

Question 1

Comment on the following situations:

- (a) An auditor purchased goods worth ₹ 501,500 on credit from a company being audited by him. The company allowed him one month's credit, which it normally allowed to all known customers.
- (b) KBC & Co. a firm of Chartered Accountants has three partners, namely, Mr. K, Mr. B & Mr. C. Mr. K is also in whole time employment elsewhere and Mr. B & Mr. C. do not hold any audits in their personal capacity or as partners of other firms. The firm is offered the audit of a public company 'ABC Ltd.' and is already holding audit of 40 companies.

Answer

- (a) **Purchase of Goods on Credit by the Auditor:** Section 141(3)(d)(ii) of the Companies Act, 2013 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding five lakh rupees.

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees five lakh, he is disqualified for appointment as an auditor of the company.

It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

- (b) **Ceiling on Number of Company Audits:** Section 141(3)(g) of the Companies Act, 2013 states that the following persons shall not be eligible for appointment as an auditor of a company i.e. 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 *other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.*

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In the given case, Mr. K, a partner in the firm KBC & Co., is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. As Mr. B and Mr. C 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 KBC & Co. is 40 *other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore*, and in the given case company is already holding 40 audits, therefore, KBC & Co. can't accept the offer for audit of a public company 'ABC Ltd.'

Question 2

At the AGM of ICI (P) Ltd., Mr. X was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to give up practice and join industry. State, how the new auditor will be appointed by ICI (P) Ltd. and the conditions to be complied for.

Answer

Appointment of New Auditor in Case of Resignation: Section 139(8) of the Companies Act, 2013 deal with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g., death, disqualification, resignation, etc.

The section provides that a casual vacancy shall be filled by the Board of Directors within 30 days. However, in case a casual vacancy has been created by the resignation of the auditor, the Board cannot fill in that vacancy itself, such appointment shall also be approved by the company at general meeting convened within 3 months of the recommendation of the board and then he shall hold office till the conclusion of the next annual general meeting.

In the instance case, Mr. X had been validly appointed and thereafter he had resigned. Consequently, the casual vacancy has been created on account of resignation.

Therefore, 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.

Question 3

Write a short note on Auditor's Lien.

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 nonpayment 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

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similar documents, it is probable that the courts would hold that these documents belong to the auditor.

Question 4

What will be position of the Auditor in the following cases:

- (a) *A, a chartered accountant has been appointed as auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2015, which assignment he accepted. Subsequently in January, 2016 he joined B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner.*
- (b) *Y, is the auditor of X Pvt. Ltd. In which there are four shareholders only, who are also the Directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Y to accept a reduced fee and for that he has been offered not to carry out such full audit as he has done in the past. Y accepted the suggestions of the directors.*
- (c) *While conducting the audit of a limited company for the year ended 31st March, 2016, the auditor wanted to refer to the Minute Book. The Board of Directors refused to show the Minute Book to the auditor.*

Answer

- (a) **Disqualifications of an Auditor:** Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor.

In the present case, A, an auditor of Laxman Ltd., joined as partner with B, who is Manager Finance of Laxman Limited, has attracted sub-section (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited.

- (b) **Restricting Scope of Audit:** "Y" may agree to temporary reduction in audit fees, if he so wishes, in view of the suggestions made by the directors (perhaps in accordance with the decision of the company taken in general meeting). But his duties as a company auditor are laid down by law and no restriction of any kind can restrict the scope of his work either by the director or even by the entire body shareholders.

There is no concept of full or part audit under Section 143 of the Companies Act, 2013. Further, remuneration is a matter of arrangement between the auditor and the shareholders. Section 142 specifies the remuneration of an auditor, shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

His duties may not necessarily commensurate with his remuneration. Y, therefore, should not accept the suggestions of the directors regarding the scope of the work to be done. Even if Y accepts the suggestions of the directors regarding the scope of work to be

done, it would not reduce his responsibility as an auditor under the law. Under the circumstances, Y is violating the provisions of the Companies Act, 2013.

- (c) **Right of Access to Minute Book:** Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books of account and vouchers of the company for conducting the audit.

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 Book. In the absence of the Minute Book, the auditor may not be able to vouch/verify certain transactions of the company.

The refusal by Chairman to provide access to Directors' Minute 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 5

Comment on the following:

- (a) *Due to the resignation of the existing auditor(s), the Board of directors of X Ltd. appointed Mr. Hari as the auditor. Is the appointment of Hari as auditor valid?*
- (b) *At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?*

Answer

- (a) **Board's Powers to Appoint an Auditor:** 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.

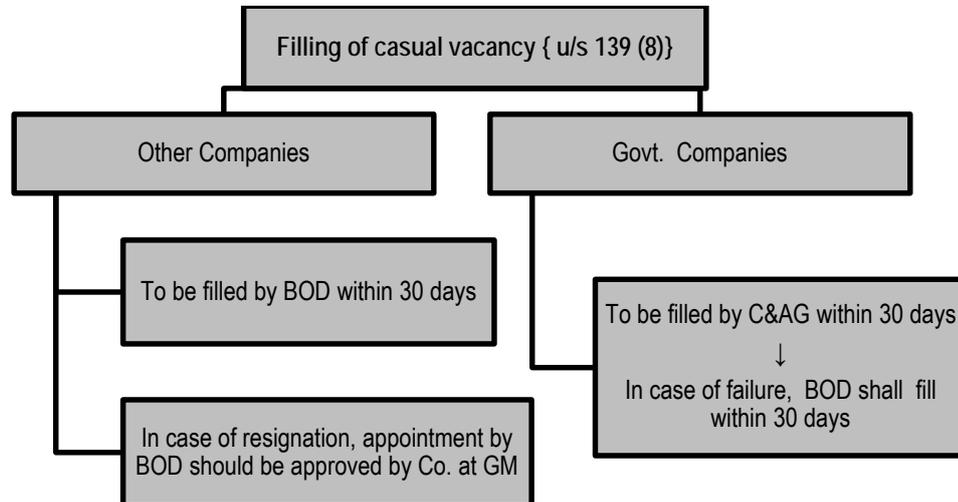
If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;

- (ii) In the case of a company whose accounts are subject to audit by an auditor appointed

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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.



In the given case, the Board of directors of X Ltd. has appointed Mr. Hari as the auditor due to resignation of the existing auditor(s). The appointment made by the Board is correct, however, such appointment should be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and newly appointed auditor shall hold office till the conclusion of the next annual general meeting.

- (b) **Restrictions on Powers of Statutory Auditors:** Section 143(1) of the Companies Act, 2013 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence, any such resolution even if passed by entire body of shareholders is *ultra vires* and therefore void.

Question 6

How would you as an auditor distinguish between Reports and Certificates?

Answer

Distinction Between Audit Reports and Certificates: The term 'certificate', is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. When an auditor certifies a financial statement, it implies that the contents of that statement can be measured and that the auditor has vouchsafed the exactness of the data. The term certificate is, therefore, used where the auditor verifies certain exact facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain precise figures and is in a position to vouch safe their accuracy as per the examination of documents and books of account.

An auditor's report, on the other hand, is an expression of opinion. When we say that an auditor is reporting, we imply that he is expressing an opinion on the financial statements.

The term report implies that the auditor has examined relevant records in accordance with generally accepted auditing standards and that he is expressing an opinion whether or not the financial statements represent a true and fair view of the state of affairs and of the working results of an enterprise. Since an auditor cannot guarantee that the figures in the Balance Sheet and Statement of Profit and Loss are absolutely precise, he cannot certify them. This is primarily because the accounts itself are product of observance of several accounting policies, the selection of which may vary from one professional to another and, thus, he can only have an overall view of the accounts through normal audit procedures. Therefore, the term certificate cannot be used in connection with these, statements.

Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.

Question 7

State with reasons your views on the following:

- (a) *Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2015-2016. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.*
- (b) *Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, working as Manager of Shrivastav & Co., a Chartered Accountant firm, signed the audit report of Om Ltd. on behalf of Shrivastav & Co.*

Answer

- (a) **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

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subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, 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. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partners Mr. Hanuman is holding equity shares of its subsidiary.

- (b) **Signature on Audit Report:** Section 145 of the Companies Act, 2013 requires that the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141 i.e. where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

Therefore, Mr. Rajendra, a fellow member of the Institute and a manager of M/s Shrivastav & Co., Chartered Accountants, cannot sign on behalf of the firm in view of the specific requirements of the Companies Act, 2013. If any auditor's report or any document of the company is signed or authenticated otherwise than in conformity with the requirements of Section 145, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document shall, if the default is willful, be punishable with a fine.

Question 8

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

- (a) *The first auditors of Health and Wealth Ltd., a Government company, was appointed by the Board of Directors.*
- (b) *The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1) of Section 143 of the Companies Act, 2013, as he was satisfied that no comment is required.*
- (c) *The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the auditor's report to them.*
- (d) *One of the directors of Hitech Ltd. is attracted by the disqualification under Section 164(2) of the Companies Act, 2013.*

Answer

- (a) **Appointment of the First Auditor in the Case of Government Company:** Section 139(6) of the Companies Act, 2013 lays down that the first auditor or auditors of a company, other than a Government Company, shall be appointed by the Board of directors within 30 days from the date of registration of the company. However, 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 auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

Hence, in the case of Health and Wealth Ltd., being a government company, the first auditors shall be appointed by the Comptroller and Auditor General of India.

Thus, the appointment of first auditors made by the Board of Directors of Health and Wealth Ltd., is null and void.

- (b) **Comment on Matters Contained under Section 143(1) of the Companies Act, 2013:** Section 143(1) of the Act deals with duties of an auditors requiring auditor to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor include relating to loans and advances, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, etc. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor of Trilok Ltd. is correct in non-reporting on the matters specified in Section 143(1).
- (c) **Dispatch of Auditor's Report to Shareholders:** Section 143 of the Companies Act, 2013 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. In *Re Allen Graig and Company (London) Ltd.*, 1934 it was held that duty of the auditor after having signed the report to be annexed to a Balance Sheet is confirmed only to forwarding his report to the secretary of the company. It will be for the secretary or the director to convene a general meeting and send the Balance Sheet and report to the members (or other person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.
- (d) **Disqualification of a Director under section 164(2) of the Companies Act, 2013:** Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as directors under section 164(2) of the Companies Act, 2013. The auditor has to ensure that written representation have been obtained by the Board from each director that one is not hit by

Section 164(2).

Since in this case, one of the director is attracted by disqualification under section 164(2) of the Act, the auditor shall state in his report as per section 143 about the disqualification of the particular director.

Question 9

- (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?*
- (b) *Preksha, a member of the ICAI, does not hold a Certificate of practice. Is her appointment as an auditor valid?*
- (c) *'B' owes ₹ 5,01,000 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?*

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) **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. Preksha does not hold a certificate of practice and hence cannot be appointed as an auditor of a company.
- (c) **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 not valid and he is disqualified as the amount of debt exceeds ₹ 5,00,000. Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not

valid because in such a case also the auditor shall be indebted to the company. The auditor is entitled to recover fees on a progressive basis only.

Question 10

Write a short note on Audit enquiry under Section 143(1) of the Companies Act, 2013.

Answer

Audit Enquiry under Section 143(1) of the Companies Act, 2013: Auditor is required to make an enquiry and report under Section 143(1) of the Companies Act, 2013, if he is not satisfied in respect of the following matters-

- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
- (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
- (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (d) whether loans and advances made by the company have been shown as deposits;
- (e) whether personal expenses have been charged to revenue account;
- (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the Balance Sheet is correct, regular and not misleading.

Question 11

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.*
- (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.*

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,

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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, 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.

Question 12

Briefly discuss the following with respect to applicable provisions under the Companies Act, 2013 and rules made there under:

- (a) *Maintenance of Cost Records*
- (b) *Applicability of Cost Audit*
- (c) *Non-applicability of Cost Audit.*

Answer

Cost Records and Audit: The provisions related to cost records and audit are covered under section 148 of the Companies Act, 2013 read with Companies (Cost Records and Audit) Rules, 2014. The audit conducted under this section shall be in addition to the audit conducted under section 143 of the Companies Act, 2013.

The Central Government has notified the Companies (Cost Records and Audit) Rules, 2014 which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

- (a) **Maintenance of Cost Records:** Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006.

The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/industry/sector/product/service prescribed under the said rule are given below:

(A) Regulated Sectors-

- (i) Telecommunication services made available to users by means of any transmission or reception of signs, signals, images etc. (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India.
- (ii) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003, other than for captive generation.
- (iii) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board.
- (iv) Drugs and Pharmaceutical.
- (v) Fertilisers.
- (vi) Sugar and industrial alcohol.

(B) Non-Regulated Sectors-

- (i) Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items.
- (ii) Turbo jets and turbo propellers.
- (iii) Tyres and Tubes.
- (iv) Steel
- (v) Cement.
- (vi) Production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent), etc. The rule excludes the foreign companies having only liaison offices.

The rules require the cost records to be maintained in Form CRA-1.

Additionally, as per clause (vi) to Paragraph 3 of the Companies (Auditor's Report) Order, 2016 [CARO 2016], where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

- (b) **Applicability of Cost Audit:** Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows-
- (1) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 25 crore or more.
 - (2) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 35 crore or more.

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.

It is provided that the auditor conducting the cost audit shall comply with the cost auditing standards.

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.

- (c) **Non-applicability of Cost Audit:** The requirement for cost audit under these rules shall not be applicable to a company which is covered under rule 3, and,
- (i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue; or
 - (ii) which is operating from a special economic zone.

Question 13

State the matters to be specified in Auditor's Report in terms of provisions of Section 143(3) of the Companies Act, 2013.

Answer

Matters to be Specified in Auditor's Report: As per sub-section 3 of section 143 of the Companies Act, 2013, the auditor's report shall also state –

- (a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
- (b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- (c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
- (d) whether the company's Balance Sheet and Statement of Profit and Loss dealt with in the report are in agreement with the books of account and returns;
- (e) whether, in his opinion, the financial statements comply with the accounting standards;
- (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
- (g) whether any director is disqualified from being appointed as a director under sub-section (2) of the section 164;
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
- (i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
- (j) such other matters as may be prescribed.

Further, Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely-

- (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (ii) whether the company has made provision, as required under any law or accounting

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standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

- (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

Question 14

Give your comments on the following:

- (a) *Mr. X, a Director of KP Private Ltd., is also a Director of another company viz., GP Private Ltd., which has not filed the financial statements and annual return for last three years 2013-14 to 2015-16. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the Companies Act, 2013, and auditor should not mention disqualification remark in his audit report.*
- (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.*
- (c) *You, the Auditor of A Ltd., have been considered for ratification by the members in the 4th general meeting as the sole auditor, where you were one of the joint auditors for the immediately preceding three years and the said joint auditors are not re-appointed.*
- (d) *No Annual General Meeting (AGM) was held for the year ended 31st March, 2016, in XYZ Ltd., Ninu is the auditor for the previous 3 years, whether she is continuing to hold office for current year or not.*

Answer

- (a) **Disqualification of a Director Under Section 164(2) of the Companies Act, 2013:** Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director under section 164(2) of the Companies Act, 2013. As per provisions of Section 164(2), if a director is already holding a directorship of a company which has not filed the financial statements or annual returns for any continuous period of three financial years shall not be eligible to be reappointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

In this case, Mr X is a director of KP Private Ltd. as well as of GP Private Ltd., and, GP Private Ltd., has not filed the financial statements and annual return for last three years. Hence the provisions of section 164(2) are applicable to him and as such he is disqualified from directorship of both the companies. Therefore, the auditor shall report about the disqualification under section 143(3)(g) 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" or "Tax 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, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139 of the said Act.

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 five lakh rupees 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 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 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 to whom notice of the meeting was sent.
 - (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 15

- (a) *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.*
- (b) *PBS & Associates, a firm of Chartered Accountants, has three partners P, B and S. The firm is already having audit of 45 companies and none of the partners are holding any audit in their personal capacity or as partners of other firms. The firm is offered 20 public company audits. Decide and advise whether PBS & Associates will exceed the ceiling prescribed under Section 141(3)(g) of the Companies Act, 2013 by accepting the above audit assignments?*

Answer

- (a) **Appointment of First Auditor of Company:** Section 139(6) of the Companies Act, 2013 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 Ganapati, 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 30 days 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.

- (b) **Ceiling on Number of Audits:** Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section 141(3)(g) of the Act which 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 20 companies *other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.*

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.

As Mr. P, B and S 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 M/s PBS & Associates is 60 *other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.* But, the firm

is already having audit of 45 companies. So the firm can accept the audit of 15 public companies only, which is well within the limit, specified by Section 141(3)(g) of the Companies Act, 2013.

Question 16

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?

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 17

As an Auditor, comment on the following:

- (a) *Company has debited ₹ 1,75,000 to Delivery Van Account received from a customer against credit sales of ₹ 1,50,000 to him who is now is not able to pay the amount. The Delivery Van has not been registered in the name of the company with R.T.O. till date of Finalisation of accounts.*
- (b) *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, 2016. The average net profits of the company for the last three years were 15 lakhs. Comment.*
- (c) *AAS Limited had provided for doubtful debts to the extent of ₹ 23 lakhs during the year 2014-15. The amount had since been collected in the year 2015-16. Another debt of ₹ 25 lakhs had been identified to be doubtful during the year 2015-16. The Company made an additional provision of ₹ 2 lakhs during the year. The Statement of Profit and Loss for the year ended 31.3.2016 charged the same as provision for doubtful debts ₹ 2 lakhs.*

- (d) *Alagar Limited is a company engaged in the business of chassis building and bus transportation services. It accounts all expenses and income in Statement of Profit and Loss under various heads explaining clearly the nature of the operations. The auditor of the company requires that the Statement of Profit and Loss should depict the Profit or Loss from the businesses of assembly as well as of operation of bus services separately.*

Answer

- (a) **AS 10 "Accounting For Fixed Assets":** As per AS 10 "Accounting for Fixed Assets" When a fixed asset is acquired in exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. For these purposes fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident.

The delivery van has been acquired in exchange for another assets i.e. receivables. The fair value of delivery van is ₹ 1,75,000 and that of receivable were ₹ 1,50,000. Here fair market value of the asset given up is more clearly evident. Therefore the delivery van should be valued at ₹ 1,50,000. Also the delivery van should be recognized as an asset of the company even though it is not yet registered in the name of the company. This is because legal title is not necessary for an asset to exist. What is necessary is control over the asset as per the framework for preparation and presentation of financial statements. Applying substance over form, we find since price has been settled, and the company has control of assets, hence it should be reflected as an asset along with a note to the effect that the registration in the name of the company is pending.

- (b) **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.

- (c) **Disclosure of Certain Ordinary Activities Under AS 5:** As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies", when items of income and expense within profit or loss from ordinary activities are of such size, nature

or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

During the relevant year, the company had collected the amount of ₹ 23 lakhs for which provision had already been made earlier in the accounts. The said provision should be reversed to that extent during the relevant year. The company estimates a doubtful debt to the extent of ₹ 25 lakhs in the current year which must be provided for during the relevant year. Circumstances which may give rise to the separate disclosure of items of income and expense in accordance with paragraph 12 of AS 5 include reversals of provisions. The company had netted off the reversal and additional provision and had shown the net debit of ₹ 2 lakhs in Statement of Profit & Loss. This practice does not seem to be good as per AS 5. Company may show the net debit in Statement of Profit & Loss but should disclose the facts of write back and additional provision made during the year by way of note. The Company's accounting treatment is wrong and it may warrant audit qualifications.

- (d) **Segmental Reporting:** As per AS 17 "Segment Reporting", the company accounts must be presented according to the primary classification based on nature of income and expenses and therefore segment results are to be disclosed accordingly. The result of segment should be disclosed in terms of segment revenue and segment expense.

In the instant case, the company has two business segments namely assembly and transportation. These two segments should be properly identified.

In this case, company should add note to show segment result after computation. It is not necessary that segment-wise details of each and every expenditure and revenue should be specified.

Question 18

M/s Seeman & Co. had been the company auditor for Amudhan Company Limited for the year 2015-16. The company had three branches located at Chennai, Delhi and Mumbai. The audits of branches-Chennai, Delhi were looked after by the company auditors themselves. The audit of Mumbai branch had been done by another auditor M/s Vasan & Co., a local auditor situated at Mumbai. The branch auditor had completed the audit and had given his report too. After this, but before finalization, the company auditor wanted to visit the Mumbai branch and have access to the inventory records maintained at the branch. The management objects to this on the grounds of the company auditor is transgressing the scope of audit areas agreed. Comment.

Answer

Right of Access of Company Auditor for Branch Records: The audit of the branch of a company is dealt with in Section 143(8) of the Companies Act, 2013. According to this section, the audits of the branches can be done by the company auditor himself or by another auditor. Even where, the branch accounts are audited, the company auditor has right to visit the branch if he deems it necessary to do so for the performance of his duties as auditor.

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He has also right of access at all times to the books and accounts and vouchers of the company maintained at the branch office. He can appropriately deal with the report of the branch auditor in framing his main report. He will disclose how he had dealt with the branch audit report.

In this case, the audits of two branches were done by the company auditor and one branch was done by a separate branch auditor.

Applying the above provisions, to the instant case, management's objection that the company auditor is transgressing the scope of audit areas agreed, is absolutely, wrong. The right of company auditor in visiting and accessing the records of branch cannot be forfeited. Even where the branch accounts are audited by another local auditor, the company auditor has right to visit the branch and can have access to the books and vouchers of the company maintained at the branch office.

Question 19

Give your assertions for the following items appearing in Balance Sheet of a Limited Company:

		₹
(i) Cash in hand		10,000
(ii) Investments		1,00,000
(iii) Secured Loans		10,00,000
(iv) Machinery:		
Opening cost	13,00,000	
Less: depreciation		
Current depreciation	1,30,000	11,70,000

Answer

(i) Cash in Hand ₹ 10,000

This is the item of current assets, exhibited on the asset side of Balance Sheet. It implies:

- (1) that the firm concerned has ₹ 10,000 in hand in valid notes and coins on the Balance Sheet date.
- (2) that the cash was free and available for expenditure to the firm.
- (3) that the books of accounts show a cash balance of identical amount at the end of the day on which the Balance Sheet is drawn up.

(ii) Investments ₹ 1,00,000

This is also the item to be exhibited on the asset side of Balance Sheet as per Schedule III to the Companies Act, 2013, as prescribed by Company Law. This description is not giving us a complete picture of investment. We, as an auditor, must know:

- (1) Nature of Investment, type of Investment; whether it is short term or long term investment or trade investment or non-trade investment.
- (2) Rate of interest receivable.
- (3) Face value or market value of investments as on Balance Sheet date.

(iii) Secured Loan ₹ 10,00,000

It Implies that the company has secured loan from some parties, worth ₹ 10,00,000. The description does not give us a complete picture. We, as an auditor, must know:

- (1) the name of the lender,
- (2) the nature of security provided; and
- (3) the rate at which interest is payable.

(iv) Machinery ₹ 11,70,000

- (1) The Company owns the Plant and Machinery whose WDV as on date of Balance Sheet is ₹ 11,70,000. Gross block is ₹ 13,00,000.
- (2) The Machinery physically exists.
- (3) The asset is being utilized in the business of the company productively.
- (4) Charge of depreciation on this asset is ₹ 1,30,000 relates to the year in respect of which the accounts are drawn up.
- (5) The amount of depreciation, has been calculated on recognized basis and the calculation is correct.

Question 20

During the year 2015-16, it was decided for the first time that the accounts of the branch office of AAS Company Limited be audited by qualified Chartered Accountants other than the company auditor. Accordingly, the Board had appointed branch auditors for the ensuing year. One of the shareholders complained to the Central Government that the appointments was not valid as the Board of Directors do not have power to appoint auditors, be they Company Auditor or Branch Auditors?

Answer

Appointment of Branch Auditor: The Companies Act, 2013 leaves it to the company to designate or not to designate any establishment of the company as 'branch office'. Under the

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Companies Act, 2013, only establishment "described as such by the company" shall be treated as a 'branch office'.

Further, as per Section 143(8) of the Companies Act, 2013, where 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 and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed.

It is provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

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.

The shareholders in general meeting, instead of appointing branch auditor, may authorize the board of directors to appoint branch auditors.

In the present case, the board has appointed branch auditors without obtaining authorization from the shareholders in general meeting. The board had appointed the auditor where it did not have authority to do so. As such, the appointment is invalid. The shareholder's complaint is right.

The branch auditor should ascertain before accepting the audit whether his appointment is valid.

Question 21

Give your comments on the following:

- (a) *Mr. Budha, Statutory Auditors of Secret Ltd. was not permitted by the Board of Directors to attend general meeting of the company on the ground that his right to attend general meetings is restricted only to those meetings at which the accounts audited by him are to be presented and discussed.*
- (b) *M/s Young & Co., a Chartered Accountant firm, and Statutory Auditors of Old Ltd., is dissolved on 1.4.2016 due to differences of opinion among the partners. The Board of Directors of Old Ltd. in its meeting on 6.4.2016 appointed another firm M/s Sharp & Co. as their new auditors for one year.*

- (c) *Mr. Fat, auditor of Thin Ltd., has his office and residence in the building owned by Thin Ltd. Mr. Fat has been given 10% concession in rent by the company as compared to other tenants.*

Answer

- (a) **Auditors to Attend General Meeting:** According to Section 146 of the Companies Act, 2013, the auditor of a company are under an obligation to attend any general meeting of the company and not only those meetings at which the accounts audited by them are to be presented and discussed.

In the instant case, the board of directors of Secret Ltd. have no right to restrict Mr. Buddha from attending the general meeting and Mr. Buddha has every right to attend such meeting as conferred by Section 146.

Thus, the action of the board of directors is contrary to the provisions of law and curtails the right of the auditor.

- (b) **Holding of Office in Case of Casual Vacancy:** Section 139(8) of the Companies Act, 2013 lays down that the Board of Directors may fill any casual vacancy in the office of an auditor provided that where such vacancy is caused by the resignation of an auditor, the vacancy shall be filled in general meeting.

The expression “casual vacancy” has not been defined in that Act. Taking its natural meaning it may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firm etc.

Furthermore, Section 139(8) stipulates that any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

In the instant case, the action of the board of directors in appointing M/s Sharp & Co. to fill up the casual vacancy due to dissolution of M/s Young & Co., is correct. However, the board of directors are not correct in giving them appointment for one year. M/s Sharp & Co. can hold office until the conclusion of next AGM only.

- (c) **Independence of Auditor:** As per SA 200, “Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing”, In the case of an audit engagement it is in the public interest and, therefore, required by the Code of Ethics, that the auditor be independent of the entity subject to the audit. The Code describes independence as comprising both independence of mind and independence in appearance. The auditor’s independence from the entity safeguards the auditor’s ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor’s ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

In the instant case, Mr. Fat has his office and residence in the building owned by Thin Ltd. who are subject to audit by Mr. Fat. Giving 10% concession in rent may be due to some other reasons other than holding auditorship of Thin Ltd. It may be due to being

very old tenant or due to office and residence in the same building or Mr. Fat might have carried out major renovation and so on.

Thus in the instant case unless and until there is direct proof, giving 10% concession in rent does not affect independence of the auditor in expressing his opinion on the audit of Thin Ltd.

Question 22

Write short notes on the following:

- (a) *Responsibilities of Joint auditors.*
- (b) *Process of Judgement formation by Auditor.*

Answer

- (a) **Responsibilities of Joint Auditors:** As per SA 299, in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him. In respect of other works, which are not divided, all the joint auditors are jointly and severally responsible for-
 - (i) Audit work which is not divided and is carried on jointly by all the joint auditors.
 - (ii) Decision 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.
 - (iii) Matters which are brought to the notice of the joint auditors by any one of them and on which there is agreement among the joint auditors.
 - (iv) Examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute.
 - (v) Ensuring that the audit report complies with the requirement of the relevant statute.
- (b) **Process of Judgement Formation by Auditor:** After the audit, the opinion that the auditor expresses is the result of exercise of judgement on facts, evidence and circumstances which he comes across in the course of audit. The judgement is formed on the following basis-
 - (i) Identification of the assertions to be examined.
 - (ii) Evaluation of the assertion as to relative importance.
 - (iii) Collection of the information or evidence about the assertions to enable him to give an informed opinion.
 - (iv) Evaluation of evidence as valid or invalid, pertinent or not pertinent, sufficient or insufficient.
 - (v) Formulation of judgement as to the fairness of the assertions under consideration.

Question 23

State the basic elements of the Auditor's Report.

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;
- (iv) 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 24

When does an auditor issue unqualified opinion and what does it indicate?

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 25

Under what circumstances the retiring Auditor cannot be reappointed?

Answer

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 26

Write short notes on the following:

- (a) *Disclaimer of Opinion.*
- (b) *Joint Audit.*

Answer

- (a) **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.-
 - (1) Books of A/c's of the company seized by IT authorities.
 - (2) 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".

- (b) **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-

- (i) In respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (ii) 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;
- (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 requirement of relevant statute; and
- (v) For ensuring that the audit report complies with the requirements of the relevant statute.

Question 27

Write a short note on responsibilities of Joint auditors.

Answer

Responsibilities of Joint Auditors: SA 299 on Responsibilities of Joint Auditors requires 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 28

As an auditor comment on the following:

- (a) *On 31.3.2016 inventory taking by Identity Ltd. revealed an inventory of ₹ 50 crores at its godown. Due to a fire on 1st April, 2016, inventory worth ₹ 30 crores was destroyed. The salvage value and insurance claim were estimated at ₹ 25 crores before the commencement of audit. No provision was made in the books of company for the year ended 31.3.2016 for ₹ 5 crores.*
- (b) *T Ltd. gave a guarantee to the court for payment of VAT dues of ₹ 15 lakhs for its subsidiary Company Y Ltd. According to the company, since the guarantee was given on behalf of its subsidiary Company, no disclosure was required.*
- (c) *Uranus Ltd. has purchased and installed new machinery during the year in expectation of increased sales. However, no production was made by using the new machine. The directors contend that as the machinery was not used, no depreciation needs to be provided.*
- (d) *Mr. D is a director of X Ltd. and Y Ltd. On 30th June, 2015, Mr. D resigned from directorship of Y Ltd. X Ltd. sold goods to Y Ltd., during the entire year at the same price and conditions as to any other customer. X Ltd. discloses only the sales for the first quarter ending 30th June, 2015 as related party transactions.*

Answer

- (a) **Subsequent Event:** SA 560 "Subsequent Events" requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor's report. However, the exact manner and treatment would depend upon whether the event falls in the category of adjusting event or non-adjusting event.

The event took place after the close of the accounting year and does not relate to conditions existing at the Balance Sheet date.

Thus, it will have no effect on items appearing at the Balance Sheet date because as per AS – 4 “Contingencies and Events Occurring after Balance Sheet Date” have to be adjusted that provide evidence of conditions existing as at the Balance Sheet date.

AS - 4 requires disclosure of the non-adjusting event, in the report of the approving authority only and no further action needs to be taken by the auditor.

As the company has correctly accounted by not providing provision, the auditor is required to ensure the proper disclosure of abovementioned event.

- (b) **Disclosure of Guarantee Given by a Company on Behalf of its Subsidiary Company:** T Ltd. in its books of accounts is required to record a contingent liability of ₹ 15 lakhs for the guarantee given by it for payment of VAT dues of its subsidiary company to the court. If, the subsidiary fails to meet its obligation, T Ltd. would be required to pay ₹ 15 lakhs to the authorities concerned.

AS 29 also states that the existence and amount of guarantees undertaken by an enterprise are generally disclosed in financial statements by way of a note, even though the possibility that the loss will occur, is remote. Thus the amount of any guarantee given by the company on behalf of its subsidiary is required to be stated and where practicable the general nature of such contingent liability if material, be specified. Accordingly, the views expressed by the company cannot be accepted.

- (c) **Charging of Depreciation:** As per AS 6 on “Depreciation Accounting”, depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising out of use, effluxion of time or obsolescence through technology and market changes. Thus, depreciation has to be charged even in case of these assets which are not used at all during the year but by mere effluxion of time provided such assets qualify as depreciable assets.

When the machinery was installed and made ready for production, it means it was intended to be used for the purpose of business. If there is an intention to use an asset, though it may not have actually been used, it is a ‘constructive’ or ‘passive’ use and eligible for depreciation. Thus, depreciation in respect of this machinery ought to have provided in the accounts for the year under audit.

Thus, the auditor may suitably qualify the report stating that depreciation has not been provided.

- (d) **Disclosure of Related Party Transaction:** As per SA 550 ‘Related Parties’, in examining the identified related party transactions, the auditor should obtain sufficient appropriate audit evidence as to whether these transactions have been properly recorded and disclosed.

As per paragraph 23 of AS 18 ‘Related Party Disclosures’, transactions of X Ltd. for the first quarter with Y Ltd. upto 30th June, 2015 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did exist need not to be disclosed as related party transactions. *Even though X Ltd. has*

correctly identified and disclosed the related party transactions, the auditor need to report under clause (xiii) of CARO, 2016 about whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards.

Question 29

Comment on the following:

- (a) *M/s XYZ & Co., auditors of Goodwill Education Foundation, a recognised nonprofit organisation feels that the standards on auditing need not to be applied as Goodwill Education Foundation is a non-profit making concern.*
- (b) *Nickson Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nickson Ltd. appointed Mr. P as statutory auditor for the year.*
- (c) *Mr. Amar, a Chartered Accountant, bought a car financed at ₹ 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be to even after taking the loan.*

Answer

- (a) **Compliance with Standards on Auditing:** As per sub-section 9 of section 143 of the Companies Act, 2013, every auditor shall comply with the auditing standards. Further as per sub-section 10 of section 143 of the Act, the Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

It is provided that until any auditing standards are notified, any standard, or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

Further, the Preface to Standards on Auditing gives the scope of the Standards on Auditing. As per the Preface, the SAs will apply whenever an independent audit is carried out; that is, in the independent examination of financial statements/information of any entity; whether profit oriented or not and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.

Also while discharging their attest function; it is the duty of the Chartered Accountant to ensure that SAs are followed in the audit of financial information covered by their audit reports.

In the given case, even though the client is a non-profit oriented entity the SAs shall apply and the auditor shall be guilty of professional misconduct for failing to discharge his duty in case of non-compliance with SAs.

- (b) **Appointment of Auditor in the Case of Government Company:** According to Section 2(45) of the Companies Act, 2013, a Government company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary company of such a Government Company.

In the given case Ajanta Ltd is a government company as its 20% shares have been held by Central Govt., 25% by U.P. State Government and 10% by M.P. State Govt. Total 55% shares have been held by Central and State governments. Therefore, it is a Government company.

As per section 139 of the Companies Act, 2013, the auditor of a government company shall be appointed by the Comptroller and Auditor General of India.

Nickson Ltd. is a subsidiary company of Ajanta Ltd. Hence Nickson Ltd. covers in the definition of a government company. Thus, the Auditor of Nickson Ltd. can be appointed only by C&AG.

Therefore, appointment of 'P' is invalid and 'P' should not give acceptance to the Directors of Nickson Ltd.

- (c) **Indebtness to the Holding Company:** According to section 141(3)(d)(ii) of the Companies Act, 2013, a person is not eligible for appointment as auditor of any company, if he is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 lakh.

In the given case Mr. Amar is disqualified to act as an auditor under section 141(3)(d)(ii) as he is indebted to Chaudhary Finance Ltd. for more than ₹ 5,00,000. Also according to Section 141(3)(d)(ii), he cannot act as an auditor of any subsidiary of Chaudhary Finance Ltd. i.e. he is also disqualified to work in Charan Ltd. & Das Ltd. Therefore, he has to vacate his office in Das Ltd. even though it is a subsidiary of Chaudhary Finance Ltd.

Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd. must have to appoint any other CA as an auditor of the company.

Question 30

M.N.P. Company Ltd. purchased a machinery for ₹ 1.00 crore. The State Government granted the company a subsidy of ₹ 40 lakhs to meet partial cost of machinery. The company credited the subsidy received from the State Government to its Statement of Profit and Loss for the year ended March 31, 2016. Comment.

Answer

Accounting Treatment for Government Grants: As per AS 12 “Accounting for Government Grants”, accounting treatment of any grants or subsidy depends on nature of grants or receipts. Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets.

Following are two methods of presentation of grants related to specific fixed assets in financial statements as acceptable alternatives;

- (i) Under the first alternative the grant is shown in the Balance Sheet as a deduction from the gross value of the assets concerned. The grant is recognized in Statement of Profit and Loss over the useful life of the depreciable life of asset by way of a reduced depreciation charge.
- (ii) Under second alternative, it is treated as a deferred income which should be recognized in Statement of Profit and Loss over useful life of asset in proportion in which depreciation will be charged on the assets concerned. Deferred income pending its apportionment to Statement of Profit and Loss should be disclosed in the Balance Sheet with a suitable description i.e. Deferred Government Grant.

In the instant case, MNP Company Ltd. received a subsidy from government worth ₹ 40 lakhs towards meeting partial cost of machinery. The company credited the same to its Statement of Profit & Loss.

Accounting treatment of grant received towards partial cost of machinery is not correct. The auditor should advise company to correct the above accounting treatments of grant; otherwise it is the duty of the auditor to qualify his report bringing out the quantification impact clearly.

Question 31

Comment on the following:

- (a) *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.*
- (b) *A partnership firm revalued its fixed assets like land and building. The firm adequately disclosed the revalued amounts in the Balance Sheet.*
Do you, as an auditor, approve the disclosure given by the partnership firm?
- (c) *R.K. & Company are the auditors of PQR Company Ltd. The Managing Director of the Company demands copies of the working papers from the auditors. Are the auditors bound to oblige the Managing Director?*

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.

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.

- (b) **Disclosure of Revalued Fixed Assets of a Partnership Firm:** As per AS 10 “Accounting for Fixed Assets”, revalued amounts substituted for historical costs of fixed assets, method adopted to compute the revalued amounts, nature of indices used, year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts should be disclosed in the financial statements.

In the instant case, the partnership firm revalued its fixed assets like building and land and adequately disclosed the revalued amounts in the Balance Sheet. The firm did not disclose the method adopted by it for arriving at the revalued figures.

Conclusion: The firm had disclosed the revalued amounts in the Balance Sheet but the method and nature of indices used etc. are not disclosed. Thus, this act of the firm is in contravention with the AS 10 for “Accounting for Fixed Assets”.

Hence, the auditor cannot approve the disclosure given by the partnership firm and shall have to qualify the report.

- (c) **Ownership and custody of working papers:** As per SA 230 “Audit Documentation”, the working papers are the property of the auditor, the auditor may, at his discretion make portion of or extracts from his working papers available to the client.

In the instant case the managing director of the company has demanded copies of the working papers from the auditor. He has no right to obtain copies of the working papers from the auditor because they are the property of the auditor. However the auditor may at his discretion make portions of or extracts from the working paper to the managing director of PQR Company Ltd.

Conclusion: The auditor is not bound to oblige the managing director by supplying copies of the audit working papers.

Question 32

Explain the concept of joint audit. Discuss its advantage and disadvantage.

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. The joint auditors should follow the principles of division of work and coordination while conducting joint audits.

"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 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 33

Discuss the following:

- (a) Ceiling on number of audits in a company to be accepted by an auditor.
- (b) Filling of a casual vacancy of auditor in respect of a company audit.
- (c) In Joint Audit, "Each Joint Auditor is responsible only for the work allocated to him".

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 *other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.*

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 to responsibilities of joint auditor 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 34

White Star Ltd. was incorporated on 01.08.2015 and Mr. T, who is a relative to the Chairman & Managing Director (CMD) of the Company, appointed as auditor by the Board of Directors in their meeting on 04.09.2015. Comment.

Answer

Appointment of First Auditors by the Board: 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 an 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 01-08-2015 and the date of appointment of auditors by the Board of Directors is 04-09-2015.

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 & Managing Director (CMD) becomes redundant.

Question 35

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. Comment.

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 the 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 36

Comment on the following situations:

- (a) *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 Statement of Profit and Loss for arriving at the figure of commission payable to the managing director.*
- (b) *ABC Company Ltd. removed its First Auditor before the expiry of his term without obtaining approval of the Central Government.*

Answer

- (a) (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 be credited to Statement of Profit and Loss. As per the provisions of Section 198 of the Companies Act, 2013 on calculation of profits, premium on issue of shares should not be considered in computation of net profit. The same need to be complied with for the purpose of managerial remuneration. The auditor should have qualified the audit report and qualified the amount by which the profit stands inflated.
- (b) **Removal of Auditor Before Expiry:** 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 the company before the expiry of his term without obtaining approval of the Central Government.

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 37

C Ltd. declared dividend amounting to ₹ 5 lacs out of Profits for the year ended 31.3.2016. Subsequently, it was noticed that company had failed to make provisions for outstanding expenses of ₹ 7.80 lacs and closing stock was also overvalued, which was not reported by

auditors of the company. Management of C Ltd. held auditors responsible for this situation. Comment.

Answer

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 38

Audit Committee is to be formed by each and every company and the auditor has right to vote in the meeting of such Audit Committee. Comment.

Answer

Formation of Audit Committee: 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 and following classes of companies:

- (i) all public companies with a paid up capital of ten crore rupees or more,
- (ii) all public companies having turnover of one hundred crore rupees or more,
- (iii) all public companies having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees 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.

Question 39

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. Comment.

Answer

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 becomes 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 & Company, is not disqualified to be appointed as an auditor of Aaradhana Company Ltd.

Question 40

What are the various types of companies covered under Companies (Auditor's Report) Order, 2016 [CARO, 2016]?

Answer

Types of Companies Covered Under CARO, 2016: The Companies (Auditor's Report) Order, 2016 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies-

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

- (ii) an insurance company as defined under the Insurance Act, 1938;
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;
- (v) a small company as defined under clause (85) of section 2 of the Companies Act; and
- (vi) *a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.*

It may be noted that the Order shall not apply to auditor's report on consolidated financial statements.

Question 41

Mr. Y was appointed as an auditor of PQR Ltd. for the year ended 31.3.2016 at the Annual General Meeting held on 16.08.2015. Mr. Y has been indebted to the company for sum of ₹ 5,10,000 as on 01.04.2015, 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 10.8.2015. One of the shareholders, complains that the appointment of Mr. Y as an auditor was invalid because he incurred disqualification u/s 141 of the Companies Act, 2013. Comment.

Answer

Indebtness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ₹ 5,00,000 shall be disqualified to act as an auditor of such company and he should vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, Mr. Y was appointment as an auditor of PQR Ltd. for the year ended 31.03.2016 at the Annual General Meeting held on 16.08.2015. He repaid the loan amount fully to the company on 10.8.2015 i.e. before the date of his appointment.

Hence, the appointment of Mr. Y as an auditor is valid and the shareholder's complaint is not acceptable.

Question 42

State the circumstances which could lead to any of the following in an Auditor's Report:

- (a) *A modification of opinion*
- (b) *Disclaimer of opinion*
- (c) *Adverse opinion*
- (d) *Qualified opinion.*

Answer

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

- (b) **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.

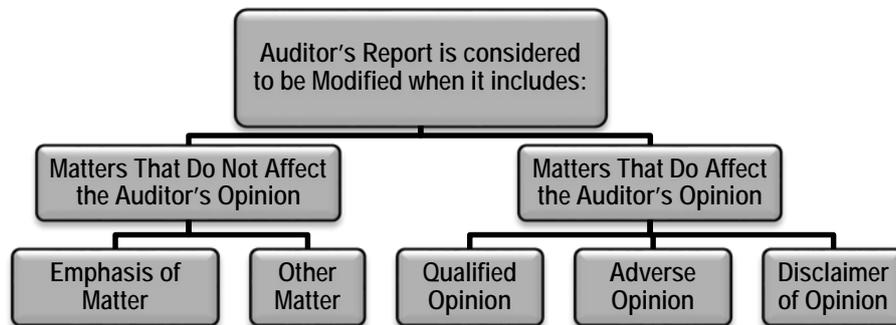
- (c) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (d) **Qualified Opinion:** The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

Question 43

What are Modified Reports? Discuss disclosure pattern when the auditor includes an Emphasis of Matter paragraph in the Auditor's Report.

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-



(a) Matters That Do Not Affect the Auditor’s Opinion

- ✓ emphasis of matter
- ✓ Other Matter

(b) 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 do not affect auditor’s opinion
(b) Matters that do 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.

7.46 Auditing and Assurance

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 44

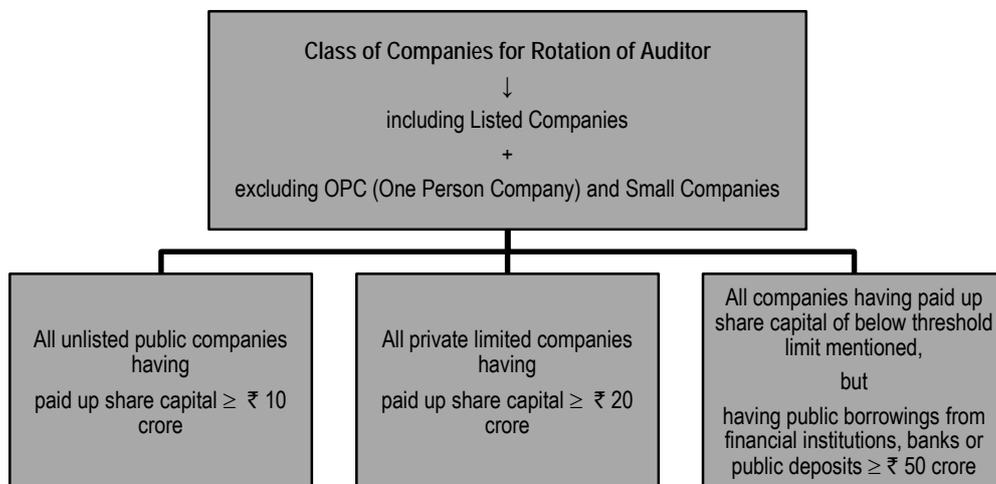
"Provisions regarding rotation of auditors affect only specific class of companies". Discuss.

Answer

Applicability of Provisions Related to Rotation of Auditors: The provisions related to rotation of auditor as provided under section 139(2) of the Companies Act, 2013 are applicable to all listed companies and other class or classes of companies as prescribed under Companies (Audit and Auditors) Rules, 2014.

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies-

- (i) all unlisted public companies having paid up share capital of ₹ 10 crore or more;
- (ii) all private limited companies having paid up share capital of ₹ 20 crore or more;
- (iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crores or more.



Question 45

State the disclosure required to be made in the financial statements if these do not comply with the accounting standards.

Answer

Deviations from Accounting Standards: According to Section 129(5) of the Companies Act, 2013, if the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements the following namely-

- (i) the deviation from the accounting standards,
- (ii) the reasons for such deviation, and
- (iii) the financial effects, if any, arising out of such deviation.

Question 46

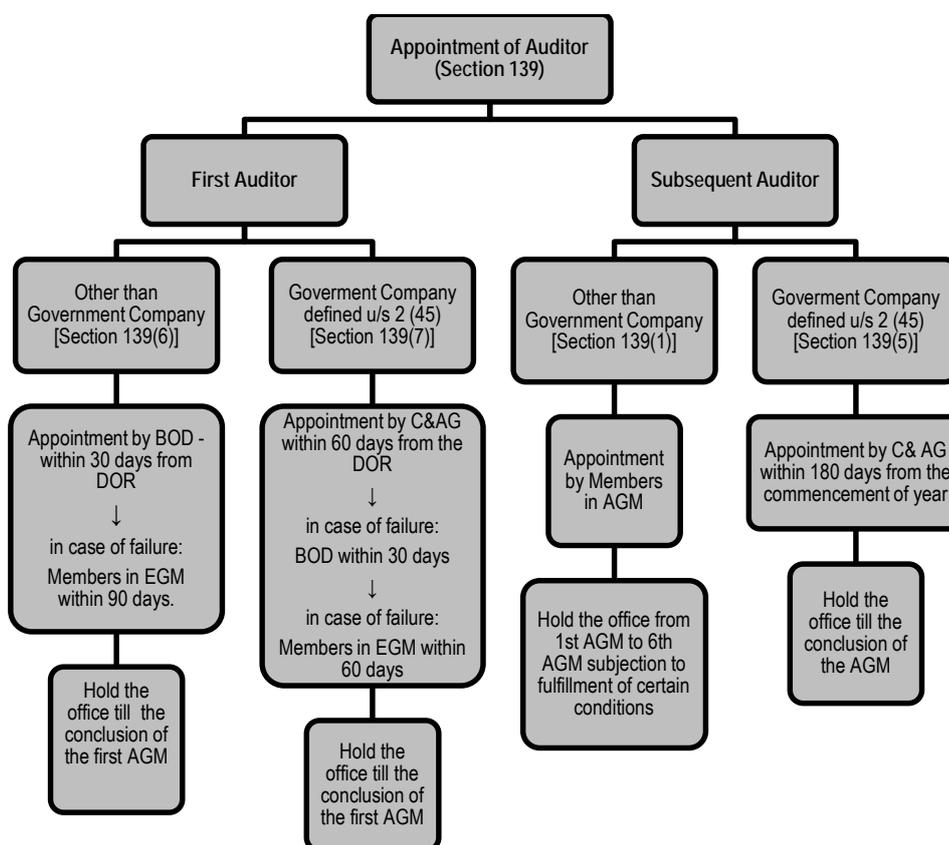
Explain the following:

- (a) *Appointment of First Auditor of a Non-Government Company.*
- (b) *Appointment of First Auditor of a Government Company.*
- (c) *Appointment of Subsequent Auditor of a Non-Government Company.*
- (d) *Appointment of Subsequent Auditor of a Government Company.*

Answer

Appointment of Auditors: Section 139 of the Companies Act, 2013 contains provisions regarding appointment of Auditors. Provisions related to appointment of auditors may be grouped under two broad headings-

- I Appointment of First Auditors.
- II Appointment of Subsequent Auditors.



- (a) **Appointment of First Auditor of a Non-Government Company:** As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

- (b) **Appointment of First Auditor of a Government Company:** Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within

the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

- (c) **Appointment of Subsequent Auditor of a Non-Government Company:** As per section 139(1) of the Companies Act, 2013, 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.
- (d) **Appointment of Subsequent Auditor of a Government Company:** As per Section 139(5) of the Companies Act, 2013, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Question 47

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

- (i) *The auditor shall not modify the opinion in the auditor's report.*
- (ii) *The first auditor of a Government company was appointed by the Board in its meeting after 10 days from the date of registration.*
- (iii) *Director's relative can act as an auditor of the company.*
- (iv) *If an LLP (Limited Liability Partnership Firm) is appointed as an auditor of a company, every partner of a firm shall be authorized to act as an auditor.*
- (v) *AB & Co. is an audit firm having partners Mr. A and Mr. B. Mr. C, the relative of Mr. B is holding securities having face value of ₹ 2,00,000 in XYZ Ltd. AB & Co. is qualified for being appointed as an auditor of XYZ Ltd.*
- (vi) *The auditor of a Ltd. Company wanted to refer to the minute books during audit but board of directors refused to show the minute books to the auditors.*
- (vii) *Manner of rotation of auditor will not be applicable to company A, which is having paid up share capital of ₹ 15 crores and having public borrowing from nationalized bank of ₹ 50 crore because it is a Private Limited Company.*
- (viii) *The auditor should study the Memorandum and Articles of Association to see the validity of his appointment.*
- (ix) *Managing director of A Ltd. himself appointed the first auditor of the company.*

- (x) *A Chartered Accountant holding securities of S Ltd. having face value of ₹ 950 is qualified for appointment as an auditor of S Ltd.*
- (xi) *Mr. N, a member of the Institute of Chartered Accountants of England and Wales, is qualified to be appointed as auditor of Indian Companies.*
- (xii) *The auditor has to report to Central Govt. within 90 days of his knowledge of an offence involving fraud.*

Answer

- (i) *Incorrect: 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.*
- (ii) *Incorrect: According to section 139(7) of the Companies Act, 2013, in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. If CAG fails to make the appointment within 60 days, the Board shall appoint in next 30 days.*
- (iii) *Incorrect: As per section 141(3) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.*
- (iv) *Incorrect: As per section 141(2) of the Companies Act, 2013, where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of the firm.*
- (v) *Incorrect: As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if his relative is holding any security of or interest in the company of face value exceeding ₹ 1 lakh.*
Therefore, AB & Co. shall be disqualified for being appointed as an auditor of XYZ Ltd. as Mr. C, the relative of Mr. B who is a partner in AB & Co., is holding securities in XYZ Ltd. having face value of ₹ 2 lakh.
- (vi) *Incorrect: The provisions of Companies Act, 2013 grant rights to the auditor to access books of account and vouchers of the company. He is also entitled to require information and explanations from the company. Therefore, he has a statutory right to inspect the minute book.*
- (vii) *Incorrect: According to section 139 of the Companies Act, 2013, the provisions related to rotation of auditor are applicable to all private limited companies having paid up share capital of ₹ 20 crore or more; and all companies having paid up share capital of below threshold limit mentioned above, but having public*

borrowings from financial institutions, banks or public deposits of ₹ 50 crore or more.

Although company A is a private limited company yet it is having public borrowings from nationalized bank of ₹ 50 crores, therefore it would be governed by provisions of rotation of auditor.

- (viii) Incorrect: The auditor should study the Memorandum of Association to check the objective of the company to be carried on, amount of authorized share capital etc. and Articles of Association to check the internal rules, regulations and ensuring the validity of transactions relating to accounts of the company.*

To see the validity of appointment, the auditor should ensure the compliance of the provisions of section 139, 140 and 141 of the Companies Act, 2013.

In addition, the auditor should study the appointment letter & the prescribed Form submitted to the Registrar of the Companies to see the validity of his appointment.

- (ix) Incorrect: As per section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a government company, shall be appointed by the Board of directors within 30 days from the date of registration of the company.*

Therefore, the appointment of first auditor made by the managing director of A Ltd. is in violation of the provisions of the Companies Act, 2013.

- (x) Incorrect: As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if he is holding any security of or interest in the company.*

As the chartered accountant is holding securities of S Ltd. having face value of ₹ 950, he is not eligible for appointment as an auditor of S Ltd.

- (xi) Incorrect: A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant.*

It may be noted that a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

Thus, Mr. N is disqualified to be appointed as an auditor of Indian Companies.

- (xii) Incorrect: If an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.*

Question 48

State the manner of rotation of auditors on expiry of their term.

Answer

Manner of Rotation of Auditors on Expiry of their Term: Prescribed manner of rotation of auditors on expiry of their term is given below-

- (1) *The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.*
- (2) *Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.*
- (3) *For the purpose of the rotation of auditors-*
 - (i) *in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;*
 - (ii) *the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.*

The term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Further, for the purpose of rotation of auditors,-

 - (a) *a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;*
 - (b) *if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.*
- (4) *Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.*

Question 49

The auditor's report is considered to be modified under certain circumstances. Discuss.

Answer

Modified Report: An auditor's report is considered to be modified when it includes -

- (A) *Matters That Do Not Affect the Auditor's Opinion*

- (i) *Emphasis of Matter paragraph: Sometimes the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.*
 - (ii) *Other Matter paragraph: If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter", or other appropriate heading.*
- (B) *Matters that Do Affect the Auditor's Opinion*
- (i) *Qualified Opinion: The auditor shall express a qualified opinion when-*
 - (1) *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*
 - (2) *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.*
 - (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.*
 - (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.*

The auditor shall modify the opinion in the auditor's report when:

- (1) *The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or*
- (2) *The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.*

Exercise

- 1 Comment on the following:
 - (a) *The company had also appointed a Cost Auditor and therefore, the management had requested your firm not to review the cost records.*
 - (b) *The management requested your firm not to comment on valuation of Inventory and realisability of certain Accounts Receivables, as they had been covered in the Directors Report.*
 - (c) *While conducting the audit of a company for the year ended 31st March, 2016 the auditor called for the General Ledger for the year ended 31 March 2013 for some reference. He would not get that ledger as the booked of accounts of that year were already destroyed as per the instructions of the Executive Director of the Company.*
 - (d) *While conducting the audit of a limited company for the year ended 31st March, 2016, the auditor called for the ledger for ascertaining the details of a particular account. The ledger could not be made available to him as it was destroyed due to space constraint as per the instruction of the Executive Director of the company.*