

COMPANY LAW

UNIT 5 : Dividends, Audit and Winding Up

TOPIC- AUDIT AND AUDITORS

Audit and Auditors

Audit refers to a systematic and independent examination of the books, accounts and vouchers of an enterprise as will enable the auditor to formulate an opinion whether they depict the picture of the enterprise in a true and fair manner.

In the case of companies, the shareholders are generally not involved in day to day working and are like the absentee owners of the company. That's why **the Companies Act has made the audit of the books of accounts of a company compulsory.**

In order to ensure the independence of the auditors so that they act as a check on directors and also work in the best interests of the shareholders, **Sections 139 to 148 of the Companies Act contain various provisions pertaining to their appointment, removal, qualifications, disqualifications, powers, duties etc.**

Appointment of Auditors(Sec.139)

Type	Who appoints them	Where appointed	When appointed	Term of appointment
First Auditors	BOD	Board Meeting	Within 1 month of company registration	From date of appointment till conclusion of First AGM
	Members, incase BOD fail to appoint	EGM	Within 90 days*	
Subsequent Auditors	Shareholders	AGM	First AGM	From conclusion of that meeting untill the conclusion of 6th AGM i.e. term of 5 yr
Auditors against casual vacancy	BOD (If casual vacancy is caused by resignation, then such appointment to be approved also by shareholders at an EGM held within 3 months of recommendation by Board)	Board Meeting	Within 30 days of vacancy	From date of appointment till conclusion of next AGM

Appointment of Auditors in a Govt. Company

First Auditor of Govt Company	CAG of India (Comptroller and Auditor General) of India		Within 60 days from registration of the company	From date of appointment till conclusion of First AGM
	BOD, if CAG doesn't appoint within the prescribed period	Board Meeting	Within next 30 days	From date of appointment till conclusion of First AGM
	Members of the company, if BOD also fail	EGM	Within 60 days of Boards failure	From date of appointment till conclusion of First AGM
Subsequent Auditor of Govt Company	CAG of India		Within 180 days from commencement of the financial year	From date of appointment till conclusion of next AGM
Auditors against casual vacancy incase of Govt Company	CAG of India (If CAG fails, then BOD shall fill it up within next 30 days)		Within 30 days of vacancy	From date of appointment till conclusion of next AGM

Other important points in case of appointment of an auditor by a company-

- Before any appointment of auditor is made, company must obtain his **written consent**
- The company must also obtain from him a **certificate** that he satisfies the prescribed criteria and conditions for appointment
- The auditor so appointed shall be informed about it within **15 days** of appointment
- Notice of such appointment shall be filed with the Registrar within **15 days**.
- Auditors , when appointed by shareholders, are appointed by **Ordinary Resolution** only.
- The term auditor includes **-an individual, a firm of auditors ,an LLP of auditors**
- Where a company has an **Audit Committee as per sec.177**, all appointments, including filling up of casual vacancies , shall be made after taking into account the recommendations of the Audit Committee.
- A **retiring auditor may be reappointed** at an AGM provided
 - he is not disqualified for reappointment;
 - he has not given in writing to the company his unwillingness to be reappointed; and
 - no such special resolution has been passed in the meeting which seeks to appoint some other auditor or expressly provides that he shall not be reappointed.

This provision will not apply to those companies where provisions regarding rotation of auditors are applicable.

- Where at any AGM , **no auditor is appointed \ reappointed, the existing auditor shall continue** to be the auditor of the company

Rotation of auditors

As per Sec139(2), the listed companies and certain prescribed companies(like unlisted co having paid up capital of 10 crores or more o/ private co having paid up capital of 50 crores or more / any company having borrowings from public ,financial institutions , banks etc of 50 crores or more) are required to compulsorily rotate their auditors in the following manner-

- An individual auditor cannot be appointed for more than **1 term of 5 consecutive years**
- An audit firm\ LLP cannot be appointed as auditor for more than **2 terms of 5 consecutive years**
- The individual auditor \ firm\LLP, who have completed their term as above, are not eligible for reappointment as auditor in the same company for 5 years from completion of such term. It implies there shall be **cooling off period of 5 years** for rotated auditor\ firm \LLP and that they can be considered for appointment again only after this gap of 5 years.
- During the cooling off period, even **an audit firm connected with the previous audit firm via a common partner, shall not be eligible** for appointment in that company. It implies that during cooling period even connected firms can't be the auditor in that co.
- Under Sec.139(3), the members of the company may resolve that in the audit firm appointed by it, the auditing partner & his team shall be rotated at specified intervals(i.e. **internal rotation**) or that audit be conducted by more than one auditor(i.e. **joint audit**)

Removal and Resignation of Auditor (Sec.140)

Removal of auditor by shareholders: An auditor may be removed from office before the expiry of his term provided

- Board Resolution to be passed to the removal of auditor
- Approval of C.Govt. (i.e. Regional Director) to be obtained (within 30 days of Board resolution)
- Special resolution for this to be passed in the general meeting (within 60 days of CG approval)
- Reasonable opportunity of being heard has been given to the concerned auditor

Removal of auditor by Tribunal : Tribunal, may, by an order, direct the co. to change its auditor if

- either suo motto or on application made to it by C.Govt. or by any person concerned
- it is satisfied that the auditor of the company acted in fraudulent manner or is involved in any fraud in the company

Resignation of auditor: An auditor who has resigned from the company shall

- file within 30 days from date of resignation , a Statement in prescribed form ,with the company and ROC ,indicating therein the reasons and other facts regarding his resignation
- In case of government companies, the auditor has to file such statement with CAG of India also
- If he fails to do so, he shall be punishable with prescribed fine or his remuneration , whichever is less

Disqualifications of an Auditor (141(3))

To ensure integrity and independence in audit , the following persons cannot be appointed as auditor of a company-

- A **body corporate** other than an LLP
- An **officer \employee** of a company
- A **partner \ employee of an officer\ employee** of a company
- A person who himself\ whose relative\ whose partner is holding any security\ interest in the company\ its subsidiary \holding\associate\co subsidiary provided that the **relative may hold security \ interest in the co. of face value<= ₹1 lakh.**
- A person who himself \ whose relative\ whose partner is **indebted** to the company \ its subsidiary\ holding\ associate \ co -subsidiary in , **excess of ₹5 lakh.**
- A person who himself\whose relative\ whose partner has given **guarantee** to the company\ its subsidiary \holding\ associate \ co- subsidiary , **in excess of ₹ 1 lakh**
- A person , who has directly or indirectly any **business relationship**, with the company\its subsidiary \ holding\associate\ co-subsidiary .
- A person whose relative is a **director\ KMP in the company**
- A person who is in **full time employment elsewhere**
- A person **convicted by a court of an offence involving fraud and 10 years have not elapsed** from such conviction.
- A person who directly or indirectly **renders any service specified in Sec.144** to the co.\ its subsidiary\ holding (viz. actuarial services ; accounting & bookkeeping services ; implementation of financial information system ; Internal audit; Investment banking/ advisory services ; management services ; outsourced financial services etc.)

If a person gets appointed as an auditor of a company but incurs any of the above disqualifications subsequently, then he shall vacate his office and such vacation shall be deemed to be casual vacancy in the office of the auditor.

Qualifications of Auditors(Sec.141(1) and 141(2))

Following are the persons who are eligible to become the auditor of a company

- An individual who is a Chartered Accountant (CA) **in practice**.
- A firm , majority of whose partners are practising CA, can be appointed by firms name
- LLP can be appointed by firms name but only CA partners can act & sign on its behalf.

Ceiling on Audit (141(3))

- No person can be auditor of more than **20 companies** at a time.
- The restriction applies to all types of companies namely, public, private and one person companies.

Remuneration of Auditors(Sec.142)

- The **shareholders in the general meeting** shall either **fix the remuneration** of the auditor or determine the manner in which it shall be paid.
- The **BOD may fix remuneration of the First auditor** appointed by it
- The remuneration of the auditor includes **fees payable to him+ reimbursement of his audit related expenses + any facility extended to him in connection with audit**. It does not include any remuneration paid for any other service rendered by him at the request of the company, e.g. consultancy provided on taxation matters etc.

SECRETARIAL AUDIT (SEC. 204)

- A secretarial audit examines legal compliances i.e. it is a process to check an organization's compliance with the provisions of law, rules , regulations and procedures.
- Secretarial Audit is required for the following companies-
 - ✓ every listed company
 - ✓ every public co having paid up share capital of ≥ 50 crores / turnover of ≥ 250 crores
 - ✓ every company having outstanding loans or borrowings from banks, FIs etc ≥ 100 crores
- Secretarial Audit shall be done by a Company Secretary in practice and the company should provide him with assistance and facilities required for examining the secretarial and other records of the co.
- Secretarial auditor is appointed by a resolution passed at Board meeting. A formal letter of engagement must be duly accepted by him.
- He shall give a Secretarial Audit Compliance Report which needs to be annexed with the Board's Report. Incase the Secretarial auditor makes any qualification, observation or remarks in his Report, the BOD should give a full explanation on that matter.
- If a company or any officer or company secretary in practice contravenes the provisions of Sec.204, penalty of Rs 2 lakhs can be imposed.