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Lesson No.

- 2.1 : Appointment and removal of company auditors
- 2.2 : Rights and powers of company auditors
- 2.3 : Liabilities of auditors
- 2.4 ; Auditor's report

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APPOINTMENT AND REMOVAL OF COMPANY AUDITORS

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2.1.1 Objectives of the Lesson :

- * To study the eligibility of an auditor.
- * To discuss the provisions regarding the appointment, removal and disqualifications of an auditor.

2.1.2 Introduction :

The Companies Act, 2013 in India has made the audit of the accounts of companies compulsory. The Companies Act contains specific provisions in this regard from sections 139 to 148. These sections lay down the qualification, disqualification, rights, duties of company auditors and the process of their appointment, reappointment, removal and fixation of remuneration. So, under the act, the appointment of an auditor is compulsory in a company. On the other, hand, there is no specific law regarding audit of the accounts of sole trading business and a partnership firm. It is obligatory for sole trading business that he may appoint an auditor. In partnership firm also the mutual agreement between partners is necessary.

2.1.3 Eligibility to become an Auditor :

Section 141 of the Companies Act provides the qualifications and disqualifications of company auditors. (1) "a person shall not be qualified for appointment as auditor of a company unless he is a chartered accountant with in the meaning of the Chartered Accountant's Act 1949," A firm and all the partners practising in India qualified for appointment as auditors, may be appointed by its firm name to be the auditor of a company. Under the Chartered Accountants Act, 1949, only a Chartered Accountant, if a chartered accountant is practising as a sole proprietor, can be appointed as an auditor only as an individual and not in the name of his firm.

Section 141 (3) provides that following persons are not qualified for the appointment as auditor of a company;

- (i) a body corporate;
- (ii) an officer or employee of the company;
- (iii) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (iv) a person who is indebted to the company for an amount exceeding rupees one thousand.

2.1.4 Appointment of Company Auditors :

Section 139 of the Companies Act lays down detailed provisions regarding the appointment of auditors of a company.

2.1.4.1 Appointment of First Auditor :

The first auditor or auditors to hold office, until the conclusion of the first general meeting should be appointed by the Board of Directors within one month of the date of registration of the company U/s 139(6). But the company, may at a general meeting, remove such an auditor or all or any of them and appoint others in his or their place on a notification being made by any member of the company, notice being given to the members of the company not less than fourteen days before the date of meeting.

2.1.4.2 Appointment by Shareholder :

If the first auditor or auditors are not appointed by the directors, the company in general meeting may appoint the first auditor of a company. The first auditor is normally is appointed by the shareholders by passing a resolution at the annual general meeting; once appointed, he holds office from the date of appointment to the conclusion of the next annual general meeting. It is obligatory on the part of a company to annually make such an appointment, as well as to give, within 7 days of the appointment intimation there of every auditor so appointed.

Under Section 139 (1) an auditor appointed u/s 224 (I), should inform the Registrar, in writing, of his acceptance of refusal within fifteen days of the receipt of intimation that he has been appointed as auditor.

2.1.4.3 Period of Appointment :

Section 139 (1) provides that an auditor is appointed for a particular period i.e. from the conclusion of one annual general meeting until the conclusion of the sixth annual general meeting. If the annual general meeting is not called within the prescribed time, the auditor will continue in office till the annual general meeting is actually held and concluded. If the annual general meeting is adjourned, the auditor will continue to hold office till the conclusion of the adjourned meeting.

2.1.4.4 Reappointment of Retiring Auditor :

Under Section-139 (2) sub section (1-B) at any annual general meeting, a retiring auditor shall be re-appointed unless :

- (i) He is not qualified for re-appointment;
- (ii) He has given to the company a notice in writing of his willingness to get reappointed;
- (iii) A resolution has been passed at the annual general meeting for appointing somebody instead of him or providing expressly that he shall not be reappointed; or
- (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 or of all those persons, as the case may be, the resolution cannot be proceeded with.

From the above, it is noted that even for the reappointment of a retiring auditor, the passing of a resolution is essential. In the absence of a resolution, the retiring auditor is not automatically reappointed.

2.1.4.5 Appointment of Auditor by the Central Government : Sec 140 (5)

If at an annual general meeting, no auditors are appointed or re-appointed the Central Government may appoint a person to fill the vacancy. It is the duty of the company to give notice of the fact, that no auditor was appointed in the annual general meeting, to the Central Government within, seven days of the date of the annual general meeting. In case of any default to give notice to the Central Government, the company and every officer in default shall be punishable with fine that may extend to Rs. 5000.

2.1.4.6 Filling of Casual Vacancy :

A casual vacancy in the office of the auditor can be filled by the Board of Directors, u/s 139 (8), the Board of Directors, may fill any casual vacancy in the office of an auditors but while any such vacancy continues, the remaining auditor or auditors if any may act." However, where such vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in general meeting." It is also provided that an auditor, "appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting."

The meaning of 'Casual Vacancy' has not been defined in the Act. Taking its natural meaning, it stands for vacancy created by the auditor ceasing to act after he was validly appointed and appointment was accepted. This vacancy may arise due to a variety of reasons, which includes death, resignation, disqualification, dissolution in case of the firm of auditors etc.

2.1.5 Ceiling on Audit :

According to Companies Act, it has been mentioned that before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit assignments by the auditor concerned over the limit laid down in section 141 (3) (g). According to Section 141 (3) (g), any Chartered Accountant can not hold more than the specified number of company audits, i.e. twenty companies.

2.1.6 Auditor appointed failing to accept the appointment

Sometimes, auditor appointed by shareholder at annual general meeting may not accept the appointment. In such a situation, it can be deemed that no auditor had been appointed by the company at its annual meeting and there upon, then Central Government would be eligible to appoint the auditor. This is because the appointment of an auditor is complete and effective only on auditor's acceptance. If auditor does not accept the post, then non-acceptance does not result in any casual vacancy.

According to the Research Committee of the Institute of Chartered Accountants of India the provisions of Section 24 of the act do not allow changing the normal law of contract. According to the Committee no appointment or reappointment makes the Board of Directors (authorised by the shareholders to appoint new auditors) complete and effective if the auditor declines the same. Such a case is neither a vacancy caused by resignation nor a casual vacancy.

The Companies Act clearly shows that appointment of auditor is right of shareholders only. They cannot delegate this power to Board of Directors, so the shareholders should exercise this power in all the cases, except the case of filling a casual vacancy or appointing the first auditor.

2.1.6.1 Self-check Exercise 1 :

1. How can an auditor be appointed?

2.1.7 Appointment of auditor of a Government Company

In respect of any government company, appointment of auditor is governed by the provisions of section 139 (5) & (2) of the Companies Act. According to this section, the auditor of government company shall be appointed and re-appointed by the central government on the advice of the Comptroller and Auditor General of India.

2.1.8 Disqualifications of an auditor

Section 141(3) provides for the following disqualifications for the appointment of auditor :

- (a) a body corporate
- (b) an officer/employee of the company
- (c) a person who is a partner or in employment of an officer/employee of the company.
- (d) a person who is indebted to the company for an amount exceeding Rs. 1,000 or who has given any guarantee or provided any security in connection with the indebtedness or any third person.
- (e) a person, who by virtue of the above disqualifications is disqualified for appointment as auditor of any other body corporate which is the company's subsidiary or holding company or a subsidiary of that company's holding company or would be so disqualified if the body corporate were a company.

2.1.9 Removal of Auditors

In order to provide a check against the removal of auditors, the Companies Act prescribes specific procedures in this regard. The procedures contain many safeguards to ensure the independence of auditors. The procedures are :

1. The first auditor, appointed by the Board of Directors can be removed by the company at an annual general meeting before the expiry of his term, without obtaining the previous approval of the Central Government. However, a special notice of at least 14 days is required for the appointment of any other person in his place.
2. Under Section 140, an auditor may be removed before the expiry of his term, only by the company in general meeting after obtaining the previous approval of the Central Government.
3. Removal by NCIT. If the Tribunal is satisfied that the auditor has acted fraudulently, it may direct the company to change its auditors. NCLT can take action S40 moto or on application made to it by Central Government 140 (5).

4. In all cases of removal of auditor, before the expiry of their term, the provisions of section 225 shall apply. These relate to the right of the auditor to make written representations, get them circulated to the members of the company, and to be heard orally at the annual general meeting. The explanation of the provisions is as follows:

Section 140 lays down the procedure regarding the appointment of new auditor in place of a retiring auditor :

- (i) A special notice is required for a resolution at an annual general meeting to appoint a person other than the retiring auditor or to provide that the retiring auditor shall not be reappointed Sec 140 (4).
- (ii) After receiving the special notice, the company shall send a copy thereof to the retiring auditor.
- (iii) The retiring auditor has a right to make written representation. At the request of the auditor, the company shall send a copy of the representation to the members if a copy of the representation can not be sent to the members 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 annual general meeting. He may also claim to be heard orally at the general meeting.
- (iv) The copies of the representations need not be circulated or read out in the meeting, if on the application of the company or any other aggrieved person, a competent court is satisfied that the auditor is abusing this right to secure needless publicity for defamatory matters, in such a case, the court can order that the auditor should meet the Company's costs.

2.1.9. 1 Self-check Exercise 2 :

2How can an auditor be removed?

2.1.10 Summary :

In this chapter, the eligibility of an auditor and provisions regarding his appointments, disqualification and removal have been discussed in detail. The Central Government also has powers to appoint an auditor in respect of Government Companies.

2.1.11 Glossary

- a) CG- Central Government

2.1.12 Answers to Self-check Exercises :

- Self-check Exercise 1 : Refer Para 18.4 Self-check Exercise 2 : Refer Para 18.10

2.1.13 Questions for Exercise :

1. Describe the provisions of the Companies Act, 2013 with regards to

- qualifications of an auditor.
2. How are auditors appointed in a public limited co.?
 3. How can an auditor be removed?
 4. Write short note on:
 - Eligibility to become an Auditor
 - Appointment of Company Auditors

2.1.14 SUGGESTED READINGS

Contemporary Auditing	:	Kamal Gupta
Auditing Theory & Practice	:	Pardeep Kumar, N.K. Sahni & Baldev Sachdeva.

RIGHTS AND POWERS OF COMPANY AUDITORS

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- 2.2.2 Introduction
- 2.2.3 Rights of Company Auditors
- 2.2.4 Duties of Company Auditors
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- 2.2.5 Position of an Auditor
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- 2.2.6 Summary
- 2.2.7 Glossary
- 2.2.8 Questions for exercise
- 2.2.9 Suggested Readings

2.2.1 Objectives of the Lesson :

- To study the rights of company auditors
- To examine the duties of company auditors
- To discuss the position of company auditors

2.2.2 Introduction :

There are various rights conferred upon the auditor by the Companies Act, 1956. The principal rights are discussed in detail in this chapter.

2.2.3 Rights of Company Auditors :

Section 143 lays down the provisions relating to the powers and duties of the auditors, summarised below :

(1) Right of access to books of accounts : (Sec 143 (1))

The auditor of a company, at all times, has the right of access to the books of accounts and vouchers of the company, whether kept at the head office or elsewhere and he is entitled to obtain from the officers of the company such information and explanation as he thinks necessary for the performance of his duties as auditor.

The term 'Officer' includes any director, manager or secretary.

The term 'books, accounts and vouchers' will include all books which have any bearing, or are likely to have any bearing on the accounts, whether these be usual financial books, or the statutory or statistical books.

The term 'vouchers' include all or any of the correspondence which may serve to vouch for the accuracy of the account.

(2) Right to require information and explanation from officers :
Section 143 (1) of the Companies Act empowers the auditor of a company to acquire from the officers of the company such information and explanations as the auditor may think necessary for the performance of his duties as auditor." The auditor can, thus, call for any explanations or information which he considers necessary. In case any information or explanations 'are not given to him, he should report this to the members.

It is obligatory for the officers of a company to furnish without delay the relevant information to the auditor.

(3) Right to attend General Meeting : (Sec 146)

The auditors of a company are entitled to attend any general meeting of company; also to receive all the notices and the communications relating to the General meetings, which members are entitled to receive and to be heard at any General meeting on any part of the business which concerns them as auditors.

Thus, the auditor has the right to attend general meetings and speak on matters, concerning him as auditor. However, the mere fact that he has made certain observations in the general meeting does not relieve him of his responsibility to make proper disclosures in his report.

(4) Right to visit Branch Office [(Section 143 (8))]

If a company has branch offices, the accounts of the branch office shall be audited by the company's auditor, or by a person qualified for appointment as auditor of the company. Where the Branch accounts are not audited by a duly qualified auditor, the auditor has a right of access at all times to the books, accounts and vouchers of the company and thus, may visit the branch, if he feels that is necessary.

(5) Right to sign Audit Report : (Section 145)

Only the person appointed as auditor of the company or where a firm is so appointed, only a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

(6) Right to be indemnified :

An auditor, has a right to be indemnified out of the assets of the company against any liability incurred by him defending himself against any civil and criminal proceedings by the company if it is proved that the auditor has acted honestly or the judgement delivered is in his favour.

(7) Right to take legal and technical advice :

The Auditor has a right to take legal or technical advice in connection with the performance of his work. But he must give his own opinion in the audit report and not that of the experts.

(8) Right to receive remuneration :

The auditor has a right to receive remuneration for auditing the accounts of the company. He can, however, claim the remuneration on the completion of his work.

2.2.4 Duties of Company Auditor :

The duties of the auditors depend on the terms of the articles as well as on the statutory provisions. The duties of auditors are as follows :

1. To make enquiries according the auditor shall inquire :

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

2. To make a report to the members :

It is the duty of the auditor to make a report to the members on the accounts examined by him on every balance-sheet, profit and loss account and on the other documents attached there, which would be laid before the general meeting during the tenure of his office. The report must state whether in his opinion and to the best of his knowledge and according to the explanations given to him, the stated accounts give the information in the manner required by this Act, and give a true and fair view in the case of the balance-sheet of the state of the company's affairs as at the end of its financial year and in the case of profit and loss account, of the

profit/loss for its financial year.

The auditors should report directly to the shareholders of the company not through the directors because the auditors are appointed by the shareholders. The report must state the true financial position of the company. The following provisions must be shown by the Audit Report, apart from expressing an opinion as to whether or not the balance-sheet and profit and loss account exhibit a true and fair view.

These provisions are :-

- (i) Whether in auditor's opinion and the best of his information and according to the information given to him, the said accounts give the information required by this Act in the manner so required. (Section 143(3).
- (ii) Whether auditor has obtained all the information and explanations which to the best of his knowledge and belief, were necessary for the purpose of his Audit. (Section 143 (3);
- (iii) Section 143 (3) further requires that the auditor should also state in his report, whether in his opinion, proper books of account as required by law, have been kept by the company, so far as appears from his examination of those books, and proper returns adequate for the purposes of his audit have been received from branches not visited by him.
- (iv) The auditor's report should also state whether the company's balance sheet and profit and loss accounts dealt with do agree with the books of accounts and returns.
- (v) Section 143 (3) provides that if any of the matters in the auditor's report is answered in negative or with a clarification, the auditor's report shall also state the reason for such an answer.
- (vi) Section 143 (3) also states that Auditor's report should include whether the report on the accounts of any branch office audited by a person other than the company auditor has been forwarded to him as required by Clause (C) of sub section (3) of that section and how he has dealt with the same in preparing the auditor's report.

3. Signing of auditor's report :

According to section 145, only the person appointed as the auditor of the company or where a firm is so appointed, only a partner in the firm practising in India, may sign the auditor's report.

4. The Auditor's report must be read in the General meeting and must be open to inspection by any member of the company.

5. Duty to certify profit and loss account in Prospectus :

The prospectus issued by an existing company contains a report from the auditor of the company regarding :

- (i) Profits and losses;
- (ii) Assets and Liabilities of the company and its subsidiaries.
- (iii) Rates of dividends paid by the company for each of the five financial years preceding the issue of the prospectus.

6. Duty to assist investigators :

An auditor is bound to assist the investigators in every possible manner when the affairs of the company are being investigated.

7. Duty at the time of voluntary winding up :

When a company goes into its voluntary winding up and a declaration of solvency is made by its directors such a declaration is to be accompanied by the report of the auditors of the company.

8. An auditor must act honestly and with reasonable care and skill :

Otherwise he may be sued for damages. It is the duty of an auditor to take reasonable care of that.

2.2.4.1 Self-check Exercise- 1

1. What are the duties of auditors?

2.2.5 Position of an auditor :

The auditor has a fiduciary relationship vis-a-vis the shareholders. Some important facts with regards to his status are given below :

- (i) **Auditor is not an adviser :** An auditor is not an adviser. Rendering audit is simply a systematic and independent examination of evidence for the purpose of ascertaining whether the balance-sheet gives a true and fair view of the state of affairs of a business. If the auditor's advice is sought by the board of directors, he may advise them on important accounting and financial matters. But it should not have any connection with the audit work and this should be stated explicitly in every communication.
- (ii) An auditor is not an insurer. An insurer, under a contract, compensates the insured for any loss or damage to the subject-matter of insurance. An auditor does not guarantee that the books of the company show the true position of its affairs or that its balance-sheet is accurate according to the books. Further, in order to ensure that the auditor discharges his duty according to requisite professional standards of reasonable care and skill, the Companies Act has clearly laid down duties of the auditor in section 143.

- (iii) An auditor is to give information not means of information.
- (iv) **An auditor as an agent** : An auditor is appointed by shareholders of a company. He should safeguard their interest. Hence, he may be referred to as an agent of the shareholders.
- (v) Auditor is a watch-dog and not a blood-hound.

2.2.5.1 Self-check Exercise-2

1. Explain role of auditor as an agent.

2.2.6 Summary :

The auditor has various rights alongwith duties, which he has to perform conscientiously. The auditor has a crucial role in determining the fairness of the working results of an organisation. He is thus, a watch-dog and not a blood hound.

2.2.7 Glossary

Clean or Unqualified Report: A clean or unqualified report is one in which the auditor does not insert any fiction, modification, or reservation.

2.2.8 Questions for Exercise :

1. Discuss the statutory powers of a company auditor.
2. What are the duties of a company auditor?
3. "An auditor is a watch-dog and not a blood-hound." Comment.
4. Write short note on:
 - a) What are the rights of an auditor?
 - b) What is the position of an auditor?

2.2.9 SUGGESTED READINGS

1. Contemporary and Auditing : Kamal Gupta
2. Auditing Theory and Practice : Pardeep Kumar, N.K. Sahni and Baldev Sachdeva.

LIABILITIES OF AUDITORS

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- 2.3.2 Introduction
- 2.3.3 Liabilities of Auditors
 - 2.3.3.1 Civil Liability
 - 2.3.3.2 Criminal Liability
 - 2.3.3.3 Self check exercise-1
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- 2.3.5 Summary
- 2.3.6 Glossary
- 2.3.7 Questions for Exercise
- 2.3.8 Suggested Readings

2.3.1 Objectives of the Lesson :

- To study the various liabilities of auditors under Companies Act, 813.
- To study the liability of auditor under other statutes.

2.3.2 Introduction :

An auditor is appointed to carry out a professional engagement either under a statute or an agreement. He is expected to carry out his duties and responsibilities according to standard audit practices with the reasonable care and intelligence expected of a member of the profession. Therefore, when it is found either he did not possess the requisite skill or had failed to exercise it; it can give rise to an action for resultant damages.

2.3.3 Liabilities of Auditors :

The liabilities of auditors may be kept under the following heads :

- 2.3.3.1 Civil Liability
- 2.3.3.2 Criminal Liability

2.3.3.1 Civil Liability may be divided into two parts :

- (1) Liability for Negligence
- (2) Liability for Mifefasance.

Now the detail of these two is as follows :

(I) Liability for Negligence

An auditor can be accused for damages arising out of negligence in the performance of his duties. Negligence is a breach of duty caused by omission to do something which a reasonable man would do, or doing something which a prudent and reasonable man would not do.

Professional Negligence :

Such negligence is culpable, only if :

- (a) There exists a responsibility owed by the one party to another to perform an act with certain degree of care and competence.
- (b) There has been breach of such duty, and
- (c) As a consequence there is some loss or damages has been suffered by the party of whom the duty was owed.

In other words, an auditor is appointed to report whether the Balance-Sheet and Profit and Loss account of the company show true and fair view of the state of affairs of the company and incidentally to detect frauds, errors etc. If on account of negligence in the performance of his duties, and from this, company suffers any loss, the auditor will be held responsible for damages. He is an agent in regard to his duties and therefore, must show reasonable skill and diligence in the performance of his duties.

Example

Leeds Estate Building & Investment Society V.S. Shepherd (1887)

In this case, it was held that if an auditor is found negligent in the performance of his duties as an auditor, he is liable for damages. In this case an auditor did not examine the articles of a company and as a result of this negligence, the dividends were paid out of the capital. It was held that the auditor was liable to pay damages to the company.

An auditor is not liable even though the company has suffered a loss if he can prove that he was not negligent in the performance of his duties. On the other side, the auditor is proved for negligence and from this negligence company has not suffered any loss, in this case the auditor will not be liable for damages.

Now, from the above it is clear that an auditor is liable for damages only if it is proved that (a) he was negligent (b) from his negligence, the client has suffered a loss and (c) the loss was suffered by the person to whom the auditor owed a duty.

(II) Liability for Misfeasance :

Under Section 543, the court has wide powers to assess damages against delinquent directors and other officers of the company (including an auditor) of misfeasance or breach of trust. This section provides a simple remedy to recover damages where

an auditor or any other officer of the company is guilty of misfeasance resulting in loss to the company will be covered by this section. Mere negligence of duty, unless there is a resultant loss, will not create any liability. An action under this section lies only when the company is being wound up. The first appointment of the liquidator in winding up, or of the cause of action having arisen, whichever is longer.

Misstatements in Prospectus :

Section 62 of the Act lays down the civil liability for misstatement in prospectus issued to invite persons to subscribe for shares in or debentures of a company. The professional accountant in such case will be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of prospectus for any loss or damage sustained because of an untrue statement made by him as an expert.

He will not be liable for misstatement if he can prove that :

- (a) The prospectus was issued without his knowledge, and when he was aware of the issue, a due public notice was given by him that it was issued without his knowledge.
- (b) He withdrew his consent in writing before sending of the prospectus for registration or,
- (c) After delivery of the prospectus but before allotment of shares, he withdrew his consent in writing and due public notice was given by him, or
- (d) He had reasonable grounds to believe, and up to the time of allotment of the shares or debentures, that the statement was true.

The civil liability under this section is in addition to the liability under the general law enforceable by suit for recovery of damages on the ground of fraud, etc. The measures of damages under this section are the losses suffered by reason of the untrue statement.

2.3.3.2 Criminal Liability :

Criminal Liability of an auditor arises out of an act constituting a crime e.g., if an auditor will make a false statement either in the balance sheet or any other document, destroys or mutilates any voucher or document.

Under Section 2(30) of the Companies Act, an auditor is considered as an officer of the company for the purpose of Section 477, 478, 539, 543, 545, 628, 633. If he fails to comply with these section, the penalties for such offences may be imprisonment and/or fine.

According to Companies Act, the criminal liabilities of an auditor are as follows :

- (i) If a prospectus has been issued by a company which contains a false

statement, any person who is authorised to the issue of such a prospectus, will be liable to be punished with imprisonment up to two years or fine up to 50,000 or both. An auditor may be punished if he has authorised the issue of the prospectus.

- (ii) If an Auditor does not write a report with the requirement of Companies Act and does not sign on the report with the requirement of the Companies Act and if this default is made wilfully, then auditor will be punishable with fine which may extend to Rs.10000.
- (iii) Under the Companies Act, if an auditor does not help the investigation work of an investigator appointed by the Central Government in the affairs of the company, then he will be punishable with imprisonment up to six months or with the fine up to Rs.20,000/- or with both.
- (iv) Under the Companies Act, if the court has doubt at the winding up of the Company that the auditor has kept any account books or documents of the Company, then the court may order to return these document, if he fails to appear in the court then court may issue arrest warrants against him.
- (v) Under the Companies Act, the auditor of the company, on the application of the official liquidator, can be publically examined in the High Court. The notes shall be taken down and be signed by the auditor and such notes may be used as an evidence against him in civil or criminal proceedings.
- (vi) If an auditor destroys, mutilates or alters any book, papers or securities or makes or is privy to the making of any false or fraudulent entries in any register or books of account or document belonging to the company or intending to defraud or deceive any person, the auditor can be imprisoned, for a time which may extend to seven years, also to pay a fine.

The auditor can be prosecuted the falsification of accounts even when the company is not being wound up and for issuing certificates which are materially false.

- (vii) The Court may direct the Liquidator of a company in winding up to prosecute the auditor if he is found guilty of any criminal offence in relation to the company.
- (viii) If in any return, report, certificate, balance-sheet, prospectus, statement or any other document, required by or for the purpose of any of the provisions of this Act, any person makes a statement.
 - (a) Which is false in any material particular, knowing it to be false, or
 - (b) Which omits any material particular, knowing it to be material, he shall be punishable with imprisonment for a time which may extend to two

years and shall also be liable to fine. Here, above 'person' means Auditor of a company. The court has powers to relieve an auditor if a case is against him for proceeding for negligence, default, breach of duty or breach of trust, if the court is satisfied that the auditor acted honestly and reasonably.

Provided, that in a criminal proceeding under this section, the court will have no power to grant relief from any civil liability which may attach to an office in respect of such negligence, default, breach of duty, misfeasance or breach of trust.

Liability towards Third Parties

A question arises for an auditor that can be responsible to third parties for any loss suffered by third parties from the statements, documents, signed by the auditor. Here, third party includes creditors, bankers, lenders, debenture holders and other persons or institutions having the dealing with the company.

Generally, an auditor is not responsible to third parties and a plea in this regard is that an auditor is not appointed by the third party.

An auditor is responsible towards third party when a fraud is established against him. To make an auditor responsible, firstly it must be provided that :

- (i) The statement made by him was false in material facts;
- (ii) The auditor wilfully made such a false statement;
- (iii) The statement was made intentionally for the plaintiff to act upon it, and
- (iv) The plaintiff acted in reliance to it and suffered losses.

An auditor is liable only in case of fraud for damages to third party. Generally, an auditor is not responsible towards third parties unless he has knowingly committed some fraud and due to this, they are put to some damages. An auditor can be made liable for the damages to third party if the auditor had authorised the issue of such a prospectus which contains misleading statement.

2.3.3. Self check exercise-1

1. what are the civil liabilities of an auditor.

2.3.4 Liability under other Statutes

2.4.4.1 Under Income-Tax Act

The Act prescribes rigorous imprisonment upto 2 years for a person who abets or induces in any manner, another person to make and deliver to the Income Tax authorities a false account, statement or declaration relating to any income chargeable to tax, which he knows to be false or does not believe to be true. An auditor may also be charged in case of wrong certification of account.

A Chartered Accountant can represent his clients before the Income Tax Authorities. But, if he is guilty of misconduct he can be disqualified from practising.

2.3.4.2 Liability for Professional Misconduct

The profession of accountancy is governed by the Institute of Chartered Accountants

of India, established under the Chartered Accountants Act, 1949. The Council of the Institute is empowered to decide how the profession of accountancy should be conducted in India.

2.3.4.3 Liability of Joint Auditor

The Institute of Chartered Accountants states the following regarding the liability of joint auditors :

The joint auditor should divide the work as far as practicable between themselves. An auditor should not be held responsible for the work done by the other joint auditor.

At the end, we can say that there is no universal and firm norms or Principles on the basis of which the liability of an auditor to third parties can be established. An auditor can be made responsible for loss suffered by third parties according to some principles normally accepted, these are :-

- (a) It is proved that the auditor showed negligence in his duty and as a result, third party suffered a loss and/or
- (b) His report is fraudulent.

2.3.4.1 Self check exercise-2

1. What are the liabilities of auditor under other statute?

2.3.5 Summary :

The role of an auditor in verification of financial results is very crucial in an organisation. Under the provisions of the Companies Act, 2013 he can be held liable for an act or omission to act leading to loss to company.

2.3.6 Glossary

- a) IT Act- Income Tax Act

2.3.7 Questions for exercise :

1. Discuss the civil liabilities of an auditor under Companies Act, 1956.
2. How can an auditor be criminally liable under Companies Act, 1956?
3. Examine the liability of an auditor under various other statutes.
4. Write short note on:
 - a) What is the liability of the joint auditor?
 - b) What is the liability of the auditor in case of misstatement in the prospectus?

2.3.8 SUGGESTED READINGS

Practical Auditing : B.N. Tandon

LESSON NO. 2.4

AUDITOR'S REPORT

Structure

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- 2.4.2 Introduction
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2.4.1 Objectives of the Lesson :

- * To study the importance of audit report
- * To study the various types of audit report.

2.4.2 Introduction :

The auditor's report is the last result of every audit. It is the source through which an auditor expresses his opinion on the financial statements or other data under audit. It is an important part of the audit process, because it presents the compact form of the work conducted by the auditor. An Audit includes collection and examination of evidence about the financial statement and from this examination of evidences the auditor draws conclusions and presents audit report.

Under Section 143 of the Companies Act, the auditor is required to make a report to the members of the company on the account examined by him and on every :

Balance-Sheet and Profit and Loss Account and on every other document declared by the Act to be annexed to the Balance Sheet or Profit and Loss Account which are laid before the company in General meeting during the tenure of office, Such report is known as the Auditor's Report.

In Lancaser's opinion, "a report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are otherwise not aware of the full facts of the subject matter of the report".

2.4.3 Importance of Audit Report

Audit Report is very important for different persons and for various organisations. The confidence of people in a company depends upon the auditor's report. In a partnership firm, it shows the sacrifice of partners to the firm. The Auditor's Report is most important for companies instead of persons and organisations. The importance of Auditor's Report for different institutions is as follows :

1. Importance for Sole Trader :

Auditor's Report shows the profit margin of the capital invested by the sole trader and it also gives information about financial position of the business. Auditors Report also expresses the soundness of internal control system of the business and also shows the behaviour of employees towards business.

2. Importance for Partnership Firm :

An Auditor's Report is also important for partnership firm. It is useful to give information of all traders which is given by it to sole traders.

3. Importance for the Company :

Auditor's Report is very important for different persons who deal with the company. These are :

(I) Shareholders :

Shareholders are the owners of the company but they reside in different parts of the country, so they can not work for the company. To operate the working of company, they select Directors for the company. Directors do all types of work for the company and give report to the shareholders at annual general meeting. But the shareholders cannot search for the correctness of the report. So, for this purpose, they select auditors of the company, who present report of the company independently to shareholders at annual meeting. So, the Auditor's Report is important for shareholders.

(II) Creditors :

Auditor's Report is very important for creditor because they want to know about the financial position of the company to safeguard their credits. The Auditor's Report gives full information about the financial position of the company; because on the basis of the Auditor's Report they give credit to the company.

(III) Directors :

Directors are policy makers of the company. Employees of the company follow policies made by the Director. From Auditor's Report, the directors can judge about the honesty of the employees of the company.

(IV) Government :

From Auditor's Report the Government can judge about the position of the public undertakings and Government may also satisfy that there is no misuse of capital of the shareholders by the Directors of the company. Government can also know about the security and profitability of his capital in Government Companies through this Auditor's Report.

So, we can say that Auditor's Report gives true and fair view to all parties interested in the company. So, it is very useful to all parties.

2.4.4 Contents of The Audit Report

An audit report normally shows the scope and nature of audit work and the opinion of the auditor.

International Auditing guideline 13 on Auditor's Report on Financial statements provides guidance on the form and content of the Auditor's Report issued after an examination of financial statements. According to the Guideline, the basic elements of the Auditor's Report are as follows :

1. Title

There should be an appropriate title for the report such as Auditor Report's which helps the reader to identify the report quickly.

2. Addressed

The report should be appropriately addressed to someone such as shareholders etc.

3. Identification of Financial Statements

The financial statements can be identified by including the name of that entity and the date and period converted by the financial statements.

4. Reference to Accounting Statements

Reference of accounting standards is necessary to the readers and they may get satisfied that audit had been carried out in accordance with the established accounting standards.

5. Opinion on Financial Statement

The report should clearly set forth the auditor's opinion on the company's financial positions and operational results.

6. Signature

The report must be signed by the audit firm or by the auditor in his name or by both as the case may be.

7. Auditor's Address

The address of the auditor's permanent office is necessary in the report.

8. Date of the Report

The report should be dated properly.

Contents :

According to Section 143 (3) of the Companies Act, the Auditor's report shall state following five facts or opinions;

1. Whether, in his opinion and to the best of his information and according to the explanation given to him, the said accounts give the information required by the act in the manner so required and give a true and fair view.

(I) In the case of the Balance-Sheet, of the State of the company's affairs at the end to its financial year, and

(II) In the case of the Profit and Loss Account, of the profit or loss for financial year.

The above opinion gives two types of duties. One is that he has got all types of information required according to the Companies Act and other Acts that the accounts give true and fair view of the company's affairs and profit and loss for its financial year.

2. The Auditor's Report shall also state

'Whether in his opinion, proper books of accounts as required by him has been kept by the company so far as appears from the examination of the books and proper returns adequate for the purpose of his audit have been received from branches not visited by him.'

The Auditor Report indicates that all types of proper books are kept by the company and proper returns are being submitted by the branches and these returns are adequate for the purpose of his audit.

3. The auditor's Report shall also state

"Whether he has obtained all the informations and Explanations which to the best of his knowledge and belief were necessary for the purpose of the audit."

Under his opinion he also admits that he has achieved all types of books, accounts and vouchers which are necessary for audit because he has right to inspect all books, accounts and vouchers for an independent audit.

4. The Report also states

"Whether the report on the accounts of any Branch Office audited under section 143 by a person other than the company's auditors has been forwarded to him as and he has dealt with the same in preparing the Auditor's Report." Under this opinion it is the duty of the auditor to state clearly that he has taken full note of the branch's report forwarded to him in preparing his own report.

The Report shall also State :

'Whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of accounts and returns.'

According to this opinion, it is also the Auditor's duty to confirm in his report, whether the Balance Sheet and Profit and Loss Account of the company are in full agreement with its books, accounts and returns.

Signature on Audit Report

Only the persons appointed as auditor of the company, or where a firm is so appointed in pursuance of the provision of section 143 (1), only a partner in the firm practising in India, may sign of the Auditor's Report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

2.4.4.1 Self-check Exercise :

1. What is the need for Auditor's Report?

2.4.5. Additional Matters to be Included in the Auditor's Report or Social Audit Order, 1998 :

The Central Government can direct by general or specific order that in case of any class or description of companies, as may be specified in order, the auditor's report should also include a statement on such matters as may be specified there in. Exercising this power, the Government of India on 7th September, 1988 issued "The manufacturing and other companies (Auditor's Report) order 1988." The order is popularly known as an "Order for Social Audit." The order provides as follows :

Application of the Order :

The order applies to every company which is engaged in one or more of the following activities, namely:

- (a) manufacturing, mining, processing;
- (b) supplying and rendering services;
- (c) trading; and
- (d) the business of financing investment, chit fund, nidhis or mutual benefit societies.

It shall not Apply to :

- (a) A banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (b) An Insurance Company Act, 1956 (of 1956), and
- (c) A company licensed to operate the under section 8 of the Companies Act, 2013.

2. The Matters to be included in the Auditor's Report :

The auditor's report on the accounts of a company to which this order applies shall include a statement on the following matters, namely;

2.4.5.1 In the case of a Manufacturing, Mining or Processing Company

- (i) Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and, if so, whether the same have been properly dealt with in the books of account.
- (ii) Whether any of the fixed assets have been revealed during the year; if so, the basis of revaluation should be indicated;
- (iii) Whether physical verification has been conducted by the management at reasonable intervals in respect of finished goods, spare parts and raw materials.
- (iv) Whether the procedures of physical verification of stocks followed by the management are reasonable and adequate in relation to the size of the company and the nature of its business? If not, the inadequacies in such procedures should be reported.
- (v) Whether all material discrepancies have been noticed on physical verification of stocks as compared to book records? and if so, whether the same have been properly dealt with the books of accounts ?
- (vi) Whether the auditor, on the basis of his examination of stocks, is satisfied that such valuation is fair and proper in accordance with the normally accepted accounting principles ? Is the basis of valuation of stocks same as in preceding year, if there is any deviation in the basis of valuation, the effect of such deviation, if material, should be reported;
- (vii) If the company has taken any loans, secured or unsecured from companies, firms or other parties listed in the register maintained the companies Act, 2013 and/or from the companies under the same managements under companies act (of 2013) whether the rate of interest and other items and conditions of such loans are prima facie prejudicial to the interest of the company.
- (viii) If the Company has granted any loans, secured or unsecured to companies, firms, or their parties listed in the registers and or to the companies under the same management as the Companies Act. 2013, whether the rate of interest and other terms and conditions of such loans are prima-facie prejudicial to the interests of the company.
- (ix) Whether the parties to whom the loans or advances in the nature of loans, have been given by the company are repaying the principal amount as stipulated and are also regular in payment of the interest and if not, whether reasonable steps have been taken by the company

for recovery of the principal and interest.

- (x) Is there any adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of the stores, raw materials including components, plant and machinery, equipment and other assets and for the sale of goods.
- (xi) Whether the transactions of purchase of goods and materials and sale of goods, material and service, made in pursuance of contracts or arrangement entered in the register under the companies Act, 2013 (1) and aggregating during the year of Rs. 50,000/- or more in respect of each party, have been made at prices which are reasonable having regard to prevailing market prices for such goods, materials or services or the prices at which transactions for similar goods or services have been made with other parties;
- (xii) Whether any unserviceable or damaged stores, raw materials or finished goods, and whether provision for the loss, if any has been made in the accounts.
- (xiii) In case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India, where applicable have been complied with. If not, the nature of contraventions should be stated;
- (xiv) Is the company maintaining reasonable records for the sale and disposal of reliable by products and scraps, where applicable :
- (xv) In the case of companies having a paid up capital exceeding Rs. 25 lakhs as at the commencement of the financial year concerned or having an average annual turnover exceeding Rs. 2 crore for a period of three consecutive financial years immediately preceding the financial year concerned. Whether the company has an internal audit system, commensurate with its size and nature of its business.
- (xvi) Where maintenance of cost records has been prescribed by the Central Government under the Companies Act, 2013 (1 of 1956), whether such accounts and records have been made and maintained;
- (xvii) Is the company regular in depositing provident fund and the employee's state insurance dues with the appropriate authority, and if not, the extent of arrears of provident fund and Employees State Insurance dues shall be indicated by the auditor.
- (xix) Whether personal expenses have been charged to revenue account; if so, the details thereof should be reported;
- (xx) Whether the company is sick industrial company within the meaning of the clause (O) of the subsection (1) of section 3 of the sick industrial of

the Companies Special Provision Act, 1985, (1 of 1986) if so, whether a reference has been made to the Board for Industrial and Financial Reconstruction under section 15 of that Act.

2.4.5.2 In the Case of a Service Company :

- (i) All the matters specified in clause (A) to the extent to which they are applicable.
- (ii) Whether the company has a reasonable system of recording receipts, issues and consumption of materials and stores and allocating materials consumed to the relative jobs, commensurate with its size and nature of its business.
- (iii) Whether the company has a reasonable system of allocating man hours utilised to the relative jobs commensurate with its size and nature of its business.
- (iv) Whether there is reasonable system of authorization at proper levels, and an adequate system of internal control commensurate with the size of the company and the nature of its business, on issue of stores, and allocation of stores and labour to jobs.

2.4.5.3 In the Case of a Trading Company :

- (i) All the matters specified in clause (A) to the extent to which they are applicable;
- (ii) have the damaged goods been determined and if the value of such goods is significant, has provision been made for the loss?

2.4.5.4 In the Case of a Finance, Investment, Chit Fund, Nidhi or Mutual Benefit Company :

- (i) All the matters specified in clause (A) to the extent to which they are applicable,
- (ii) Whether adequate documents and records are maintained in case where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities;
- (iii) Whether the provision of any special status applicable to chit fund nidhi or mutual benefit society have been duly complied with; and
- (iv) If the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company in its own name except to the extent to the exemption, if any, granted under the Companies Act, 2013.

3. Reason to be Stated for Unfavourable or Qualified Answers :
Where in Auditor's Report, the answer to any of the questions referred to paragraph 4 is unfavourable or qualified; the Auditor's report shall also state the reasons for such unfavourable and qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons it is not possible for him to give out of the answers to such question.

2.4.6. Kinds of Audit Report

The report may be of following types :-

(I) Final Report :

The report which is presented by the auditor after completing all his work is called final report.

(II) Interim Report :

The report which is presented in the middle of the year is called interim report. It is presented before completing the whole work of investigation.

(III) Partial Report :

When a company's Audit is not done by one auditor wholly then audit report presented by the auditor of the part of the work is called partial report.

Above reports may be clean, unqualified report or qualified report.

(1) Clean or Unqualified Report :

A clean or unqualified report is that in which the auditor does not insert any fiction, modification or reservation. It is made by an auditor when he finds nothing in the negative in full or in part and, as a result, the auditor gives report about a true and fair view of the state of the company's financial affairs.

(2) Qualified Report :

A qualified report is one in which the matters referred to in section 227 (2) are answered in the negative in full or in part and, as a result, the auditor has to state the reasons for such qualification or reservations;

2.4.7. Difference between clean audit report and qualified audit report:

(i) In a clean audit report, the auditor expresses an unqualified audit opinion i.e. opinion without reservation therein, whereas in a qualified audit report, auditor expresses an opinion with reservation therein.

(ii) Clean audit report is issued when :

- * financial statements give a true and fair view
- * are prepared in accordance with GAAP
- * comply with statutory requirements; and
- * disclosure is adequate.

Qualified audit report is issued when -

- * subject-matter for reservation is highly material and pervasive; and

- * auditor believes that the overall financial statements give a true and fair view
- (iii) In case of a limited company
If an auditor makes various statutory affirmations without any reservation, he is said to have issued an unqualified/clean report. If any of the statutory affirmations are answered in negative or with qualification by the auditor, the audit report would be termed as a qualified audit report.

2.4.7.1 Self-check Exercise 2

1. What is a clean audit report?

2.4.8. Answers to Self-check Exercises :

Self-check Exercise 1 : Refer Para 21.3

Self-check Exercise 2 : Refer Para 21.7

2.4.9. Summary :

The auditor's report is prepared keeping in view the type of company in question i.e. whether it is a manufacturing, service or trading company etc. There are various types of reports that are prepared by auditors, viz. final report, interim report, clean report and qualified report etc.

2.4.10. Glossary

- a) GAAP- Generally Accepted Accounting Principles

2.4.11. Questions for Exercise :

1. What are the various elements of an audit report?
2. Distinguish between a clean audit report and qualified audit report.
3. Write short note on:
 - a) what are the various kinds of audit report
 - b) importance of audit report

2.4.12. SUGGESTED READINGS

Contemporary Auditing : Kamal Gupta

Auditing Theory & Practice : Pardeep Kumar, N.K. Sahni & Baldev Sachdeva

Mandatory Student Feedback Form

<https://forms.gle/KS5CLhvpwrpgjwN98>

Note: Students, kindly click this google form link, and fill this feedback form once.

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