

## CH. 21 Accounts and Audit of Company

### Introduction

The shareholders provide capital to the company for running the business. They are in a way, the owners of the company. But, all of them cannot take part in managing the affairs of the company as their number is usually much more. But they have every right to know as to how their money has been dealt with by the directors in a particular period. Therefore, Accounts of the company are maintained. Section 128 of the Companies Act, 2013 contains the provisions for books of account etc. to be kept by company.

### REQUIREMENT OF KEEPING BOOKS OF ACCOUNT (SECTION 128)

Maintenance of books of account would mean records maintained by the company to record the specified financial transaction.

This section specifies the main features of proper books of account as under –

- (i) The company must keep the books of account.
- (ii) The books of account must show all money received and expended, sales and purchases of goods and the assets and liabilities of the company.
- (iii) The books of account must be kept on accrual basis and according to the double entry system of accounting.
- (iv) The books of account must give a true and fair view of the state of the affairs of the company.

### Place of Keeping Books of Account

Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office.

However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides the company is required within seven days of such decision to file with the Registrar a notice in writing giving full address of that other place.

Such intimation to be made in **Form AOC 5** to the Registrar of Companies.

### Maintenance of Books of account in electronic form

The maintenance of books of account and other books and papers in electronic mode is permitted and is optional. Such books of accounts or other relevant books or papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent use.

### Period for which books to be preserved

The books of accounts, together with vouchers relevant to any entry in such books, are required to be preserved by the company for a period of not less than eight years immediately preceding the relevant financial year.

<b>Persons responsible to maintain books</b>
The person responsible to take all reasonable steps for the maintenance of books of accounts etc. shall be: (i) Managing Director, (ii) Whole-Time Director, in charge of finance (iii) Chief Financial Officer (iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.
<b>Penalty</b>
In case the aforementioned persons (i.e. MD, WTD, CFO etc.) fail to take reasonable steps to secure compliance of section 128 and contravene such provisions, they shall in respect of each offence, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or both.

<b>SECTION 129: FINANCIAL STATEMENT</b>	
This Section seeks to provide that the financial statements shall give a true and fair view of the state of affairs of the companies and shall comply with accounting standards	
<b>Definition of Financial Statement</b>	Financial Statement is defined under Section 2 (40), to include - Balance Sheet Profit and Loss account or Income and Expenditure account Cash flow Statement Statement of change in equity, if applicable any explanatory notes annexed to or forming part of financial statements.  However, the financial statement with respect to one-person company, small company and dormant company, may not include the cash flow statement.
<b>True and Fair view</b>	True and Fair view in respect of financial statement means- (a) financial statements and items contained should comply with accounting standards notified under section 133;  (b) financial statements should be prepared for financial year and shall be in form as per Schedule III.  (c) In case of any insurance or banking company or any company engaged in the generation or supply of electricity, not treated to be disclosing a true and fair view of the state of affairs of the company, merely by the reason of the fact that they do not disclose - — in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999; — in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;

– in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003.

#### **Other Requirements for financial statements**

(a) Financial statements shall lay before the board of the directors in every annual general meeting of a company.

(b) Where a company has one or more subsidiaries, in addition to financial statement provided, it shall prepare a consolidated financial statement of the company with salient features of financial statements of subsidiary and subsidiaries in such form as prescribed and the same shall be laid before board in annual general meeting.

(c) Central Government may prescribe for the consolidation of accounts of companies.

(d) Where financial statements of the company do not comply with the applicable accounting standards, the company shall disclose the following:

- (i) the deviation from the accounting standards
- (ii) the reason for such deviation and
- (iii) financial effects arising out of such deviation

(e) Central Government may exempt any class or classes of the companies from complying with any of the requirements of this section or the rules there under.

(f) Central Government may notify the class of companies to mandatorily file their financial statements in Extensible Business Reporting Language (XBRL) format.

#### **RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS (This section is yet to be notified)**

Section 130 provides for provisions relating to re-opening or re-casting of books of accounts of the company. Accordingly,

(i) A company shall not re-open its books of account and shall not recast its financial statements, unless an application in this regard is made by any one or more of the following -

- (a) the Central Government, or
- (b) the Income-tax authorities, or
- (c) the Securities and Exchange Board of India (SEBI), or
- (d) any other statutory regulatory body or authority, and
- (e) an order in this regard is made by a court of competent jurisdiction or the Tribunal.

(ii) The re-opening and recasting of financial statements is permitted only for the following reasons –

- (a) the relevant earlier accounts were prepared in a fraudulent manner; or
- (b) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

(iii) The Court or the Tribunal, as the case may be, shall give the notice to-

- (a) the Central Government
- (b) the Income-tax authorities,
- (c) the Securities and Exchange Board,

(d) any other statutory regulatory body or authority concerned and shall take into consideration the representations, if any, made by Central Government or the income tax authorities, Securities and Exchange Board or the body or authority concerned before passing any order under this section.

(iv) The accounts so revised or re-cast under this section shall be final.

**VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT  
(This section is yet to be notified)**

Section 131 allows the directors to prepare revised financial statement or a revised Board's report in respect of any of the three preceding financial years after obtaining approval of the Tribunal, if it appears to them that the company's financial statement or the Board's Report do not comply with the requirements of Section 129 or Section 134.

**NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA)  
(This section is yet to be notified)**

Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority as national authority for financial reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards.

NFRA shall be responsible for monitoring and enforcing compliance of auditing and accounting standards and for that purpose, oversee the quality of professions associated with ensuring such compliances.

The Authority shall investigate professional and other misconducts which may be committed by Chartered Accountancy members and firms. There is also a provision for appellate authority.

The National Financial Reporting Authority shall be a quasi – judicial body to regulate matters related to accounting and auditing.

National Financial Reporting Authority shall give its recommendations on accounting standards and auditing standards. It shall only recommend and it is the Central Government who shall prescribe such standards.

**Objective of NFRA**

The objectives of National Financial Reporting Authority shall be as follows:

- (1) Make recommendations on formulation of accounting and auditing policies and standards for adoption by companies, or their auditors;
- (2) Monitor and enforce the compliance with accounting standards, monitor and enforce the compliance with auditing standards;
- (3) Oversee the quality of service of professionals associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service, and
- (4) Perform such other functions as may be prescribed in relation to aforementioned objectives.

These objectives simply bring chartered accountants, cost accountants, management accountants, company secretaries as well as independent directors / members audit committees under jurisdiction of NFRA.

### **Constitution of NFRA**

(i) It shall consist of a chairperson, who shall be a person of eminence & having expertise in accountancy, auditing, finance, business administration, business law, economics or similar disciplines, to be nominated by Central Government, and such other prescribed members not exceeding 15.

(ii) The chairperson and all members shall make a declaration in prescribed form about no conflict of interest or lack of independence in respect of their appointment. The chairperson and all full – time members shall not be associated with any audit firm or related consultancy firm during course of their appointment and two years after ceasing to hold such appointment.

(iii) The head office of National Financial Reporting Authority shall be at New Delhi and it may, meet at such other places in India, as it deems fit.

(iv) Its accounts shall be audited by Comptroller and Auditor General of India (CAG) and such accounts as certified by CAG, together with audit report, shall be forwarded annually to the Central Government.

### **Jurisdiction, Powers of and Imposition of Penalties by NFRA**

The National Financial Reporting Authority shall have jurisdiction over companies and professional persons and misconduct committed, by any member registered under the Chartered Accountants Act, 1949.

No other institute or body (including professional institutes) shall initiate or continue any proceeding in such matters of misconduct where the authority has initiated an investigation under this section.

The Authority shall have powers as are vested in a civil court under Code of Civil Procedure in respect of following matters:

1. Discovery and production of books of accounts and other documents
2. Summoning and enforcing the attendance of persons and examining them on oath
3. Inspection of any books, registers and other documents of any person
4. Issuing commission for examination of witness or documents.

The Authority shall have powers to make an order in relation to:

(A) Imposing penalty of

- (i) not less than one lakh rupees which may extend to five times of the fees received in case of individuals &
- (ii) not less than ten lakh rupees which may extend to ten times of the fees received in case of firms.

(B) Debarring member or the firm from engaging himself or itself from practice for a period of six months to ten years.

### **Appeals and Appellate Authority**

Any person aggrieved by any order of the National Financial Reporting Authority may prefer appeal to Appellate Authority, set up for this purpose.

The Appellate Authority shall consist of a chairperson and not more than two members. However, the Appellate Tribunal constituted under the Chartered Accountants Act, 1949 will not act as Appellate Tribunal under this section.

**SEC. 133: CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS**

The Central Government may prescribe the standards of accounting, as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

The Ministry has clarified that till the Standards of Accounting is prescribed by Central Government in consultation and recommendation of the National Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act 1956 shall continue to apply.

On 6th Feb. 2015, the Ministry of Corporate Affairs (MCA), the Central Government, in consultation with the National Advisory Committee on Accounting Standards (NACAS), notified the Companies (Indian Accounting Standards) Rules, 2015. These rules came into force on 1st April 2015.

As a result of this notification, Companies (Indian Accounting Standards) Rules, 2015, there shall be two separate sets of Accounting Standards –

1. Indian Accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015.
2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.

**Indian Accounting Standards (Ind AS)**

Indian Accounting Standards (Ind AS) are the accounting standards prescribed under Section 133 of the Companies Act, 2013.

39 Indian Accounting Standards (Ind AS) are specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015.

**Applicability under Rule 3 of the Companies (Indian Accounting Standards) Rules, 2015**

1.	Indian accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015	shall be applicable to classes of company specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.
2.	Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.	shall be applicable to the companies other than the classes of companies specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.

**Classes of company specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015**

<b>(i) Ind AS applicable on voluntary basis</b>	Any company may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after 1st April, 2015, with the comparatives for the periods ending on 31st March, 2015, or thereafter on voluntary basis. “Comparatives” means comparative figures for the preceding accounting period.
<b>(ii) Ind AS applicable on mandatory basis for the accounting periods beginning on or after 1<sup>st</sup> April, 2016</b>	The following companies shall mandatorily comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely: -  (a) Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more; (b) Unlisted companies having net worth of rupees five hundred crore or more; (c) Holding, subsidiary, joint venture or associate companies of companies covered above.
<b>(iii) Ind AS applicable on mandatory basis for the accounting periods beginning on or after 1<sup>st</sup> April, 2017</b>	The following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1st April, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely: -  (a) Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore; (b) Unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore. (c) Holding, subsidiary, joint venture or associate companies of companies covered above.

**Companies exempted under Rule 5 of the Companies (Indian Accounting Standards) Rules, 2015**

The following companies are not required to apply Indian Accounting Standards (Ind AS) for preparation of their financial statements either voluntarily or mandatorily -

- (i) Insurance companies
- (ii) Banking companies and
- (iii) Non-banking finance companies

**SECTION 134: FINANCIAL STATEMENT, BOARD'S REPORT ETC.**

Section 134 deals with financial statements as well as board's report.

The Board's Report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies. The consolidated financial statement is approved by the Board of directors before they are signed

and submitted to auditors for their report. The auditor's report is to be attached to every financial statement.

#### **Requirements as to financial statements**

Financial statement of the company including consolidated financial statements, if applicable, should be approved by the Board of Directors, before such statements are signed.

Financial statement should be signed on behalf of the board by at least

- chairperson of company, duly authorized board, or
- two directors of whom one should be the managing director, and
- chief executive officer, if he is director, chief financial officer and company secretary.

#### **Penal provisions**

Any contravention of provisions of Section 134 is punishable to the following extent –

- (a) company is punishable with fine of not less than rupees fifty thousand but which may extend up to rupees twenty-five lakhs, and
- (b) every officer in default is punishable with –
  - (i) imprisonment up to a term of three years, or
  - (ii) monetary fine from fifty thousand rupees to rupees five lakh, or
  - (iii) both (i) and (ii) above

### **SECTION 135: CORPORATE SOCIAL RESPONSIBILITY**

According to Section 135(1) of the Companies Act 2013, the CSR provision will be applicable companies which fulfills any of the following criteria during any of the three preceding financial years:

- Companies having net worth of rupees five hundred crore or more, or
- Companies having turnover of rupees one thousand crore or more or
- Companies having a net profit of rupees five crore or more

The CSR Rules have widened the ambit for compliance obligations to include the holding and subsidiary companies as well as foreign companies whose branches or project offices in India which fulfills the criteria specified above.

If a company ceases to be a company covered u/s 135(1) of the Act for three consecutive financial years shall not be required to –

- (a) constitute a CSR Committee; and
- (b) comply with the other provisions of section 135.

#### **CSR Committee**

##### **Conditions**

Companies that fulfil any of the aforesaid conditions must constitute a Corporate Social Responsibility Committee of the Board to formulate and monitor the CSR policy of a company.

<b>Composition</b>	CSR Committee to consist of at least three directors, including at least one independent director.
	However, CSR Rules exempts unlisted public companies and private companies that are not required to appoint an independent director from having an independent director as a part of their CSR Committee.
	CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. In case where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors.
	The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India and the other person nominated by the foreign company.
	The Board's report shall disclose the composition of the Corporate Social Responsibility Committee.

<b>CSR Policy</b>
CSR Policy relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.
The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of business profit of a company.
The Board after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website. The Board of every company ensures that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.
<b>CSR Expenditure</b>
The Board of every company shall ensure that the company spends, in every financial year, <b>at least two per cent of the average net profits</b> of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. This amount will be CSR expenditure.
If the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount.
The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

Expenditure incurred on specified activities that are carried out in India only will qualify as CSR expenditure. Such expenditure includes contribution to the corpus or on projects or programs relating to CSR activities.

Expenditure incurred in undertaking normal course of business will not form a part of the CSR expenditure. Companies would need to clearly distinguish those activities which are undertaken specifically in pursuance of normal course of business and those that are done incrementally as part of the CSR initiatives.

Any surplus arising out of CSR activities will not be considered as business profit for the spending company.

Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

### **CSR Activities**

The CSR activities shall be undertaken by the company, as per its stated CSR Policy or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

The Board of a company may decide to undertake its CSR activities approved by the CSR Committee through a registered trust or a registered society or a company established under section 8 of the Act by the company either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company.

A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

The CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure.

The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities.

Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

### **List of CSR Activities**

Some activities are specified in Schedule VII as the activities which may be included by companies in their Corporate Social Responsibility Policies.

These are activities related to:

(i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swachh Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centers and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, protection of flora and fauna, animal welfare, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veteran, war widows and their dependents;

(vii) training to promote rural sports nationally recognized sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(x) rural development projects.

However, in determining CSR activities to be undertaken, preference would need to be given to local areas and the areas around where the company operates.

#### **Activities which would not qualify as CSR**

The following activities shall not qualify as CSR activities.

1. The CSR projects or programs or activities that benefit only the employees of the company and their families.
2. One-off events such as marathons/awards/charitable contribution/advertisement/sponsorships of TV programs etc.
3. Expenses incurred by companies for the fulfillment of any other Act/Statute of regulations (such as Labor Laws, Land Acquisition Act, 2013, Apprentice Act, 1961 etc.)
4. Contribution of any amount directly or indirectly to any political party.
5. Activities undertaken by the company in pursuance of its normal course of business.
6. The project or programs or activities undertaken outside India.

## Disclosure Requirements

It is mandatory for companies to disclose in Board's Report, an annual report on CSR. The report of the Board of Directors attached to the financial statements of the Company would also need to include an annual report on the CSR activities of the company in the format prescribed containing following particulars –

1. A brief outline of the company's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
2. The Composition of the CSR Committee.
3. Average net profit of the company for last three financial years
4. Prescribed CSR Expenditure
5. Details of CSR spent during the financial year.
6. In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

## Important Points

1. **If a company spends in excess of 2% of its average net profit of three preceding years on CSR in a particular year, can the excess amount spent be carried forward to the next year and be offset against the required 2% CSR expenditure of the next year?** Any excess amount spent (i.e., more than 2% as specified in Section 135) cannot be carried forward to the subsequent years and adjusted against that year's CSR expenditure.
2. **Can the unspent amount from out of the minimum required CSR expenditure be carried forward to the next year?** The Board is free to decide whether any unspent amount from out of the minimum required CSR expenditure is to be carried forward to the next year. However, the carried forward amount should be over and above the next year's CSR allocation equivalent to at least 2% of the average net profit of the company of the immediately preceding three years.
3. **Whether government is proposing to establish any mechanism for third parties to monitor the quality and efficacy of CSR expenditure as well as to have an impact assessment of CSR by Companies?** Government has no role to play in engaging external experts for monitoring the quality and efficacy of CSR expenditure of companies. Boards/CSR Committees are fully competent to engage third parties to have an impact assessment of its CSR program to validate compliance of the CSR provisions of the law.
4. **Can CSR funds be utilized to fund Government Scheme?** In principle, CSR fund of companies should not be used as a source of funding Government Schemes. However, under CSR provision of the Act and rules made thereunder, the Board of the eligible company is competent to take decision on supplementing any Government Scheme provided the scheme permits corporates participation.

5. **Who is the appropriate authority for approving and implementation of the CSR programs/projects of a Company? What is Government's role in this regard?**  
Government has no role to play in this regard. all CSR programs/projects should be approved by the Boards on the recommendations of their CSR Committees. Changes, if any, in the program/project should also be undertaken only with the approval of the committee/Board.
  
6. **Whether involvement of employees of the company in CSR project/programs of a company can be monetized and accounted for under the head of 'CSR expenditure'?** Contribution and involvement of employees in CSR activities of the company will no doubt generate interest/pride in CSR work and promote transformation from Corporate Social Responsibility (CSR) as an obligation to Socially Responsible Corporates (SRC) in all aspects of their functioning. Companies therefore, should be encouraged to involve their employees in CSR activities. However, monetization of pro bono services of employees would not be counted towards CSR expenditure.
  
7. **What tax benefit can be availed under CSR?** No specific tax exemptions have been extended to CSR expenditure per se.

### **SECTION 138: INTERNAL AUDIT**

#### *Classes of companies requiring Internal Audit*

Following classes of companies are required to appoint internal auditor-

1. All Listed Company	2. Public Company with				Private Company with	
	Paid up capital	Turnover	Outstanding loans and borrowings	Outstanding deposits	Turnover	Outstanding loans and borrowings
	50 Cr or more or	200 Cr or more or	100 Cr or more or	25 Cr or more	200 Cr or more or	100 Cr or more.

An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

#### **Who can be an Internal Auditor**

- (a) a Chartered Accountant or;
- (b) a Cost Accountant or;
- (c) such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company.

#### **APPOINTMENT OF AUDITORS**

<b>First Auditor</b>	The Board of Directors of a company shall appoint an individual or firm as the first auditor of a company within thirty days from the date of registration of the company.
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	The appointment of first auditor shall be ratified by members at the first annual general meeting. The auditor so appointed shall hold the office from the conclusion of that meeting till the conclusion of sixth annual general meeting and thereafter till the conclusion of every sixth meeting. The appointment of auditors shall be ratified by members at every annual general meeting.
<b>Failure to appoint First Auditor</b>	In the case of failure of the Board to appoint the first auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.
<b>Causal Vacancy</b>	Any casual vacancy (except as a result of the resignation of an auditor) in the office of an auditor of a company shall be filled by the Board of Directors within thirty days. If casual vacancy is as a result of the resignation of an auditor, the Board of Directors shall fill the vacancy within thirty days but such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
<b>Re-appointment</b>	A retiring auditor may be re-appointed at an annual general meeting, if— (a) he is not disqualified for re-appointment; (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed. If at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
<b>Disqualification of Auditor</b>	
Section 141 (3) of the Act read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor of a company, namely:	
<ol style="list-style-type: none"> <li>1. A body corporate, except LLP;</li> <li>2. An officer or employee of the company;</li> <li>3. Any partner of officer or employee of company;</li> <li>4. A person who himself or his relative is holding any security or interest in the company, or any company which is its holding, subsidiary, associate;</li> <li>5. A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment;</li> <li>6. A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment;</li> <li>7. A person or a firm who, whether directly or indirectly, has “business relationship” with the company, or its subsidiary, or its holding or associate company;</li> <li>8. A person whose relative is a director or is in the employment of the company as a director or key managerial personnel;</li> <li>9. A person who is in full time employment elsewhere;</li> </ol>	

10. Person who is auditor of more than 20 companies;  
 11. A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

### **Mandatory Rotation of Auditors Section 139 (2) and Rule 5**

The Companies Act, 2013 has introduced the system of rotation of auditors which is applicable to-

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

The concept of rotation of auditors shall not apply to one person companies and small companies.

All the companies mentioned above shall not appoint or re-appoint **an individual** as an auditor of the company for more than 1 term of 5 consecutive years.

An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the date of completion.

All the companies mentioned above shall not appoint or re-appoint **an audit firm** as an auditor of the company for more than 2 terms of 5 consecutive years.

An audit firm which has completed its 2 terms of 5 consecutive years shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms.

No audit firm shall be appointed as auditor of the company for a period of five years, if same firm presently having a common partner(s) to the previous audit firm, whose tenure has expired in a company immediately preceding the financial year.

### **POWERS AND DUTIES OF AUDITORS**

Section 143(1) provided that every auditor can access at all times to the books of accounts, vouchers and seek such information and explanation from the company and enquire such matters as he considers necessary, including the matters specified in sub-Clauses (a) to (f).

**(a) Loans and Advances made by the Company**

Auditor shall inquire into “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 not prejudicial to the interest of the company or its members”.

**(b) Transactions represented by book entries**

Auditor is required to inquire “whether the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company”.

<b>(c) Sale of investments</b>	Auditor should inquire, “whether the assets of the company have been sold at a price less than that at which they were purchased by the company”.
<b>(d) Loans and Advances shown as deposits</b>	Auditor must verify “whether loans and advances made by the company have been shown as deposits”. The auditor must inquire in respect of all the deposits shown by the company and satisfy himself that the loans and advances have not been shown as deposits.
<b>(e) Charging of Personal expenses to revenue account</b>	Auditor should inquire as to “whether personal expenses have been charged to revenue account”.
<b>(f) Allotment of shares for cash</b>	Auditor should inquire as to “whether cash has actually been received in respect of shares stated to have been allotted for cash and if no cash has actually been so received, whether the position as stated in the account books and balance sheet is correct, regular and not misleading”.

### **AUDIT REPORT**

Section 143 (2) prescribed that auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required to be laid in the general meeting of the company.

The Audit report should state that to the best of his information and knowledge, the said accounts and financial statements give a true and fair view of the state of the company’s affair.

Section 143 (3) laid down that auditor’s report shall also state other details which are as under:

- (a) whether he has sought and obtained all the information and explanations which were necessary 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 and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
- (c) whether the branch audit report prepared by a person other than the company’s auditor has been sent to him;
- (d) whether the company’s balance sheet and profit and loss account 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 section 164 (2);

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(j) Rule 11 prescribed that 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 for material foreseeable losses, if any;

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

#### **SIGNING OF AUDIT REPORTS - Section 145**

Auditor shall sign the auditor's report of the company. Any qualifications, observations or comments on financial transactions matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.