "Tax Consultant" of MN Ltd., in which his father Mr. 'C' is the managing director.*
- (d) *Deviation in accounting policies are to be reported in auditor's report.*
- (e) *Audit of Private Limited Companies are to be excluded while calculating ceiling on number of audits.* (2 Marks each, November, 2013)

## Answer

- (a) **Incorrect:** According to the Research Committee of the Institute, a question often arises as to whether indebtedness arises in cases where in accordance with the terms of his engagement by a client (e.g. resolution passed by the general meeting) the auditor recovers his fees on a progressive basis as and when a part of work is done without waiting for the completion of the whole job. Where in accordance with such terms, the auditor recovers his fees on a progressive basis, he cannot be said to be indebted to the company at any stage.

In view of the above, Rajat cannot be said to be indebted to the company.

- (b) **Incorrect:** In the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013 which states that the first auditors of a Government Company shall be appointed by the Comptroller and Auditor General of India.

Thus, the appointment of first auditor made by the Board of Directors of PQR Ltd., is null and void.

- (c) **Correct:** A chartered accountant appointed as an auditor of a company, should ensure the independence in respect of his appointment as an auditor, else it would amount to “misconduct” under the Chartered Accountants Act, 1949 read with Guidance Note on Independence of Auditors.

In this case, Mr R is a “Tax Consultant” and not a “Statutory Auditor” of MN Ltd., hence he is allowed to accept the appointment as consultant of the company.

- (d) **Incorrect:** It is not that all deviations in accounting policies be reported in the auditor’s report. Only those deviations in accounting policies are to be reported in the auditor’s report in respect of which proper disclosure regarding such deviations in the accounting policies have not been made.
- (e) **Incorrect:** As per section 141(3)(g) of the Companies Act, 2013, audit of Private Limited Companies are not excluded while calculating ceiling on number of audits.

#### Question 9

- (a) *What are the general considerations about the duties of an auditor that can be summarized on the basis of legal decisions taken by court so far?*

*(5 Marks, November, 2013)*

- (b) *Under what circumstances the retiring auditor can not be reappointed?*

*(6 Marks, November, 2013) (5 Marks, November, 2008)*

#### Answer

- (a) **General Considerations:** The statutory duties of the auditor cannot be limited in any way either by the Articles or by the directors or members but a company may extend them by passing a resolution at the general meeting or making a provision in the articles. [*Newton v. Birmingham Small Arms Co. Ltd.*]

An auditor is expected to determine the scope of his duties on a consideration of the nature of business carried on by the concern, provisions of the law that govern the organisation and the system of internal control in operation. Under the Companies Act, 2013, sub-sections (1), (2), (3) (4) and (11) of section 143 lays down scope of auditor’s duties. However, on taking into account the legal decisions in the cases which so far have been taken to courts, his duties and responsibilities can be summarised as follows-

- (i) To verify that the statements of account are drawn up on the basis of the books of the business: The auditor is not responsible for failure to disclose the affairs of the company kept out of the books and concealed from him which could not be known in the ordinary course of exercise of reasonable care and diligence. However, it is his duty to check the books for finding out that the position, as shown by the books of account, is true and substantially correct.
- (ii) To verify that the statements of account drawn up on the basis of the books exhibit a true and fair state of affairs of the business: The duty of the auditor is not limited to mere verification of the arithmetical accuracy of the statements of account. He must find out that these are substantially correct, having regard to provisions in the

Articles and the statute governing the business of the organisation under which it is being carried on.

- (iii) To confirm that the management has not exceeded the financial administrative powers vested in it by the Articles or by any specific resolution of the shareholders recorded at a general meeting.
  - (iv) To investigate matters in regard to which his suspicion is aroused as to the result of a certain action on the part of the servants of the company - He is, however, not required to start an audit with a suspicion or to prove in the manner of trying to detect a fraud or an irregularity unless some information has reached him which excites his suspicion or should arouse suspicion in a professional man of reasonable competence. This is because his duty is verification and not primarily detection of fraud.
  - (v) To perform his duties by exercising reasonable skill and care - For the verification of matters which are not capable of direct verification, he can rely on what he believes to be honest statements of the management. He must, however, review the verification of assets by the company and not rely merely on the statement made by the persons appointed by the company.
- (b) **Circumstances where Retiring Auditor cannot be Reappointed:** In the following circumstances, the retiring auditor cannot be reappointed-
- (i) A specific resolution has not been passed to reappoint the retiring auditor.
  - (ii) The auditor proposed to be reappointed does not possess the qualification prescribed under section 141 of the Companies Act, 2013.
  - (iii) The proposed auditor suffers from the disqualifications under section 141(3), 141(4) and 144 of the Companies Act, 2013.
  - (iv) He has given to the company notice in writing of his unwillingness to be reappointed.
  - (v) A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed.
  - (vi) A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 141(3)(g) of the Companies Act, 2013.

#### Question 10

*Comment on the following:*

- (a) *AGM is not held in time, auditor automatically vacates his office.*
- (b) *ABC Ltd. having turnover of ₹ 100 crores during financial year 2011-12, need not get its branch audited whose turnover is ₹ 1.5 crores during the same year.*
- (c) *CARO, 2004 does not apply to a foreign company. (2 Marks each, May, 2013)*

## Answer

- (a) **Tenure of Appointment:** Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting. But in this regard it is to be noted that the company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.

In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded. Therefore, auditor shall continue to hold office till the conclusion of the annual general meeting. Auditor's office is not vacated automatically if AGM is not held in time.

- (b) **Branch Audit:** As per section 143(8) of the Companies Act, 2013 if a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

Therefore, ABC Ltd. has to get its branch audited.

- (c) This question is redundant in view of the provisions of the Companies Act, 2013.

## Question 11

- (a) *State the circumstances which could lead to any of the following in an Auditor's Report:*

(i) *A modification of opinion*

(ii) *Disclaimer of opinion*

(iii) *Adverse opinion*

(iv) *Qualified opinion.*

*(4 x 2 = 8 Marks, May, 2013)*

- (b) *What are the cases in which special audit may be called by Central Government?*

*(4 Marks, May, 2013)*

## Answer

- (a) (i) **Modification of Opinion:** The auditor shall modify the opinion in the auditor's report when-

(a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

- (ii) **Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

- (iii) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

- (iv) **Qualified Opinion:** The auditor shall express a qualified opinion when-

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

- (b) This question is redundant in view of the provisions of the Companies Act, 2013.

## Question 12

*Discuss on the following:*

- (a) *Ceiling on number of audits in a company to be accepted by an auditor.*

*(5 Marks, November, 2012)*

- (b) *Filling of a casual vacancy of auditor in respect of a company audit.*

*(5 Marks, November, 2012)*

- (c) *In Joint Audit, "each Joint Auditor is responsible only for the work allocated to him".*

*(5 Marks, May, 2012)*

## Answer

- (a) **Ceiling on Number of Audits:** Section 141(3)(g) of the Companies Act, 2013 prescribes that a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies.

In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be  $3 \times 20 = 60$  company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

**(b) Filling of a Casual Vacancy:** As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-

(i) 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 30 days.

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 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

(ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

**(c) Responsibility of Joint Auditor:** The principles governing the responsibilities of joint auditors are prescribed in SA 299, "Responsibility of Joint Auditor". As per SA 299, if joint auditors are appointed, they should divide the audit work among themselves by mutual discussion. The division of work would usually be in terms of audit of identifiable units or specified areas. Such division of work should be adequately documented and preferably communicated to the entity.

It is the responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the area of work allocated to him. The issue such as appropriateness of using test checks, sampling or other audit techniques should be decided by each joint auditor individually in relation to his work. Thus, the responsibility will not be shared by the other auditor. Therefore, it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him.

Hence, in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. However, all the joint auditors are jointly and

severally responsible in respect of the audit work which is not divided among the joint auditors and is carried out by all of them, in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors, in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors, for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute and for ensuring that the audit report complies with the requirements of the relevant statute.

### Question 13

*State any six basic elements of the Auditor's Report.*

*(6 Marks, November, 2012)*

### Answer

**Basic Elements of the Auditor's Report:** As per SA 700 "Forming an Opinion and Reporting on Financial Statements", the auditor's report includes the following basic elements, ordinarily, in the following layout-

- (i) Title;
- (ii) Addressee;
- (iii) Introductory Paragraph;
- (vi) Management's Responsibility for the Financial Statements;
- (v) Auditor's Responsibility;
- (vi) Auditor's Opinion;
- (vii) Other Reporting Responsibilities;
- (viii) Signature of the Auditor;
- (ix) Date of Auditor's Report;
- (x) Place of signature.

### Question 14

*Write a short note on "Auditor's lien".*

*(4 Marks, November, 2012)*

### Answer

**Auditor's Lien:** In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property.

On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

Under section 128 of the Companies Act, 2013, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect

under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

SA 230 issued by ICAI on Audit Documentation also states that, "working papers are the property of the auditor". The auditor may at his discretion make portions of or extracts from his working papers available to his clients.

Thus, documents prepared by the professional accountant solely for the purpose of carrying out his duties as auditor (whether under statutory provisions or otherwise) belong to the professional accountant.

#### Question 15

- (a) *Discuss appointment of Auditor by special resolution.* (6 Marks, May, 2012)
- (b) *State the matters which only the shareholders can sanction at a General Meeting.* (4 Marks, May, 2012)

#### Answer

- (a) This question is redundant in view of the provisions of the Companies Act, 2013.
- (b) **Matters to be sanctioned only by the Shareholders:** Some of the matters which only the shareholders can sanction at a general meeting (List is not exhaustive)-
- (i) Appointment and fixation of remuneration of auditors in the annual general meeting - section 139 and 142 of the Companies Act, 2013.
  - (ii) Declaration of dividends.
  - (iii) Entering into transactions with related party for such company and exceeding such sum as prescribed in the rules [first proviso to section 188(1) of the Companies Act, 2013].
  - (iv) Sale, lease or a disposal of the whole of the company's undertaking or a substantial part of it [Section 180(1)(a)].
  - (v) Donations above certain limit [Section 181].

#### Question 16

*Discuss CARO 2003 requirement with regard to internal audit system. What are the factors to be considered by the auditor to examine whether the internal audit system is commensurate with the size of the company and the nature of its business?* (8 Marks, May, 2012)

#### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

#### Question 17

*Comment on "Removal of auditor before expiry of term".* (5 Marks, November, 2011)

## Answer

**Removal of Auditor before Expiry of Term:** According to 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 as per Rule 7 of Companies (Audit and Auditors) Rules, 2014-

- (i) The application to the Central Government for removal of auditor shall be 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.
- (ii) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- (iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

## Question 18

*What is Companies (Auditor's Report) Order 2003? Explain the companies which are not covered by the CARO order. (8 Marks, November, 2011)*

## Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

## Question 19

*Comment as an auditor on the following situations:*

- (a) *Government of India has appointed Mr. M, a retired Finance Director and a non-practising member of the Institute of Chartered Accountants of India, as an auditor to conduct special audit of ABC Ltd. on the ground that the company was not being managed on sound business principles. The Managing Director of the company contends that the appointment of Mr. M is not valid because he does not hold a certificate of practice.*
- (b) *Sri & Company, a firm of Chartered Accountants was appointed as statutory auditors of Aaradhana Company Ltd. Aaradhana Company Ltd. holds 51 % shares in Sarang Company Ltd. Mr. Sri, one of the partners of Sri & Company, owed ₹ 1,500 as on the date of appointment to Sarang Company Ltd. for goods purchased in normal course of business. (5 Marks each, November, 2010)*

## Answer

- (a) This question is redundant in view of the provisions of the Companies Act, 2013.
- (b) **Indebtness to the Subsidiary Company:** As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company,

for an amount exceeding ₹ 5,00,000/-, then he is not qualified for appointment as an auditor of a company.

Where an auditor purchases goods or services from a company audited by him or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, whether in normal course of business, he is definitely indebted to the company and if the amount outstanding exceeds ₹ 5,00,000, he is disqualified for appointment as an auditor of the company. In such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

In the given case, Sri & Company, a firm of Chartered Accountants was appointed as statutory auditors of Aaradhana Company Ltd. where the company holds 51% shares in Sarang Company Ltd. Mr. Sri, one of the partners of Sri & Company owed ₹ 1,500 as on the date of appointment to Sarang Company Ltd. for goods purchased.

Accordingly, the partner Mr Sri is not disqualified to be appointed as auditor of the company as he is indebted to the company for an amount not exceeding ₹ 5,00,000.

Due to this, Sri & Co., is not disqualified to be appointed as an auditor of Aaradhana Company Ltd.

#### Question 20

*Write a short note on "Physical verification of fixed assets "at reasonable intervals".*

*(4 Marks, November, 2010)*

#### Answer

**Physical Verification of Fixed Assets "at reasonable intervals":** Clause 3(i)(b) of CARO, 2015 requires the auditor to comment whether the fixed assets of the company have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

"Reasonable Intervals" depends upon the circumstances of each case. The factors to be considered in this regard includes the number of assets, nature of assets, relative value of assets, difficulty in verifications, situation and spread of the assets etc.

The management may decide about the periodicity of physical verification of fixed assets considering the above factors while an annually verification may be reasonable; it may impracticable to carry out the same in some cases. Even in such cases the verification program should be such that all assets are verified at least once in every three years where verification of all assets is not made during the year, it will be necessary for the auditor to report the fact, but if he is satisfied regarding the frequency of verification, he should also make a suitable comment to that affect.

The auditor is required to state whether any material discrepancies were noticed on verification and, if so, whether the same have been properly dealt with in the books of account.

It would be appropriate for the auditor to obtain a management representation letter confirming that the fixed assets are physically verified by the company in accordance with the policy of the company. The management representation letter should also mention the periodicity of the physical verification of fixed assets. The letter should also include the details of the material discrepancies noticed during the physical verification of the fixed assets. If no discrepancies were noticed during the physical verification, the management representation letter should also mention this fact.

#### **Question 21**

*State briefly the circumstances when an auditor issues a disclaimer of opinion.*

*(4 Marks, November, 2010)*

#### **Answer**

**Disclaimer of Opinion:** The auditor can express a disclaimer of opinion when the possible effect of a limitation on scope of the auditor's work is so material and pervasive that he has not been able to obtain sufficient and appropriate evidence and is accordingly unable to express an opinion on the financial statements. For example, when the books of account of the auditee company have been seized by Income tax/Excise authority, the auditor will be unable to express his opinion on the financial statements.

Similarly when the terms of engagement specify that the auditor will not carry out an audit procedure that the auditor believes necessary, the auditor may express disclaimer of opinion.

A scope of limitation may be imposed by circumstances, for example, when the timing of the auditor's appointment is such that he is unable to observe the counting of physical inventories.

It may also arise when in the opinion of the auditor the entity's accounting records are inadequate or when the auditor is unable to carryout an audit procedure believed to be desirable.

The resolution on certain matters dependent upon future events may also cause the auditor to make a disclaimer of opinion.

When there is a limitation on the scope of the auditor's work that requires disclaimer of opinion, the auditor's report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.

#### **Question 22**

*X Ltd. has its Registered Office at Mumbai. During the current accounting year it shifted its Corporate Office to Delhi. The Managing Director of the Company wants to shift company's books of account to Delhi because he holds the view that there is no legal bar in doing so. Comment.*

*(4 Marks, November, 2010)*

#### **Answer**

**Shifting of Books of Account:** As per section 128(1) of The Companies Act 2013, every company shall keep at its registered office proper books of accounts. It is permissible,

however, for all or any of the books of accounts to be kept at such place in India as the Board of Directors may decide but, when a decision in this regard is taken, the company must file within 7 days of such decision with the Registrar of Companies a notice in writing giving full address of the other place.

**Conclusion:** In view of the above provisions, X Ltd should maintain its books of account at its registered office at Mumbai. The Managing Director is not allowed to shift its books of account to Delhi unless decision in this behalf is taken by the Board of Directors and a notice is also given to the Registrar of Companies.

### Question 23

*PQR Company Ltd. removed their first auditor by passing a resolution in the meeting of the Board of Directors for his removal without obtaining prior approval from the Central Government. Offer your comments in this regard. (4 Marks, November, 2010)*

### Answer

**Removal of First Auditor:** As per sub-section (1) of Section 140 of the Companies Act, 2013, an 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 prior approval of the Central Government in that behalf as per Rule 7 prescribed under Companies (Audit & Auditors) Rules, 2014-

- (i) The application to the Central Government for removal of auditor shall be 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.
- (ii) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- (iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

In the instant case, the first auditor was removed by a resolution in the meeting of the Board of Directors inspite of the Special resolution of the Company as per the requirement of section 140(1) along with the prior approval of the Central Government in that behalf.

Therefore, it may be concluded that the action of the company for removal of the auditor before expiry of term is not justified and auditor may be removed from his office only by following the above mentioned procedure.

### Question 24

*State with reasons (in short) whether the following statements are True or False:*

- (i) *While conducting audit of Government Companies, the auditors are paid their Professional Fees as prescribed by the Government.*

- (ii) *Audit Committee is to be formed by each and every company and the auditor has no compulsion to attend the meeting of the Audit Committee.*
- (iii) *The auditor should study the Memorandum and Articles of Association to see the validity of his appointment.*
- (iv) *The company in which 15% of subscribed capital is held by State Financial Corporation and 10% of Subscribed capital is held by General Insurance Co., the appointment of auditor can be done by passing a general resolution at annual general meeting.*

*(2 Marks each, May, 2010)*

#### **Answer**

- (i) **False:** As per section 142(1) of the Companies Act, 2013, the fees of auditors of a company is fixed by the company in its general meeting or in such a manner as the company in general meeting may determine.
- (ii) **False:** As per section 177 of the Companies Act, 2013 read with the Companies (Meeting of Board and its Powers) Rules, 2014, audit committee is to be formed by every listed companies, all public companies with a paid up capital of ₹ 10 crore or more, all public companies having turnover of ₹ 100 crore or more, all public companies having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹ 50 crore or more. Further, the Auditor shall have the right to be heard in the meetings of the Audit Committee when it considers the Auditor's Report but shall not have the right to vote.
- (iii) **False:** Memorandum of Association lays down the object to be carried on and Articles of Associations reflects the regulations of the company to govern its internal management and to regulate the rights of the members. Auditor should ascertain whether the company has complied with provisions of section 139 and 140 to ensure validity of his appointment.
- (iv) This question is redundant in view of the provisions of the Companies Act, 2013.

#### **Question 25**

*Comment on the following situations:*

- (a) *Mr. Y was appointed as an auditor of PQR Ltd. for the year ended 31.3.2009 at Annual General Meeting held on 16.08.2008. Mr. Y has been indebted to the company for sum of ₹ 10,000 as on 1.4.2008, the opening date of accounting year which has been subject to his audit. However, Mr. Y having come to know that he might be appointed as auditor, he repaid the amount on 10.8.2008. One of the shareholders, complains that the appointment of Mr. Y as an auditor was invalid because he incurred disqualification u/s 226 of the Companies Act, 1956.*  
*(6 Marks, May, 2010)*
- (b) *XYZ (Pvt.) Ltd. has paid up Capital and Reserves of ₹ 60 lacs and secured Loans of Nationalized Banks having sanctioned limit of ₹ 28 lacs and outstanding balance of ₹ 23 lacs. The turnover of the company is 5.10 crores for the year ended 31.3.2009. A customer returns goods worth 40 lacs on 2.4.2009, out of sales made during the year*

ended 31.3.2009. The management of CO. is of the opinion that CARO, 2003 is not applicable to the company. (6 Marks, May, 2010)

- (c) C Ltd. declared dividend amounting to ₹ 5 lacs out of Profits for the year ended 31.3.2009.

Subsequently, it was noticed that company had failed to make provisions for outstanding expenses of ₹ 7.80 lacs and closing stock was also over valued, which was not reported by auditors of the company. Management of C Ltd. holds auditors responsible for this situation. (8 Marks, May, 2010)

#### Answer

- (a) This question is redundant in view of the provisions of the Companies Act, 2013.
- (b) This question is redundant in view of the provisions of the Companies Act, 2013.
- (c) **Failure to detect Untrue and Incorrect Financial Position of a Company:** In the given case, profit of the company has been inflated by non-provisioning of outstanding expenses of ₹ 7.80 lacs and by overvaluation of closing stock and based on such inflated profit the company has declared and paid dividend of ₹ 5.00 lacs. Thus it can be said that dividend has been paid out "inflated profit" and not out of "real profit". If there is insufficient profit after above adjustment of outstanding expenses and correction of stock valuation and there is no past reserve, it would amount to payment of dividend out of capital.

It was the duty of auditor to ascertain whether the Balance Sheet and Statement of Profit and Loss of the company show a true and fair view of the financial position and revenue earning capacity. For that he has to exercise proper audit procedure of substantive test (i.e. vouching and verification) and valuation of various items of Balance Sheet and Statement of Profit and Loss. The auditor should have checked whether all the outstanding expenses have been provided or not and whether closing stock has been properly valued as per AS-2. If he was not satisfied, he should have issued a qualified report or adverse report. In the instant case he has failed to do so, he will be guilty of gross negligence in the performance of his duty.

The facts of the case are similar to the established judgement on "**The Leeds Estate Building & Investment Co. Ltd vs Shepherd (1887)**", where, it was held, that it was an auditor's duty to ascertain that the accounts, he certifies, are correct and that if he fails in his duty, he is liable for damages for dividends wrongly paid by the company out of capital.

#### Question 26

*Differentiate between 'Qualified report' and 'Adverse report'.* (5 Marks, May, 2010)

#### Answer

##### Distinction between Qualified Report and Adverse Report

- (i) A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is

not so material and pervasive as to require a disclaimer of opinion. An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate, to disclose the misleading or incomplete nature of the financial statements.

- (ii) In qualified report, the auditor's reservation is generally written as "subject to or except for, we report that the Balance Sheet shows a true and fair view". Whereas in case of adverse report, the auditor states that "the financial statements do not present a true and fair view of the state of affairs and working results".
- (iii) In the qualified report, the auditor gives an opinion subject to certain reservations whereas in the case of adverse report the auditor concludes that on the basis of his examination he is not satisfied with the affirmation made in the financial statements.

### Question 27

*State with reasons (in short) whether the following statements are True or False:*

- (i) *A casual vacancy caused by resignation of the auditor can be filled by the Board of Directors.*
- (ii) *Comptroller and Auditor General of India can be removed by the Prime Minister of India on the recommendation of his Council of Ministers.*
- (iii) *Provisions of Companies (Auditor's Report) order 2003 as amended upto date, apply to clubs, chambers of commerce, research institutes etc, which have been established under Section 25 of the Companies Act, 1956.*
- (iv) *Mr. X, a Chartered Accountant, is an employee of M/s M & N Co., a firm of Chartered Accountants of India. The firm is the Auditors of ABC & Co. Ltd. After auditing the accounts of the Company the Auditor firm allowed Mr. X, their employee, to sign the audit report which he did.*
- (v) *The Auditor disagreed with the management with regard to the acceptability of the Accounting Policies and the inadequacy of disclosures in the financial statements and issued a disclaimer.* (2 Marks each, November, 2009)

### Answer

- (i) **False:** As per section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall be filled by the Board of Directors within 30 days. However, 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 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
- (ii) **False:** The Comptroller and Auditor General of India cannot be removed by the Prime Minister of India on the recommendation of his Council of Ministers. He can be removed on the ground of proven misbehaviour or incapacity, when each House of Parliament decides to do so by majority of not less than 2/3 of the members of the house present and voting.

- (iii) This question is redundant in view of the provisions of the Companies Act, 2013.
- (iv) **False:** An employee Chartered Accountant cannot sign the auditor's report on behalf of the auditing firm. Only a partner in the firm can sign the audit report in compliance with the provisions of Section 145 read with 141(2) of the Companies Act, 2013.
- (v) **False:** The auditor is wrong in issuing a disclaimer. If the auditor disagrees with the management in the matters relating to the acceptability of Accounting Policies selected and inadequacy of the disclosures in the financial statements, he should issue a qualified report or express an adverse opinion.

### Question 28

*Comment on the following situations:*

- (a) *XYZ Ltd. Co. gave a donation of ₹ 50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2009. The average net profits of the company for the last three years were 15 lakhs.*  
(8 Marks, November, 2009)
- (b) *Mr. X, a shareholder of the company pointed out that:*
  - (i) *The goodwill in the Balance Sheet of the company has appeared on same figure during the past three years.*
  - (ii) *Premium received on issue of shares prior to the date of balance sheet has been transferred to Profit and Loss account for arriving at the figure of commission payable to the managing director.* (6 Marks, November, 2009)
- (c) *A, B & C Company Ltd. removed its first Auditor before the expiry of his term without obtaining approval of the Central Government.* (6 Marks, November, 2009)

### Answer

- (a) **Donation to Charitable Institutions:** Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent of its average net profits for the three immediately preceding financial years.

In the instant case, the company has given donation of ₹ 50,000 each to the two charitable organisations which amounts to ₹ 1,00,000. Assuming that the charitable organisations are not related to the business of the company, the average profits of the last 3 years is ₹ 15 lakhs and the 5% of this works out to ₹ 75,000. Hence the maximum of donation could be ₹ 75,000 only. For excess of ₹ 25,000 the company is required to take prior permission in general meeting which is not been taken.

Conclusion: By paying donations of ₹ 1,00,000 which is more than ₹ 75,000, the Board has contravened the provisions of Section 181 of the Companies Act, 2013. Hence, the auditor should qualify his audit report accordingly.

- (b) (i) **Disclosure of Intangible Assets in the Books of Accounts:** As per the provisions of AS 26 "Intangible Assets", an intangible assets should be carried in the books at cost less accumulated amortization and accumulated impairment losses. The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a reputable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use according to Para 63 of AS 26. In the given case, the company has not amortized any value of goodwill since past three years. The auditor should have indicated this fact in his report that no amount of goodwill has been written off during the past three years.
- (ii) **Treatment of Premium received on issue of Shares:** Premium received on issue of shares is capital receipt and should not credited to Statements of Profit and Loss. As per the provisions of Section 198 of the Companies Act, 2013, premium on issue of shares should not be considered in computation of net profit for the purpose of managerial remuneration. The auditor should have qualified the audit report and qualified the amount by which the profit stands inflated.
- (c) **Removal of First Auditor:** As per sub-section (1) of Section 140 of the Companies Act, 2013, an 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 prior approval of the Central Government in that behalf as per Rule 7 prescribed under Companies (Audit & Auditors) Rules, 2014-
- (i) The application to the Central Government for removal of auditor shall be 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.
- (ii) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- (iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

**Conclusion:** In the instant case, the first auditor was removed by the company before the expiry of his term without obtaining approval of the Central Government inspite of the Special resolution as per the requirement of section 140(1) along with the prior approval of the Central Government in that behalf.

Therefore, it may be concluded that the action of the company for removal of the auditor before expiry of term is not justified and auditor may be removed from his office only by following the above mentioned procedure.

#### Question 29

*XYZ Co. Ltd. reappointed A and B as their joint auditors in the Annual General Meeting. The AGM authorised the Board for fill up the vacancy on their own in the event of both or either of*

*auditors declined to accept the assignment. The Board passed a resolution to appoint C if any of the auditors declined to accept the assignment.*

*B declined to accept the assignment and Board of Directors appointed C in place of B as per its resolution. Comment.* (5 Marks, November, 2009)

#### **Answer**

This question is redundant in view of provisions of the Companies Act, 2013.

#### **Question 30**

*State with reasons (in short) whether the following statements are True or False:*

- (i) An auditor of a company in which not less than 25% of authorized capital is held by public financial institution is to be appointed by a special resolution in general meeting.*
- (ii) Disclaimer of opinion is issued when an auditor confronts a different stand by management in respect of a material issue which auditor does not approve of.*

*(2 Marks each, June, 2009)*

#### **Answer**

- (i) False:** The auditor's appointment of such company should be made as per the provisions of the section 139(1) of the Companies Act, 2013 i.e. Appointment of Auditor which does not require the special resolution in general meeting.
- (ii) False:** Disclaimer of opinion is issued when the auditor is unable to frame an opinion in view of certain reasons like non-availability of information, non-performance of procedure etc. Where the auditor is positively in disagreement with management on certain issue, he would issue qualified report.

#### **Question 31**

*P, the first auditor of XYZ Ltd. resigned as auditors of the Co. Board of Directors appointed Mr. Q as statutory auditors in their place. Comment.* (6 Marks, June, 2009)

#### **Answer**

**Casual Vacancy on account of Resignation:** As per Section 139(8) of the Companies Act, 2013, in case the casual vacancy created on account of resignation, the Board of Directors will have to fill the vacancy within 30 days and such appointment shall be approved by the company at the general meeting within 3 months of the recommendations of the board. The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting.

Therefore, the casual vacancy created on account of resignation by Mr. P, cannot be filled in by the Board of Directors itself, such appointment shall also be approved by the company at general meeting convened within 3 months of the recommendation of the board.

#### **Question 32**

*Write a short note on "Responsibilities of Joint auditors".* (5 Marks, June, 2009)

## Answer

**Responsibilities of Joint Auditors:** SA 299 on Responsibilities of Joint Auditors, require that joint auditors should by mutual discussion divide the audit work among themselves. It further states that each joint auditor is responsible only for the work allocated to him, whether or not he has prepared separate report on the work performed by him.

On the other hand, all joint auditors are jointly and severally responsible:

- (i) in respect of the work which is not divided among joint auditors and is carried out by all of them;
- (ii) in respect of decision taken by all joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;
- (iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
- (v) for ensuring that the audit report complies with requirements of the statute.

## Question 33

*State with reasons (in short) whether the following statements are True or False:*

- (i) *The auditor of a company is entitled to attend any General Meeting of the company as his duty.*
- (ii) *An Auditor may be removed from Office before the expiry of his term, by the company in General Meeting.*
- (iii) *C.A. Mr. X is the Auditor of PQ Ltd. in which one of his relative is having substantial interest, whether Mr. X is qualified to be an Auditor? (2 Marks each, November, 2008)*

## Answer

- (i) **True:** As per Section 146 of the Companies Act, 2013, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.
- (ii) **False:** As per Section 140(1) of the Companies Act, 2013, the auditor may be removed from the office before the expiry of his term by the company only by a special resolution and obtaining the prior approval of the Central Government.
- (iii) **False:** CA Mr. X is not qualified to be an auditor of PQ Ltd. as he would be held guilty of misconduct if he expresses his opinion on financial statements of any business in which his relative has a substantial interest as per the Chartered Accountants Act, 1949.

## Question 34

*Write short notes on the following:*

- (i) *Disclaimer of Opinion.* (5 Marks, November, 2008)
- (ii) *Joint Audit.* (5 Marks, November, 2008)

## Answer

- (i) **Disclaimer of Opinion:** As per SA 500 "Audit Evidence", the auditor must collect sufficient and appropriate audit evidence, on the basis of which he draws his conclusion to form an opinion, on the financial statements. But, if the auditor fails to obtain sufficient information to form an overall opinion on the matter contained in the financial statements, he issues a disclaimer of opinion.

The reasons due to which the auditor is not able to collect the audit evidence are:

- (i) Scope of audit is restricted.
- (ii) The auditor may not have access to the books of accounts, e.g.-
  - (a) Books of A/c's of the company seized by IT authorities.
  - (b) Sometimes, inventory verifications at locations outside the city bound the scope of duties of the auditor.

In such a case, the auditor must state in his audit report that-

"He is unable to express an opinion because he has not been able to obtain sufficient and appropriate audit evidence to form an opinion".

- (ii) **Joint Audit:** The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work.

With a view to providing a clear idea of the professional responsibility undertaken by the joint auditors, the Institute of Chartered Accountants of India had issued a statement on the Responsibility of Joint Auditors which now stands withdrawn with the issuance of SA 299, "Responsibility of Joint Auditors" w.e.f. April, 1996. It requires that where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of work would usually be in terms of audit of identifiable units or specified areas. In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time. Certain areas of work, owing to their importance or owing to the nature of the work involved, would often not be divided and would be covered by all the joint auditors. Further, it states that in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible-

- (a) In respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (b) In respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;

- (c) In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (d) For examining that the financial statements of the entity comply with the disclosure requirement of relevant statute; and
- (e) For ensuring that the audit report complies with the requirements of the relevant statute.

### Question 35

*State with reasons (in short) whether the following statements are True or False:*

- (i) *An auditor can be appointed as first auditor of a newly formed company simply because his name has been stated in the Articles of Association.*
- (ii) *CARO '2004 is also applicable to the audit of branch of a company, except where the company is exempt from the applicability of the order.*
- (iii) *All the joint auditors are jointly and severally responsible for the work, which is not divided and carried on jointly by all the joint auditors. (2 Marks each, May, 2008)*

### Answer

- (i) **False:** As per Section 139(6) of the Companies Act, 2013, first auditor of a newly formed company is to be appointed by the BOD within 30 days from the date of registration of the company. An auditor cannot be appointed as first auditor simply because his name has been stated in the articles of association.
- (ii) This question is redundant in view of the provisions of the Companies Act, 2013.
- (iii) **True:** As per SA 299 on "Responsibility of Joint Auditors", all the joint auditors are jointly and severally responsible for the audit work which is not divided and carried on jointly by all the joint auditors.

### Question 36

*When does an auditor issue unqualified opinion and what does it indicate? (4 Marks, May 2008)*

### Answer

**Unqualified Opinion:** The auditor should express an unqualified opinion when he concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for preparation and presentation of the financial statements.

An unqualified opinion indicates that-

- (i) The financial statements have been prepared using the generally accepted accounting principles and being constantly followed.
- (ii) The financial statements comply with relevant statutory requirements and regulations.
- (iii) All material matters relevant to proper presentation of the financial information, subject to statutory requirement, if applicable, have been adequately disclosed.

### Question 37

State with reasons (in short) whether the following statements are True or False:

- (i) The first auditor appointed by the board of directors can be removed by the board at its subsequent meeting.
- (ii) Internal auditor of the company cannot also be its cost auditor.
- (iii) Where the accounts of the company do not present a "true and fair" view, the auditor should express disclaimer of opinion.
- (iv) Government companies are also to be considered for the ceiling on number of audits.
- (v) If appointment of a person as an auditor is void-ab-initio, it should be treated as a casual vacancy.
- (vi) A company running a departmental store and having total turnover of ₹ 100 crores during the financial year 2006-07, need not get its branch audited whose turnover is ₹ 1.90 crores during the same year. (2 Marks each, November, 2007)

### Answer

- (i) **False:** According to 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 as per Rule 7 of Companies (Audit and Auditors) Rules, 2014.
- (ii) **True:** As per notification issued by the DCA, cost auditor should not be the internal auditor of a company for the period for which he is conducting the cost audit. If the cost auditor is also the internal auditor, he would not be able to discharge his duties properly.
- (iii) **False:** An adverse opinion is appropriate where the reservations or the objections are so substantial that he feels that the accounts do not give a true and fair view. In this situation the auditor should give an adverse or negative opinion only.
- (iv) **True:** As per section 141(3)(g) of the Companies Act, 2013, government companies will be considered for ceiling on number of audits.
- (v) **False:** If appointment of a person as an auditor is void-ab-initio, it should not be treated as a casual vacancy, rather the existing auditor shall continue to be the auditor of the company u/s 139(10) of the Companies Act, 2013.
- (vi) **False:** As per section 143(8) of the Companies Act, 2013, if a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139. Therefore, branch audit is required.

### Question 38

State the circumstances under which special audit may be called under Section 233A of the Companies Act, 1956. (3 Marks, November, 2007)

### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

### Question 39

*State with reasons (in short) whether the following statements are True or False:*

- (i) *Auditor's lien on his client's books and record is not unconditional.*
- (ii) *An adverse report is one where an auditor gives an opinion subject to certain reservation.*
- (iii) *CARO, 2003 does not applies to a Foreign company.*
- (iv) *If the auditor appointed at the AGM refuses to accept the same, the Company can appoint another person by holding General Meeting. (2 Marks each, May, 2007)*

### Answer

- (i) **True:** The auditor can exercise his lien on client's books and records subject to the following conditions-
  - (a) Document retained must belong to the client who owes the money.
  - (b) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
  - (c) The auditor can retain the documents only if he has done work on the documents assigned to him.
  - (d) Such of the documents can be retained which are connected with the work on which fees have not been paid.
- (ii) **False:** An adverse report is given when the auditor concludes that based on his examination he does not agree with the affirmation made in the financial statements.
- (iii) This question is redundant in view of the provisions of the Companies Act, 2013.
- (iv) **False:** This is not a casual vacancy. Since the newly appointed auditor has refused to accept the appointment, no appointment can be said to have been made at the AGM. Therefore, as per Section 139(10) of the Companies Act, 2013, the existing auditor shall continue to be the auditor of the company.

### Question 40

*State the basic elements of the Auditor's Report with illustration of Opening and opinion paragraphs. (7 Marks, May, 2007)*

### Answer

The question is redundant in view of change in Auditor's Report Format and Standard on Auditing.

#### Question 41

*Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director.* (4 Marks, November, 2006)

#### Answer

**Appointment of First Auditor of Company:** Section 139(6) of the Companies Act, 2013 (the Act) lays down that "the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company". In the instant case, the appointment of Shri Ganpati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within 1 month of registration of the company.

In view of the above, the Managing Director of PQR Ltd should be advised not to appoint the first auditor of the company.

#### Question 42

*PBS & Associates, a firm of Chartered Accountants, has three partners P, B and S. The firm is already having audit of 60 companies, which includes 2 branch audits of a company. The firm is offered 3 company audits, out of which one is a private company, other is a foreign company and the third one is a public company. Decide and advise whether PBS & Associates will exceed the ceiling prescribed under Section 224(1B) by accepting the above audit assignments?* (4 Marks, November, 2006)

#### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

#### Question 43

*Explain the scope paragraph of auditors Report.* (8 Marks, November, 2006)

#### Answer

**Scope Paragraph:** As per "SA 700 Forming an Opinion and Reporting on Financial Statements", a description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes-

- A reference to Standards on Auditing and the law or regulation; and
- A description of an audit in accordance with those Standards;

Therefore, the auditor's report should prescribe the scope of the audit by stating that the audit was conducted in accordance with auditing standards generally accepted in India. The Engagement and Quality Control Standards issued by ICAI establish the auditing standards generally accepted in India. The reader needs this as an assurance that the audit has been carried out in accordance with such established standards. Scope means auditor's ability to perform audit procedures deemed necessary in the circumstances.

#### Question 44

*Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term?*  
(4 Marks, November, 2006)

#### Answer

**Permission of Central Government for Removal of Auditor under section 140(1) of the Companies Act, 2013:** Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence.

Further, in case of conflict of interest the shareholders may remove the auditors in their own interest.

Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval.

On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention.

In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term.

#### Question 45

*X Ltd., to whom Companies (Auditor's Report) Order, 2003 is applicable, has issued 9% Debenture of ₹ 5 crores, redeemable after 5 years and used the proceeds of issue for payment of Sundry Creditors and other Current Liabilities of ₹ 2.80 crores. As an auditor, comment.*

(5 Marks, May, 2006)

#### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

#### Question 46

*Give your comments on the following:*

(a) *Mr. X, a Director of M/s KP Private Ltd., is also a Director of another company viz., M/s GP Private Ltd., which has not filed the annual accounts and annual return for last three years 2002-03 to 2004-05. Mr. X is of the opinion that he is not disqualified u/s 274(1)(g) of the Companies Act, 1956, and auditor should not mention disqualification remark in his audit report.*  
(5 Marks, May, 2006)

(b) *Mr. Aditya, a practising chartered accountant is appointed as a "Tax Consultant" of ABC Ltd., in which his father Mr. Singhvi is the Managing Director.*  
(4 Marks, May, 2006)

(c) *You have been appointed the sole auditor of a company where you were one of the joint auditors for the immediately preceding year and the said joint auditors is not re-appointed.*

(4 Marks, May, 2006)

- (d) *No Annual General Meeting (AGM) was held for the year ended 31st March, 2005, in XYZ Ltd., Ninu is the auditor for the previous year, whether she is continuing to hold office for current year or not.* (3 Marks, May, 2006)

**Answer**

- (a) This question is redundant in view of the provisions of the Companies Act, 2013.
- (b) **Appointment of a Practising CA as 'Tax Consultant':** A chartered accountant appointed as an auditor of a company, should ensure the independence in respect of his appointment as an auditor, else it would amount to "misconduct" under the Chartered Accountants Act, 1949 read with Guidance Note on Independence of Auditors.

In this case, Mr. Aditya is a "Tax Consultant" and not a "Statutory Auditor" of ABC Ltd., hence he is not subject to the above requirements.

- (c) **Appointment of Sole Auditor:** When one of the joint auditors of the previous years is considered for ratification by the members as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors. As per sub-section 4 of section 140 of the Companies Act, 2013, special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

Accordingly, provisions of the Companies Act, 2013 to be complied with are as under:

- (i) Ascertain that special notice u/s 140(4) of the Companies Act, 2013 was received by the company from such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than ₹ 5 lakh has been paid up on the date of the notice not earlier than 3 months but at least 14 days before the AGM date as per Section 115 of the Companies Act, 2013 read with rule 23(1) and 23(2) of the Companies (Management and Administration) Rules, 2014.
  - (ii) Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per Section 115 of the Companies Act, 2013 read with rule 23(3) of the Companies (Management and Administration) Rules, 2014.
  - (iii) Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.
  - (iv) The notice is also sent to the retiring auditor as per Section 140(4)(ii) of the Companies Act, 2013.
  - (v) Verify whether any representation, received from the retiring auditor was sent to the members of the company.
  - (vi) Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.
- (d) **Tenure of Appointment:** Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an

auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting. But in this regard it is to be noted that the company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.

In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded. Therefore, Ninu shall continue to hold office till the conclusion of the annual general meeting.

#### Question 47

*Write a short note on "Statutory Report of a Public Company under section 165(4)".*

*(4 Marks, May, 2006)*

#### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

#### Question 48

*Mr. A was appointed auditor of AAS Ltd. by Board to fill the casual vacancy that arose due to death of the auditor originally appointed in AGM. Subsequently, Mr. A also resigned on health grounds during the tenure of appointment. The Board filled this vacancy by appointing you through duly passed Board resolution. As an auditor, comment. (4 Marks, November, 2005)*

#### Answer

**Filling of a Casual Vacancy:** Section 139(8) of the Companies Act, 2013 provides that any casual vacancy in the office of an auditor shall be filled by the Board of Directors within 30 days. However, 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 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

In the present case, the auditor Mr. A resigned and the vacancy had been filled in by Board. But, the vacancy caused by resignation cannot be filled by Board itself, such appointment shall also be approved by the company at general meeting.

The fact that Mr. A was appointed by Board originally is a matter irrelevant in this situation. If the cause of vacancy is resignation, then the power of appointment shall vest with the general meeting only. As such, the appointment made by Board is invalid.

#### Question 49

*The auditors of ABC Ltd. issued a qualified opinion about the truth and fairness of the accounts of the company for the year ended 31.3.2005. They typed out the matters of qualifications in a bold font so as to invite the attention of the readers to them. The Board objected to it and required them to be typed out in the same normal font as other paragraphs of the report appear. Comment. (5 Marks, November, 2005)*

## Answer

**Qualified Report:** It is duty of the auditor to state the reason for qualification or negative report as per sub-section 4 of section 143 of the Companies Act, 2013. As per section 143 (4) where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons there for. It hardly matters that such qualifications are given in bold or normal font but it is important to provide the reason for.

Further, according to ICAI, this requirement does not in any way extent the scope of audit. It requires the auditor to evaluate his qualifications and make a judgement regarding which of them deal with matters that may have an adverse effect on the functioning of the company. Since auditor is of the view that such qualifications need to be highlighted in bold in conformity with the provisions of the set, the management has no right to object on the same.

## Question 50

*State the matters to be specified in Auditor's Report in terms of provisions of Section 227(3) of the Companies Act, 1956. (8 Marks, November, 2005)*

## Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

## Question 51

*As an auditor, comment on the following situations/statements:*

(a) *A Ltd. has its Registered Office at New Delhi. During the current accounting year, it has shifted its Corporate Head Office to Indore though it has retained the Registered Office at New Delhi. The Managing Director of the Company wants to shift its books of account to Indore from New Delhi, as he feels that there is no legal bar in doing so.*

*(4 Marks, May, 2005)*

(b) *The Board of Directors of a company have filed a complaint with the Institute of Chartered Accountants of India against their statutory auditors for their failing to attend the Annual General Meeting of the Shareholders in which audited accounts were considered.*

*(5 Marks, May, 2005)*

(c) *The auditor of a company wanted to see the minutes book of Directors meetings. The Chairman of the company refused for the same on the ground that matters of confidential nature were contained therein.*

*(5 Marks, May, 2005)*

## Answer

(a) **Shifting of Books of Account:** As per section 128(1) of The Companies Act 2013, every company shall keep at its registered office proper books of accounts. It is permissible, however, for all or any of the books of accounts to be kept at such place in India as the Board of Directors may decide but, when a decision in this regard is taken, the company must file within 7 days of such decision with the Registrar of Companies a notice in writing giving full address of the other place.

In view of the above provisions, A Ltd should maintain its books of account at its registered office at New Delhi. The Managing Director is not allowed to shift its books of account to Indore unless decision in this behalf is taken by the Board of Directors and a notice is also given to the Registrar of Companies within the specified time. The auditor may accordingly, inform the Managing Director that his contention is not in accordance with the legal provisions.

- (b) **Auditor's Attendance at Annual General Meeting:** As per Section 146 of the Companies Act, 2013, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

In the instant case, the Board of Directors of a company have filed a complaint with the Institute of Chartered Accountants of India against their statutory auditors for their failing to attend the Annual General Meeting of the Shareholders in which audited accounts were considered.

In view of above discussed provisions of section 146, the statutory auditor of the company should attend the general meetings either through himself or through his authorised representative.

- (c) **Right of Access to Board's Minutes:** Under Section 143(1) of the Companies Act, 2013, the auditor of a company has the right of access at all times to books of account and vouchers of the company, whether kept at the registered office of the company or elsewhere.

Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties as Auditor. Therefore, he has a statutory right to inspect the directors' minute book.

In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company.

It is, therefore, essential for the auditor to refer to the Minute Books. In the absence of the Minute Books, the auditor may not be able to vouch/verify certain transactions of the company.

Therefore, the refusal by Chairman to provide access to Directors' Minutes Book shall constitute limitation of scope as far as the auditor's duties are concerned. The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion.

#### **Question 52**

*Give your comment on "The Central Government has appointed Mr. Sushil, a retired Finance Director of a reputed company, a non-practising member of ICAI, as a special auditor of MM Ltd., on the ground that the company was not being managed on sound business principles.*

*Mr. Ajay, MD of MM Ltd. feels, that the appointment of Mr. Sushil is not valid as he does not hold a certificate of practice".* (5 Marks, May, 2005)

**Answer**

This question is redundant in view of the provisions of the Companies Act, 2013.

**Question 53**

*What categories of Companies are specifically exempted from the application of Companies (Auditor's Report) Order, 2003?* (8 Marks, May, 2005)

**Answer**

This question is redundant in view of the provisions of the Companies Act, 2013.

**Question 54**

*Explain the term "Auditor's Lien".* (8 Marks, May, 2005)

**Answer**

**Auditor's Lien:** In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property.

On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions-

- (i) Documents retained must belong to the client who owes the money.
- (ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
- (iii) The auditor can retain the documents only if he has done work on the documents assigned to him.
- (iv) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under section 128 of the Companies Act, 2013, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

Further, as per SA 230 "Audit Documentation", "working papers are the property of the auditor". The auditor may at his discretion make portions of or extracts from his working papers available to his clients.

Thus, documents prepared by the professional accountant solely for the purpose of carrying out his duties as auditor (whether under statutory provisions or otherwise) belong to the professional accountant.

In the case of *Chantrey Martin and Co. v. Martin*, it was held that the following documents were the property of the auditor: working papers and schedules relating to the audit, draft accounts of the company, and the draft tax computation prepared by an employee of the auditor.

It is also clear that the accountant's correspondence with his client (letters written by the client to the accountant and copies of the letters written by the accountant to the client) belong to the accountant. In the case of *Chantrey Martin and Co. v. Martin*, it was also held that the correspondence between the accountant and the taxation authorities with regard to the client's accounts and tax computations was the property of the client since the accountant merely acted as agent of the client.

However, where the accountant communicates with third parties not as an agent, but as a professional man, e.g., as an auditor, the correspondence with third parties would seem to belong to the accountant. According to the statement, where an auditor obtains documents confirming the bank balance or confirming the custody of securities of the client or other similar documents, it is probable that the courts would hold that these documents belong to the auditor.

#### **Question 55**

*Write a short note on "Cost Audit".*

*(4 Marks, May, 2005)*

#### **Answer**

**Cost Audit:** Cost Audit is covered by Section 148 of the Companies Act, 2013. The audit conducted under this section shall be in addition to the audit conducted under section 143 of the Companies Act, 2013.

As per the section 148 the Central Government may by order specify audit of items of cost in respect of certain companies.

The audit shall be conducted by a Cost Accountant in Practice who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed.

No person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

The auditor conducting the cost audit shall comply with the cost auditing standards ("cost auditing standards" mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government).

The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter X of the Companies Act, 2013 shall, so far as may be applicable, apply to a cost

auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

The report on the audit of cost records shall be submitted to the Board of Directors of the company and company shall within 30 days from the date of receipt of a copy of the cost audit report prepared furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

#### Question 56

- (a) *E and S were appointed as Joint Auditors of X and Y Ltd. What will be their professional responsibility in a case where the company has cleverly concealed certain transactions that escaped the notice of both the Auditors.* (5 Marks, November, 2004)
- (b) *Aakansha is a member of the Institute of Chartered Accountants of England and Wales. Is she qualified to be appointed as auditor of Indian Companies?* (2 Marks, November, 2004)
- (c) *Preksha, a member of the ICAI, does not hold a Certificate of practice. Is her appointment as an auditor valid?* (4 Marks, November, 2004)
- (d) *'B' owes ₹ 1001 to 'C' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses?* (4 Marks, November, 2004)

#### Answer

- (a) **Responsibilities of Joint Auditors:** In conducting a joint audit, the auditor(s) should bear in mind the possibility of existence of any fraud or error or any other irregularities in the accounts under audit. The principles laid down in SA 200, SA 240 and SA 299 need to be read together for arriving at any conclusion. The principle of joint audit involves that each auditor is entitled to assume that other joint auditor has carried out his part of work properly. However, in this case, if it can be assumed that the joint auditors E and S have exercised reasonable care and skill in auditing the accounts of X & Y Ltd. and yet the concealment of transaction has taken place, both joint auditors cannot be held responsible for professional negligence. However, if such concealment could have been discovered by the exercise of reasonable care and skill, the auditors would be responsible for professional negligence. Therefore, it has to be seen that while dividing the work, the joint auditors have not left any area unattended and exercised reasonable care and skill while doing their work.
- (b) **Qualification for Appointment as an Auditor:** Aakansha, a member of the Institute of Chartered Accountants in England and Wales is not qualified to be appointed as an auditor of a limited company in India, since she is not a chartered accountant within the meaning of the Chartered Accountants Act, 1949 and hence not a member of the Institute of Chartered Accountants of India. Because as per the Chartered Accountants Act, 1949, a person must be a member of the Institute and holds certificate of practice. However, as it appears from the facts given in the case, Aakansha is not a member of the Institute of

Chartered Accountants of India and, thus, is not qualified to audit companies under the Companies Act, 2013.

- (c) **Qualifications of an Auditor:** A person shall be qualified for appointment as an auditor of a company, only if one is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, only a chartered accountant holding the certificate of practice can engage in public practice.

In the instant case, Preksha does not hold a certificate of practice, hence, she cannot be appointed as an auditor of a company.

- (d) **Indebtedness to the Company:** As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, for an amount exceeding ₹ 5,00,000 then he is not qualified for appointment as an auditor of a company. Accordingly, B's appointment is valid and he is not disqualified as the amount of debt does not exceeds ₹ 5,00,000. No, it will not make any difference, if the advance is taken for meeting-out travelling expenses as the amount is within the prescribed limit.

#### Question 57

*Explain the various types of companies under Companies (Auditor's Report) Order, 2003 (CARO). (8 Marks, November, 2004)*

#### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

#### Question 58

*Write a short note on "Audit enquiry under Section 227(1A)". (4 Marks, November, 2004)*

#### Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

#### Question 59

*Give your comments on the following:*

- (a) *PQR & Co. a firm of Chartered Accountants has three partners, P, Q and R; P is also in whole time employment elsewhere. The firm is already holding audit of 40 companies including audit of one foreign company. The firm is offered the audit of Z Ltd. and its 20 branches. (5 Marks, May, 2004)*
- (b) *Nene and Sane Associates, Chartered Accountants in practice have been appointed as statutory auditor of Do Good Ltd. for the accounting year 2003-04. Mr. Nene holds 200 equity shares of DDA Ltd. a subsidiary company of Do Good Ltd. (5 Marks, May, 2004)*
- (c) *White Star Ltd. was incorporated on 1.8.2013 and Mr. T who is related to the Chairman of the Company appointed as auditor by the Board of Directors in their meeting on 4.9.2013.*

*(4 Marks, May, 2004)*

## Answer

- (a) **Ceiling on Number of Company Audits:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies.

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be  $3 \times 20 = 60$  company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

In the given case of PQR & Co., P is in whole-time employment elsewhere. Hence he will be excluded in determining the number of company audits that the firm can hold. If Q and R do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by PQR & Co. is  $20 \times 2 = 40$  and in the given case, the firm is already holding 40 audits. Therefore, PQR & Co. cannot accept audit of Z Ltd. and its 20 branches as per section 141(3)(g) of the Companies Act, 2013.

- (b) **Auditor holding Securities of a Company:** As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. It is provided that the relative may hold security or interest in the company of face value not exceeding ₹ 1 lakh.

Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

In the present case, Mr. Nene, Chartered Accountant, a partner of M/s Nene and Sane Associates, holds 200 equity shares of DDA Ltd. which is a subsidiary of Do Good Ltd. Therefore, the firm, M/s Nene and Sane Associates would be disqualified to be appointed as statutory auditor of Do Good Ltd., which is the holding company of DDA Ltd., because one of the partner Mr. Nene is holding equity shares of its subsidiary.

- (c) **Appointment of First Auditors:** Apparently, there are two issues arising out of this situation, viz., first one relates to appointment of first auditor by the Board of Directors; and second, pertains to relation of such auditor with the Chairman of the company. Regarding the first issue relating to appointment of auditor, particularly, in this case relating to appointment of first auditors, it may be noted as per the provisions of Section

139(6) of the Companies Act, 2013, the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. As per the facts given in the case, the Board has failed to appoint the first auditor within 30 days from the registration of company because the date of incorporation of White Star Ltd. is 1-8-2013 and the date of appointment of auditors by the Board of Directors is 4-9-2013. Accordingly, if the Board fails to appoint the first auditor, it shall inform the members of the company, who shall within 90 days at an extraordinary general meeting has to make the appointment. Thus, the appointment of Mr. T is not valid. Under the circumstances, the second issue relating to relationship of auditor with the Chairman becomes redundant.

**Question 60**

*Draft an illustrative Audit Report u/s 227 of the Companies Act, 1956, with a few qualifications. Annexure u/s 227(4A) is not required. (16 Marks, May, 2004)*

**Answer**

This question is redundant in view of the provisions of the Companies Act, 2013.