

## Chapter X

### Audit and Auditors

#### Section 139 – 148

Read with

**Companies (Audit and Auditors) Rules, 2014**

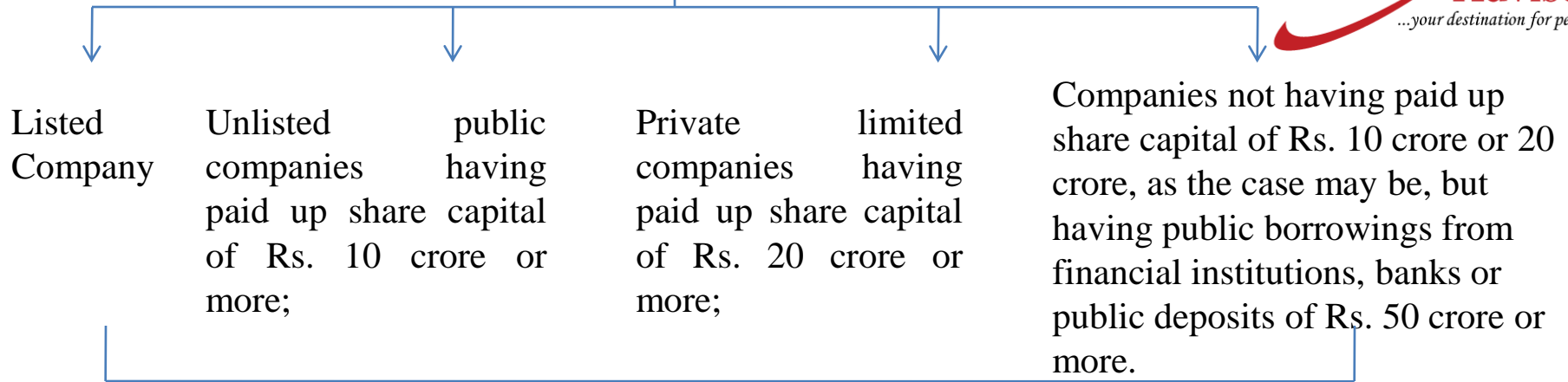
**Sections applicable from April 1 2014:** 139, 140 (except second proviso to sub section 4 and 5), 141, 142, 143, 144, 145, 146, 147, 148

## Appointment of Auditors Section 139; Rule 3, 4, 5



- 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.
- If audit committee is constituted, then such committee otherwise Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor
- At every annual general meeting, Company shall place the matter relating to such appointment for ratification by members through ordinary resolution
- Written consent and a certificate that the appointment shall be made in accordance with the prescribed conditions, be obtained from the auditor
- Certificate shall also indicate whether the auditor satisfies the criteria provided in section 141
- Company shall inform the auditor of his or its appointment and also file a notice of such appointment with the Registrar within fifteen days of the meeting in **Form ADT – 1**.

# Tenure of Auditor



Individual Auditor

Audit firm

Maximum one term of five consecutive years

Maximum two terms of five consecutive years

- Cooling period for re-appointment of Auditor shall be five years
- Cooling period of five years shall be applicable on audit firms having a common partner(s) whose tenure has expired in a company immediately preceding the financial year
- The existing companies shall comply with the stated provisions within 3 years from the date of commencement of this Act
- Nothing contained in section 139(1) shall prejudice the right of the Company to remove an auditor or the right of the auditor to resign from such office of the Company

- Members of a company may resolve to provide that—
  - a) *in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or*
  - b) *the audit shall be conducted by more than one auditor.*

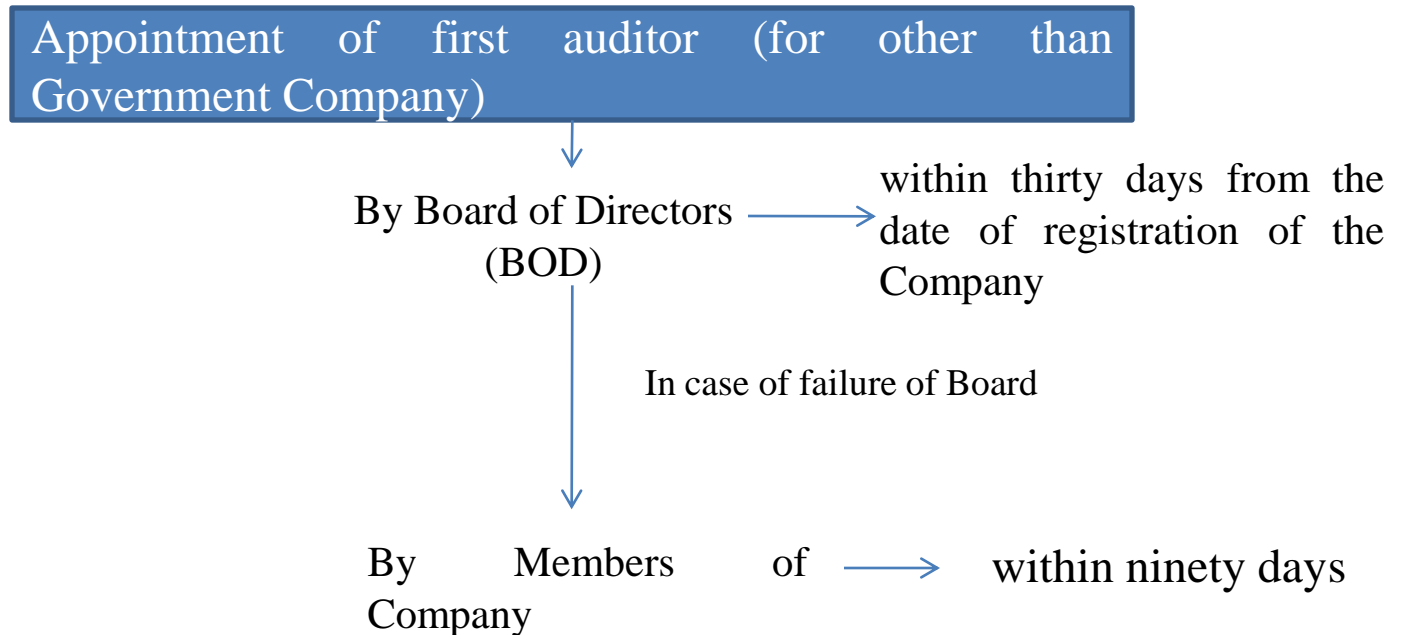
**Manner of rotation of Auditors:**

- The Audit Committee shall recommend to the Board the name of the Auditor who may replace incumbent Auditor on the expiry of his term.
- Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee
- 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

- In case of 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.



Comptroller and Auditor-General of India shall appoint an auditor within 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting



## Appointment of first auditor (for Government Company)

By CAG

By BOD

By Members of Company

Within sixty days from the date of registration of the Company

*In case CAG does not appoint*

Within next thirty days

*In case BOD fails*

Within sixty days at an EGM

## Casual vacancy of Auditor (For Government Company) shall be filled

By CAG

within thirty days

*In case CAG does not fill the vacancy*

By BOD

Within next thirty days

## Casual vacancy of Auditor (For other than Government Company) shall be filled

Vacancy due to resignation

Vacancy due to other than resignation

Appointment shall be approved at a general meeting convened within three months of the recommendation of the Board

within thirty days by BOD

**A retiring auditor cannot be re-appointed at an annual general meeting if:**

→ He is disqualified for reappointment

→ If he gives notice in writing of his unwillingness to be re-appointed

→ If special resolution has been passed for 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
- Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor shall be made after taking into account the recommendations of such committee

## Removal, resignation of Auditor and giving of special notice Section 140; Rules 7, 8

- Auditor may be removed by special resolution and previous approval of Central Government.

The application to the Central Government shall be made in **Form ADT 2** within 30 days of the passing of the Board Resolution

- Company shall hold general meeting within sixty days of approval of Central Government for passing special resolution
- Concerned Auditor shall be given a reasonable opportunity of being heard

A statement shall be filed by Auditor who has resigned in Form ADT 3 within thirty days of resignation to



### Penalty

Penalty on Auditor for non compliance of section 140(2)

Fine: Rs. 50,000/- to Rs. 5,00,000/-



- If Auditor is appointed at an annual general meeting other than retiring auditor before expiry of his tenure, special notice shall be given for resolution
- The Company shall send a copy of notice to retiring auditor
- Representation given by Auditor to Company shall:
  - state the fact of the representation in notice of resolution given to members
  - send a copy of the representation to every member
- If a copy of the representation is not sent because it was received too late or because of the company's default, the auditor may require that the representation shall be read out at the meeting
- If a copy of representation is not sent, a copy thereof shall be filed with the Registrar
- If the Tribunal is satisfied (on an application either of the company or of any other aggrieved person) that the rights are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.
- Tribunal may order to Company to change its Auditor, if it is satisfied that the auditor of a Company has, whether directly or indirectly, acted in a fraudulent manner
- Tribunal may give aforesaid order either suo motu or on an application made to it by the Central Government or by any person concerned

- If application made by Central Government to Tribunal and Tribunal is satisfied that any change of the auditor is required , then within 15 days of receipt of application, Tribunal shall give order for change of the Auditor and Central Govt. may appoint another Auditor
- Auditor against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any Company for a period of five years from the date of passing of the order
- The auditor shall also be liable for action under section 447
- In case of criminal liability of any Audit firm, the liability other than fine shall devolve on the concerned partner who acted in a fraudulent manner.

## Eligibility, qualifications and disqualifications of auditors Section 141, Rule 10



- Individual Auditor shall be Chartered Accountant
- Audit firm having majority of partners practicing in India may be appointed as an Auditor of the Company
- In case of 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
- **Persons not eligible for appointing as an Auditor:**

→ Body Corporate other than LLP

→ An officer or employee of Company

→ Person who is a partner or in employment of an officer or employee of Company

→ A person who, or his partner or relative:

- ✓ holding any security or interest in Company or its subsidiary or its holding or subsidiary of such holding Company or associate Company - *but relative may hold security or interest of face value not exceeding Rs. 1,000 or such sum as may be prescribed*

- ✓ Indebted in excess of Rs. 5,00,000/- to company or its subsidiary or its holding or subsidiary of such holding company or associate company
- ✓ Given any guarantee or provide security in excess of 1,00,000 to Company or its subsidiary or its holding or subsidiary of such holding company or associate company

→ A person or firm who has business relationship of such prescribed nature with Company or its subsidiary or its holding or subsidiary of such holding Company or associate Company

→ A person whose relative is a director or is in the employment of the Company as a director or key managerial personnel

→ A person who is in full time employment elsewhere or a person or a partner holding appointment as auditor of more than 20 Companies

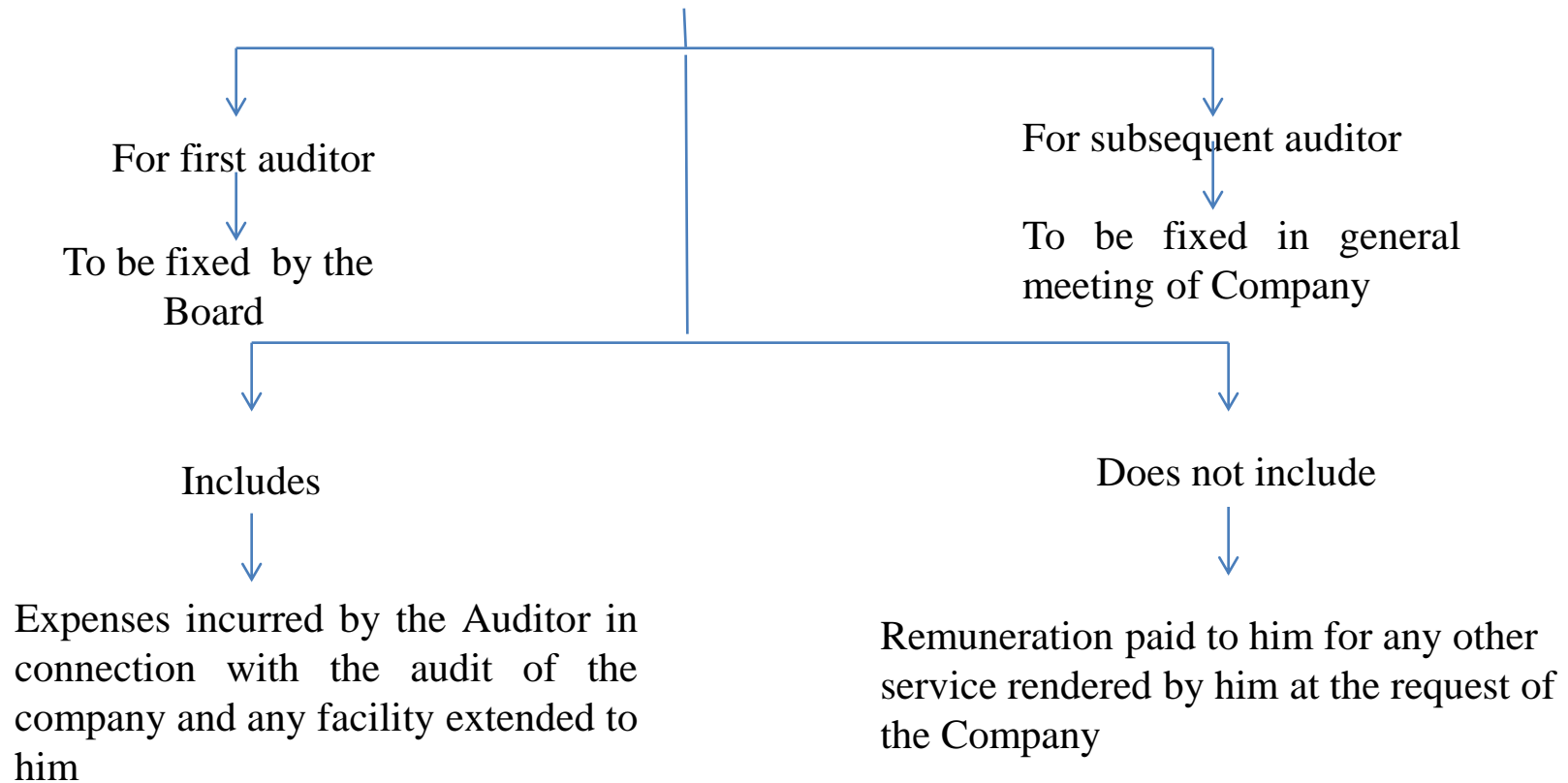
→ Person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed

→ Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144

- If Auditor has been disqualified 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.

# Remuneration of Auditors Section 142

## Remuneration of Auditor



## Powers and duties of Auditors and Auditing Standards Section 143; Rules 12, 13



- Auditor shall have a right of access at all times to the books of accounts and vouchers of the Company, entitled to require such information for the performance of his duties and amongst other matters inquire into following :
  - Whether loans and advances have been properly secured and the terms are prejudicial to the interests of the company or its members
  - Transactions represented by mere book entries are prejudicial to the Company.
  - Whether 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 (company not being an investment or banking company)
  - Whether loans and advances made by the company are shown as deposits
  - Whether personal expenses are charged to revenue account
  - Where it is stated in the books and documents that shares have been allotted for cash, whether cash received or not, if not the position as stated in the account books and balance sheet is correct and not misleading
- Auditor shall make a report to the members regarding the accounts and financial statements of the Company and that they are prepared according to the Auditing Standards and shall give a true and fair view

***The auditor's report shall also state:***

- ✓ whether he has obtained all the information 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
- ✓ whether, in his opinion, proper books of account as required by law have been kept by the company and those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him
- ✓ whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him and the manner in which he has prepared his report
- ✓ 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
- ✓ whether, in his opinion, the financial statements comply with the accounting standards
- ✓ the observations or comments of the auditors on financial transactions or matters having any adverse effect on the functioning of the company
- ✓ whether any director is disqualified from being appointed as a director under sub-section (2) of section 164
- ✓ any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith, Powers and duties of auditors and auditing standards.
- ✓ whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
- ✓ such other matters as may be prescribed.

- Where any matters included in the audit report is answered in a negative or a qualification, the report shall state the reasons therefor.
- In case of a Government Company, the Comptroller and Auditor General of India shall appoint an auditor and direct such auditor the manner in which accounts shall be audited .
- The auditor shall submit a copy of audit report to CAG and include the directions if any issued by it , the actions taken thereon and its impact on accounts and financial statements of the company
- The CAG within 60 days from the receipt of the Audit report have a right to :
  - ✓ conduct a supplementary audit of the financial statement of the company by person(s) authorized in this behalf, and require information or additional information to be furnished to any person(s) so authorised, on such matters, by such person(s) and in such form, as the CAG in India may direct; and
  - ✓ comment upon or supplement such audit report
- The CAG of India may in case of any company under section 139(5) or 139(7) order test audit to be conducted of the accounts of such Company
- The provisions u/s 19A of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 shall apply to the test audit



- If Company has a branch office
  - ✓ **In India:** Accounts shall be audited either by the Auditor of the Company or any person qualified to be appointed as an auditor and appointed as such under section 139
  - ✓ **Outside India:** Accounts shall be either audited by the company's auditor or accountant or any other person qualified to act as an auditor as per the laws of that country
- The branch auditor shall submit his report to the company's auditor
- The provisions of section 143(12), regarding reporting of fraud by the Auditor shall also extend such branch Auditor to the extent it relates to the concerned branch
- Every Auditor shall comply with the auditing standards
- The Central Government may prescribe the standards of auditing or any addendum thereto, 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 - *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*

- The Central Government may:
  - ✓ in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.
- The auditor shall report to the Central Government about the offence involving fraud against the company by officers or its employees within 60 days and as per the manner prescribed in the rules
- The provisions of this section shall mutatis mutandis apply to:
  - ✓ the cost accountant in practice conducting cost audit under section 148
  - ✓ the company secretary in practice conducting secretarial audit under section 204
- If any auditor, cost accountant or company secretary in practice do not report the fraud to Central Government, he shall be punishable with fine which ***shall not be less than Rs. 1,00,000/- to Rs. 25,00,000/-***.

## Auditor not to render certain services Section 144

- Auditor shall not provide following services to Company
  - ✓ Accounting and book keeping services
  - ✓ Internal Audit
  - ✓ Design and implementation of any financial information system
  - ✓ Actuarial services
  - ✓ Investment advisory services
  - ✓ Investment banking services
  - ✓ Rendering of outsourced financial services
  - ✓ Management services
  - ✓ Any other kind of prescribed services
- An auditor or audit firm who has been performing non-audit services on or before the commencement of the Act shall comply before the closure of the first financial year after the date of such commencement

Auditor to sign audit reports, etc.  
Section 145

- Any person appointed as an auditor shall sign the Auditor's report or certify any other document of the company in accordance to the provisions of sub section (1) of section 141.
- Any qualifications, comments or observations which have any adverse effect on the functioning of the company by the auditor in his report shall be read out before the company in General meeting and shall be open to inspection by member.

Auditors to attend General meeting  
Section 146

- All notices, communications of the general meeting shall be given to the Auditor and he shall attend the General meeting unless otherwise exempted by the Company.
- Auditor can attend either by himself or through his authorised representative who shall be qualified to be an Auditor and shall have the right to be heard on part of the business which concerns him as the Auditor

## Punishment for contravention Section 147

### Contravention by:

Company or its officer

Auditor

Any of the provisions of section 139 to 146(both inclusive) are contravened then;

- Company shall be liable to pay fine not less than 25,000 which may extend to 5 lakh rupees.
- Every Officer of the Company who is in default will be punishable with imprisonment which may extend to 1 year or with fine not less than 10,000 which may extend up to 1 lakh rupees or with both.

Any of the provisions of section 139, 143, 144 or 145 are contravened then;

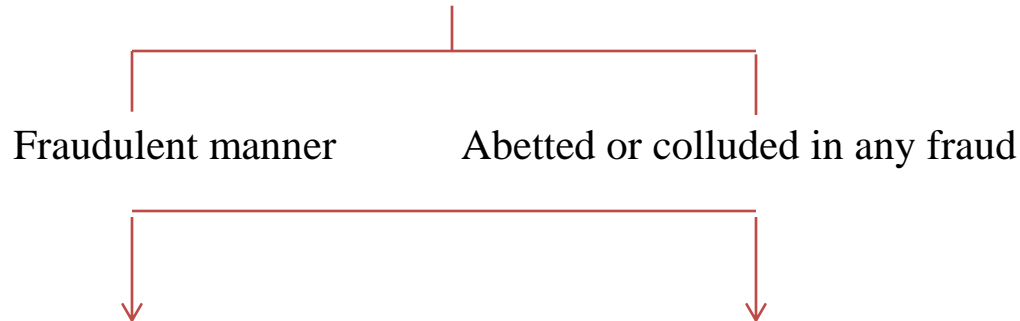
- He shall be punishable with fine not less than 25,000 which may extend to 25 lakh rupees.
- If Auditor has contravened wilfully to deceive the company, shareholders, Income tax Authorities or creditors then he shall be punishable with imprisonment which may extend to 1 year and fine not less than 1lakh rupees which may extend up to 25 lakh rupees

➤ Where an Auditor is been convicted under sub section(2), he shall

- Refund the remuneration received by him to the Company
- Pay for damages to the Company, statutory bodies, Authorities or any other persons for loss arising out of incorrect or misleading statements of particulars made in his Audit Report.

➤ Central Government may by notification specify :

- Any Statutory body, Authority or an Officer to ensure payment referred to in clause(2) of sub section(3).
  - It shall make a Report to the Central Government regarding payment of damages in the manner as may be prescribed.
- Where Audit has been conducted by an Audit Firm, it is proved that the partner(s) of the Audit Firm has or have acted in a :



By or in relation to the Company or its Directors or officers, the liability whether civil or criminal as provided under this Act or in any other law, for such act shall be of the partner or partners concerned of the Audit firm and of the Firm jointly or severally

Central Government to specify Audit of certain items of cost  
in respect of certain Companies

Section 148 Rule 14



The Central Government may order, such class of Companies engaged in such goods and services as may be prescribed

- To keep particulars of material, labour or such items of cost to be included in the books of accounts kept by the company.
- In case of Companies constituted under a special Act, Central Government before issuing such order shall consult Regulatory body established under this special Act

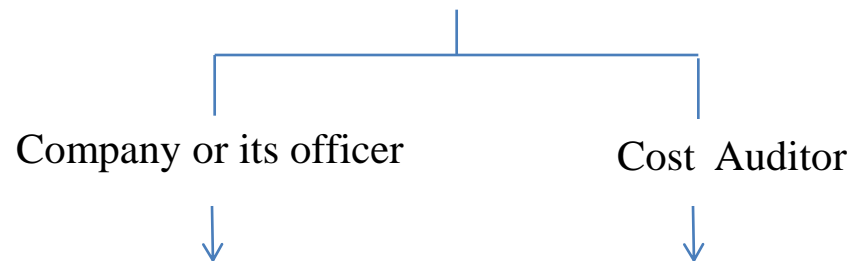
If the Central Government feels necessary it may direct the audit of the Cost records in the manner as specified for the Companies covered under sub section(1) and having net worth or turnover as may be prescribed

The Audit shall be conducted by a Cost Accountant in practice appointed by the Board on such remuneration as may be prescribed. In case of Companies in which Audit Committee has been constituted the remuneration has to be recommended by the Audit Committee and approved by the Board of Directors, which needs subsequent ratification by the Shareholders

No person appointed as an Auditor under Section 139 shall be appointed for conducting cost Audit

- The Auditor shall comply with the cost accounting standards
- The qualifications, disqualifications, rights, duties and obligations applicable to Auditors shall be applicable to Cost Auditor also.
- Audit of cost records shall be submitted by Cost Auditor to the Board of Directors of the Company.
- This Company shall within 30 days from the receipt of a copy of Cost Audit report submit it to the Central Government along with such report with full explanation on every reservation or qualification contained therein
- If the Central Government is of the opinion that further explanation is necessary, it may call for it and the Company shall furnish it within the time specified

If default is made by



Company shall be punishable in the manner as specified in sub section(1) of section 147.

He shall be punishable in the manner specified in sub section (2) to (4) of section 147



➤ Rules regarding remuneration of Cost Auditor

In case of Companies which are required to constitute an Audit committee

- Board shall appoint an individual, who is a cost accountant in practise, or firm of cost accountant in practise, as a cost Auditor on recommendations of the committee which shall recommend its remuneration.
- The remuneration decided shall be approved by the Board which shall be ratified by the shareholders.

In case of Companies which are not required to constitute an Audit committee:

Board shall appoint an individual, who is a cost accountant in practise, or firm of cost accountant in practise, as a cost Auditor, remuneration. Shall be ratified by the shareholders

Forms:

Form No. ADT-1: Notice of Appointment of Auditor by the Company

Form No. ADT-2: Application for removal of Auditor(s) from his/their office  
before expiry of term

Form No. ADT-3: Notice of resignation by the Auditor

Form No. ADT-4: Report to the Central Government