

## UNIT IV : COMPANY AUDIT

### Unit IV:- Appointment, Qualification, Disqualifications, Removal & Remuneration of an auditor of a Ltd. Company. Statutory Audit Report.

#### 1.QUALIFICATIONS OF AN AUDITOR

According to section 226 of the Companies Act, the qualifications of a company auditor are as under:

**(1) Chartered Accountant:** A person who is a Chartered Accountant is qualified for appointment as an auditor of a company. Where all the partners of a firm of auditors practicing in India are qualified for appointment as aforesaid, the firm may be appointed, to be the auditor of the company by its firm name. In such case, any partner so practicing may act in the name of the firm.

**(2) Certified Auditors:** A person holding a certificate under the Restricted Auditor's Certificates (Part B State) Rules, 1956 is also qualified to act as auditor of a company.

#### 2.DISQUALIFICATIONS OF AN AUDITOR

According to the provisions of section 226 of the Companies Act, the following persons, are not qualified to be appointed as auditor of a company:

(1) a body corporate.

(2) an officer or employee of the company.

(3) a person who is a partner or who is in the employment of an officer or employee of the company.

(4) A person who is indebted to the company for an amount *exceeding one thousand rupees*, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount *exceeding one thousand rupees*.

(5) a person who is director or member of a private company or a partner of a firm, which is the managing agent or secretaries and treasurers of the company.

(6) a person who is a director, or the holder of shares exceeding five per cent in nominal value of the subscribed capital of anybody corporate which is the managing value of the subscribed capital of anybody corporate which is the managing agents or the secretaries and treasurers of the company.

(7) If a person is disqualified by virtue of any of the disqualification mentioned above with regard to either a holding company or its subsidiary company, he shall also be disqualified to act as an auditor of the first company (holding company).

(8) Moreover, according to section 8 of the Chartered Accountants Act of 1949 an auditor is disqualified under certain circumstances.

If an auditor becomes subject to any of the above mentioned disqualifications after his appointment, shall be deemed to have vacated his office as such.

#### 3.APPOINTMENT OF AN AUDITOR

The provisions regarding appointment of the auditor are contained in section 224 which are as under:

**(1) First Appointment:** The first auditor of a company is appointed by the Board of Directors of the company within in month of its registration. The auditor thus appointed shall hold office till the conclusion of the first Annual General Meeting. However, if the Board fails to make such appointment, the company in its general meeting may appoint the first auditor.

**(2) Appointment every year:** The auditor of a company is usually appointed at annual general meeting every year. The auditor thus appointed holds office till the conclusion of the next annual general meeting. The company, shall *within seven days* of appointment, give intimation thereof to every auditor so appointed.

The auditor who is so appointed has to inform the Registrar in writing ***within thirty days*** of his appointment that he has accepted or refused to accept the appointment. This provision is also applicable to the retiring auditor who is reappointed.

**(3) Reappointment of retiring auditor:** The auditor appointed by whatever authority (whether by Board or by the Central Government) shall be reappointed at annual general meeting unless:

- (i) He is not qualified for reappointment, or
- (ii) He has given notice to the company in writing of his unwillingness to be re-appointed, or
- (iii) A resolution has been passed at that meeting appointing somebody instead of him or providing expressly that such retiring auditor shall not be reappointed.
- (iv) Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor and by reason of the death, incapacity or disqualification of that person, the resolution cannot be proceeded with.

**(4) Appointment by the Central Government:** Where at an annual general meeting, the company fails to appoint or re-appoint an auditor; it has to give notice of such fact to the Central Government within seven days. The Central Government may appoint a person to fill the vacancy.

**(5) Appointment to fill the Casual Vacancy:** Any casual vacancy in the office of an auditor may be filled by the Board of Directors. However, where such casual vacancy is caused by the resignation of auditor, the vacancy can be filled only by the company in general meeting. Till the casual vacancy is filled by the Board or the Company, the retiring auditor will continue to act. An auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

**(6) Appointment of auditor of Government Companies:** The auditor of a Government company is appointed or re-appointed by the Central Government on the advice of the Comptroller and Auditor General of India.

**(7) Appointment by a Special Resolution :** According to the provisions of the Companies Amendment Act, 1974 the appointment of the auditor of a company in which not less than 25 per cent of the subscribed share capital is held, whether singly or in any combination by the following institutions, can be made only by passing a Special Resolution.

- (a) A public financial institution, or
- (b) A Government company, or
- (c) Central Government or any State Government
- (d) Any financial corporation or other institution established by any Provincial or State Act, in which the state government holds not less than fifty per cent of the subscribed share capital
- (e) A Nationalized Bank.
- (f) An insurance company carrying on general insurance business.

The Companies Act provides, that where such company omits or fails to pass at its annual general meeting, any special resolution appointing an auditor or auditors, it shall be deemed that no auditor or auditors had been appointed by the company at its annual general meeting.

#### 4.REMOVAL OF AUDITOR

The auditor of a company can be removed either (a) on the expiry of his term. or (b) before the expiry of his term.

**(a) Removal on expiry of term:**

The first auditor of a company is appointed by the Board of Directors and holds office till the conclusion of first annual general meeting. The company may remove such an auditor at a general meeting and appoint in his place, any other person or persons who have been nominated for appointment by any member of the company. But notice for his nomination must have been given to the members of the company, not less than 14 days before the date of the meeting.

As we have discussed, the retiring auditor is entitled to be reappointed at every annual general meeting. Thus the auditor of a company is not usually removed on the expiry of his term. But as we have seen, he may not be reappointed in certain circumstances. If the retiring auditor is to be removed on the expiry of his term, and some other person is to be appointed in his place, a special notice of 14 days has to be given to the company. The company has to send a copy of it to the retiring auditor forthwith. On receiving this notice, the retiring auditor can make representation. The company has to send before seven days of general meeting the notice declaring that the retiring auditor shall not be re-appointed.

**(b) Removal before expiry of term:** The auditor can be *removed before the expiry of his term* under the following circumstances:

(1) **First Auditor Appointed by Board:** The auditor appointed by the Board of Directors can removed by the shareholders in the general meeting and another person proposed or nominated to be appointed in his place for which a special notice has to be given to members 14 days before the meeting. The approval of Central Government is not required for this purpose.

(2) **Subsequent Auditors Appointed by Shareholders:** In other circumstances the auditor can be removed before the expiry of his term only by the company in general meeting but the previous approval of Central Government must be obtained in that behalf. In such situation a due notice should also be given to the auditor intended to be so removed has the right to attend meeting and to speak there at if he so desires.

Thus the powers of appointing and removing the auditor are practically exercised by the shareholders only. The underlying idea behind such provisions is to prevent the directors from removing the auditor without the knowledge of shareholders.

#### 5.AUDITOR'S REMUNERATION

Generally the authority appointing the auditor has to fix his remuneration. There are three such authorities viz. (1) The Board of Directors has a right to appoint the first auditors and also to fill up the casual vacancies. (2) The members have a right to appoint auditor every year in the annual general meeting. (3) if no auditor is appointed at an annual general meeting, the Central Government may appoint a person to fill the vacancy.

Hence, these authorities will fix up the auditor's remuneration.

(1) If an auditor is **appointed by the Board of Directors**, his remuneration may be fixed by the Board.

(2) If the auditor is **appointed by the members at a general meeting**, they will fix the remuneration payable to him. However, the members may authorize the Board to fix remuneration of the auditors. It is not necessary that the remuneration of the auditor should be fixed at the same meeting at which his appointment is made.

(3) If the **Central Government** appoints the auditor, the Central Government will fix his remuneration.

The retiring auditor who is reappointed at the annual general meeting is *entitled to get the same remuneration* as he was getting previously.

Any sums paid by the company in respect of *auditor's expenses* shall be deemed to be included in the expression 'remuneration.'

The provisions of the Companies Act require detailed information in respect of payments to the auditor as an auditor and in other capacity. These *details are to be given in the profit and loss account.*

It should be noted that when the auditor is asked to undertake other functions in addition to his normal audit work e.g. preparing accounting statements, final accounts, taxation returns etc, *he is entitled to get extra remuneration.*

## **6.AUDIT REPORT- MEANING**

Under the provisions of Companies Act (Section 227 (2)), the auditor of a company has to examine the accounts and has to submit his report to the shareholders on the accounts audited by him. The auditor is required to report to them that (i) he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and (ii) that the accounts are drawn up in accordance with the requirements of the Companies Act and (iii) give the information required by the provisions of the Act. and that (iv) the accounts thus drawn up give a true and fair view of the state of affairs of their of their company and they reflect true and fair view of the profit or loss of the company for its financial year.

It is a duty imposed upon the auditor by Section 227 (2) of the Companies Act, to submit such report to the shareholders. The auditor shall make a report to be members of the company on the accounts examined by him, and on every balance-sheet and profit and loss account and on every other document declared by this Act to be part of or annexed to the balanced sheet or profit and loss account, which are laid before the company in general meeting during his tenure of office.”

### **6.1 TYPES OF AUDIT REPORT**

Reports of the Auditor are of two types:

- (a) Clean Report
- (b) Qualified Report

### **6.2 CLEAN AUDIT REPORT**

Where the Balance Sheet of a company gives a true and fair view of the state of affairs of the company and Profit and Loss Account give a true and fair view of the profit or loss of the company and where no defect or discrepancy has been found by the auditor during examination of accounts, the auditor gives a clean (unqualified) report.

A specimen of such clean report is given in Specimen No. 1.

#### **Specimen No. 1 : Audit Report**

To  
The Shareholders of X Co. Ltd.,

We have audited the attached Balance Sheet of X Co. Ltd. as at 31-3-2012 and also the Profit and Loss Account on the company for the year ended on that date annexed thereto and report that :

1. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
2. In our opinion proper books of account as required by law have been kept by the company so far as appears from our examination of the books.
3. The Balance Sheet and Profit & Loss Account dealt with by this report are in agreement with the books of account.
4. In our opinion, the profit and loss account and balance sheet comply with the accounting standards as per sec. 211 (3c)
5. No director is disqualified from being appointed as director under Sec. 274 (1) (g)

6. In our opinion and to the best of our information and according to the explanations given to us, the accounts, subject to notes thereon give the information required by the Companies act, 1956, in the manner so required and give a true and fair view :

(a) In the case of the Balance Sheet, of the state of affairs of the company as at 31st March, 2012 and

(b) In the case of Profit and Loss Account, of the profit (or loss) for the year ended on that date.

Date : 1-6-2012.  
Kolhapur

Shinde & Co.  
Chartered Accountants

### 6.3 QUALIFIED AUDIT REPORT

During the course of auditing the books of account, the auditor requires several explanations in regard to the transactions of a company. Whenever the auditor is not satisfied with any explanation or information furnished to him, or if he otherwise feels that the Balance Sheet and the Profit and Loss Account do not exhibit a true and fair view of the state of affairs of the company and its financial results, he must mention the fact in his report. Such a report is called a “**Qualified Report**”. Also, when the auditor is of the opinion that the accounts presented by the directors with their elucidations are not supported by the information, he qualifies his report mentioning therein the factual position.

#### **Circumstance under which Qualified Audit Report can be given:**

Under the following circumstances, a qualified report can be given by the auditor.

(i) Where the examination of accounts could not be carried on in accordance with the accepted principles of auditing i.e. the auditor is prevented from conducting physical verification of stock or he is prevented from visiting the branch office or there is no proper internal check system in existence which affects the verification of accounting records.

(ii) Where the auditor is not furnished with the required books of account, vouchers and records or the necessary information for the purpose of auditor and explanations are not satisfactorily furnished to him.

(iii) Where the accounts and financial statements are not prepared according to generally accepted accounting principles. e.g. assets and liabilities are not valued properly.

(iv) Where the Profit and Loss Account and Balance Sheet are prepared in a manner which is not in accordance with the requirements of the Companies Act.

(v) Where the books of account are not maintained as required by law.

(vi) Where the directors, or managing director work in violation of provisions of the Companies Act or of the regulation of Articles and Memorandum of Association.

(vii) Where he is satisfied that the Balance Sheet and the Profit and Loss Account fail to give a true and fair view of the state of affairs of the company and of its financial results e.g.

(a) Where inadequate provision is made for depreciation on fixed assets.

(b) Where the provision for bad doubtful debts is not adequately made.

(c) Where the assets are either undervalued or overvalued.

### **Specimen No. 3 : A Qualified Audit Report**

To  
The Shareholders of Swastik Company Ltd.

We have audited the attached Balance Sheet of Swastik Company Ltd. as at 31.3.2012 and also the Profit and Loss Account of the company, for the year ended on that date annexed thereto and report that

(a) We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit.

(b) In our opinion proper books of account as required by law have been kept by the company so far as appears from our examination of the books.

(c) In our opinion, the profit and loss account and balance sheet comply with the accounting standards at per sec. 211 (3c)

(d) No director is disqualified from being appointed as director under Sec. 274 (1) (g)

(e) The Balance-Sheet and Profit and Loss Account dealt with by this report are in agreement with the books of account.

(f) In our opinion and to the best of our information and according to the explanations given to us the accounts subject to note hereunder give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view :

(i) In the case of the Balance-Sheet of the state of affairs of the company as at 31.3.2012 and In the case of the Profit and Loss Account, of the profit for year ended on that date.

(1) In our opinion, the provision for depreciation on Fixed Assets is not adequate.

(2) There has been change in the basis of the valuation of closing stock due to which the profit of the company is shown more by Rs. 35,00,000/-

(3) One of the directors of the company is granted an advance of Rs. 10,00,000/- against the provisions of Section 295 of the Companies Act.

(4) A contingent liability for Rs. 5,00,000/- in respect of bills discounted but not matured on the date of Balance Sheet, has not been shown.

Dae : 1-7-2012

Patil & Co.  
Chartered Accountants