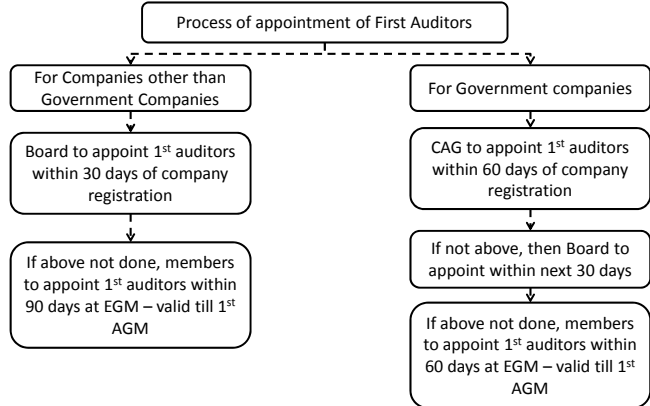


# Audit, Auditors And Fraud Reporting under Companies Act 2013

CA Shrinivas Joshi

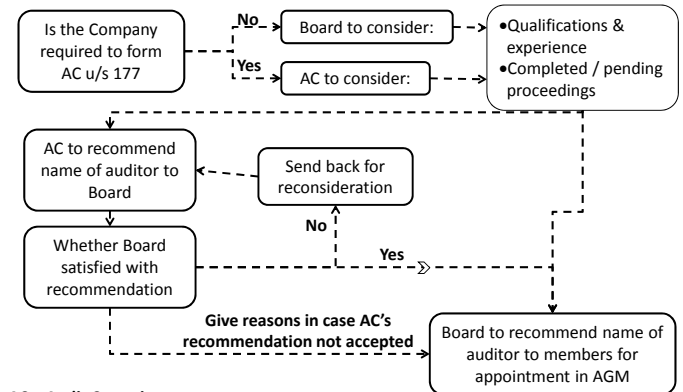
## Audit & Auditors

### Sec 139 – Appointment of Auditors



### Sec 139 – Auditors appointment (continued..)

Process of appointment of Auditors in existing Companies / at 1<sup>st</sup> AGM



AC = Audit Committee

## Sec 139 – Auditors appointment (continued..)

### Other conditions

- An individual or a firm can be appointed as auditor
- The term of appointment will be 5 years
- The appointment shall be confirmed by ratification at each AGM
- Proposed auditor has to submit certificate that he / it is eligible to be appointed, and the conditions pertaining to term and limit are met
- Company to file notice of auditor appointment within 15 days
- In case of Government companies, CAG to appoint auditor within 180 days of commencement of financial year
- Retiring auditor to be reappointed unless he is disqualified, he has expressed unwillingness, or special resolution passed appointing another auditor / refusal to re-appoint existing auditor
- At AGM, where no auditor appointed – existing auditor to continue

## Sec 139 – Auditor rotation

### Concept & process of auditor rotation

- Individual cannot be auditor for continuous period of > 5 years
- Audit firm cannot be auditor for continuous period of > 10 years
- Cooling period of 5 years after above tenure
- Members in AGM may decide to rotate audit signing partner / team.
- Provisions regarding rotation are to be applied retrospectively – however, 3 years time to give effect to provisions of auditor rotation (from notification of date of the section)
- Incoming auditor not eligible for appointment if it has common partner / partners with outgoing firm (on the date of appointment)
- Incoming auditor not eligible if associated with outgoing auditor under same network / trade mark / brand
- Joint auditors can also be appointed – provided all joint auditors do not complete term in same year

## Sec 139 – Auditor rotation (continued...)

### To which companies is auditor rotation applicable?

- Auditor rotation is applicable to;
  - All Listed Companies
  - Unlisted public companies with paid up capital > Rs. 10 crores
  - Private companies with paid up capital > Rs. 20 crores,
  - All companies with o/s loans / deposits > Rs. 50 crores

Type of auditor	Number of years of consecutive audit (in 1 <sup>st</sup> AGM to be held in Sep 2014)	Maximum consecutive years for which appointment can be made
Individual	5	3
Individual	1	4
Firm	10	3
Firm	6	4
Firm	1	9

## Sec 139 – Auditor rotation (continued...)

- Auditor rotation not applicable to OPC & small companies
- Definition of small company [sec 2 (85)] – A company other than public company –
  - Where paid up capital < Rs. 50 lakhs or higher amount not > Rs. 5 crores (to be prescribed); **OR**
  - Turnover < Rs. 2 crores or higher amount not > Rs. 20 crores (to be prescribed)
- Following are not small companies –
  - Holding & subsidiary company
  - Company registered under section 8
  - Company / body corporate governed under any special Act

## Sec 140 – Change in auditors

### Casual Vacancy

- Casual vacancy caused in the office of auditor in case of Government companies to be filled by CAG within 30 days – if CAG does not do so, Board shall fill the vacancy within next 30 days.
- In case of other companies, casual vacancy to be filled by the Board within 30 days – if such casual vacancy is caused due to auditor resignation, Board recommendation for appointment of new auditor to be confirmed at EGM convened within 3 months.

### Removal by Tribunal

- Tribunal can suo moto or on application of Central Government direct company to change auditor, if it is satisfied that auditor has acted in fraudulent manner.
- If above application is made by Central Government, Tribunal to decide within 15 days & Central Government can appoint another auditor
- The 'removed' auditor cannot function as auditor of any company for 5 years. Firm liable for fines but only partners liable for effects of fraud

## Sec 140 – Change in auditors (continued..)

### Removal of auditors by Members

- Application for removal of auditor to be filed with Central Government within 30 days of Board meeting resolving thus
- EGM to be held within 60 days of receiving approval from Central Government
- Removal to be valid only after confirmation through special resolution at EGM

### Resignation by auditors

- Resigning auditor to file prescribed form for resignation with Company & ROC within 30 days of resignation ( ADT- 3 )
- In case of Government companies, statement to be filed with CAG
- Reasons for resignation to be specified in both situations above

### Non-reappointment

- Special notice to be given if existing auditor is not to be re-appointed
- Company to send such proposed resolution to the auditor
- Auditor's representation on the notice, if any, to be sent by company to members
- If not sent to members, auditor may speak or require it to be read at AGM
- Right abused by Auditor, Relief by Tribunal

## Sec 141 – Auditor eligibility, etc

- Only chartered accountant can be appointed as auditor
- LLP can be Appointed
- Definition of chartered accountant – [Sec 2(17)]
  - Member of ICAI
  - Who holds certificate of practice
- Multi-disciplinary partnership firms allowed to be appointed as auditors, provided signing partner is a chartered accountant.
- ICAI yet to issue guidelines for operationalisation of multi-disciplinary firms.

## Sec 141 – Auditor eligibility, etc (Continued..)

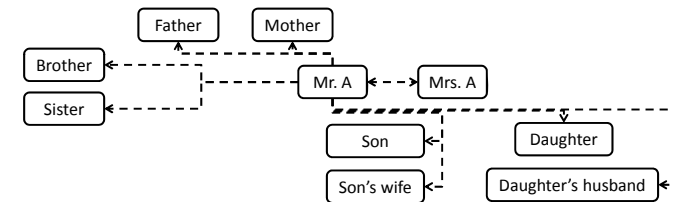
Following persons not eligible for appointment as auditor;

- Body corporate (LLPs are eligible)
- Officer or employee of Company
- Partner / employee of officer / employee of Company
- CA, if he / relative / partner
  - Holds security / interest in company / subsidiary / holding co. / associate co. / subsidiary of holding co (Relative is allowed to hold securities with face value up to Rs. 1 lakh)
  - Indebted to abovementioned company / companies exceeding Rs. 5 lakhs
  - Given guarantee / provided security in connection with indebtedness of third person to abovementioned companies exceeding Rs. 1 lakhs

### Sec 141 – Auditor eligibility, etc (Continued..)

- CA or firm who have business relationship with abovementioned companies (business relationship not to include professional services allowed to be rendered by a CA, as well as commercial transactions which are on arm's length basis)
  - CA whose relative is director / KMP in the company
  - CA who is in full time employment elsewhere / holding appointment as auditor of more than 20 companies at the date of re/appointment
  - CA convicted of offence involving fraud and 10 years yet to pass
  - CA / firm / subsidiary / associate company is engaged in consulting services mentioned u/s 144 to the company.
- Auditor who incurs any disqualification as above after date of appointment, to be automatically vacate office – to be treated as casual vacancy.

### Sec 2 (77) – Definition of relative



- Relatives include all members of HUF
- Father, mother, son, brother, sister also includes step-relations

### Sec 142 – Auditor's Remuneration

- Auditor's remuneration to be fixed in AGM or by discussion between Board and auditors, if so authorised by the AGM
- Remuneration of 1<sup>st</sup> Auditor to be fixed by the Board
- Auditor's remuneration to include expenses incurred by him in connection with the audit and any facility extended to him.

- Does cost of putting an auditor in a company guest house while undertaking the audit, be construed as a facility?

### Sec 143 – Auditor to inquire into...

- Auditor shall inquire in to the following while conducting his audit;
  - Whether loans and advances are secured & whether terms are prejudicial to interests of company / members
  - Whether transactions represented by book entries are prejudicial to interests of company
  - In case of company (other than investment company / bank), whether any shares / debentures / securities are sold at less than cost price
  - Whether loans and advances are shown as deposits
  - Whether personal expenses are charged to revenue
  - Whether cash has actually be received, if it is disclosed in Books that shares are issued for cash
- Auditor shall have access to Books of company and all its subsidiaries.

## Auditors' report

- Announcements of AASB
- Change in Management Responsibility Statement

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position and financial performance of the Company in accordance with the Accounting Standards ~~referred to in~~ notified under sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). read with the General Circular 15/2013 dated 13<sup>th</sup> September 2013 of the Ministry of Corporate Affairs in respect of section 133 of the Companies Act, 2013. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

## Auditors' report

- Auditor's Responsibility para 2 -

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

## Auditors' report

- Report on other Legal and Regulatory Requirements –

c. The Balance Sheet and Statement of Profit and Loss dealt with by this Report are in agreement with the books of account;

d. In our opinion, the Balance Sheet and Statement of Profit and Loss comply with the Accounting Standards ~~referred to in~~ notified under sub-section (3C) of section 211 of the Companies Act, 1956; read with the General Circular 15/2013 dated 13<sup>th</sup> September 2013 of the Ministry of Corporate Affairs in respect of section 133 of the Companies Act, 2013.

## Sec 143 – Auditors' report

- Auditor to report whether financial statements show a true and fair view of the balance sheet, profit or loss and cash flow for the year
- Auditor's report to also state –

Matters covered under Companies Act 1956
Whether all information necessary for the purposes of audit were sought & obtained
Whether proper books of account have been kept by the company / branch
Whether branch audit report received & how it has been dealt with
Whether BS/P&L are in agreement with Books
Whether financial statements comply with Accounting Standards
Observations / comments on financial transactions / matters which have adverse effect on company's functioning
Any disqualification of director

### Sec 143 – Auditors’ report (continued..)

Additional matters introduced by Companies Act 2013
Any qualifications, reservations, adverse remark relating to maintenance of accounts
Whether company has adequate internal financial controls in place and operating effectiveness of such controls
Whether company has disclosed effect of pending litigation on financial position
Whether company has made provision for foreseeable losses on long term contracts, including derivatives contracts
Whether any delay in depositing money in Investor Education and Protection Fund ( Rule 12)

- Auditors to comply with auditing standards issued by NFRA after consultation with ICAI

### Sec 143 – CAG / branch audits

#### CAG audits

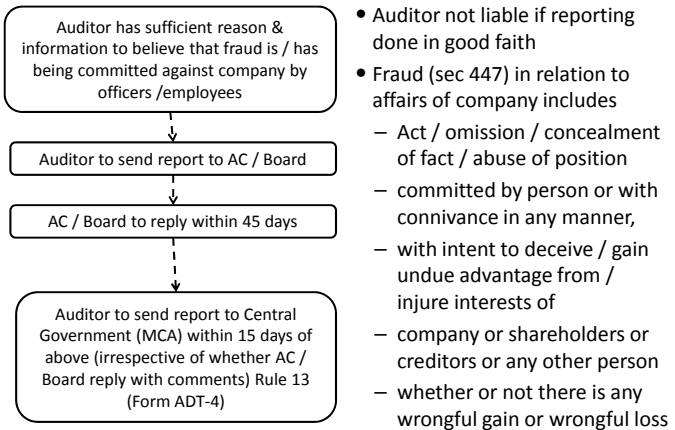
- CAG to appoint auditors in case of Government companies and direct the manner in which audit should be conducted and reported upon.
- CAG can conduct a supplementary audit within 60 days from date of receipt of audit report from auditor. Alternatively, CAG can comment upon / supplement such audit report
- Comments of CAG, as above, to be sent to all members and placed in AGM along with audit report
- CAG may also conduct test audit of any Government company

#### Branch audits

- Appointment of branch auditor – Branch in India – company auditor / any CA appointed by Company; Branch outside India – company auditor / person duly qualified to act as auditor in that country
- Branch auditor to submit report to company auditor – All responsibilities of reporting similar to company auditor

## FRAUD REPORTING

### Sec 143 – Fraud reporting



## Sec 144 – Restrictions on services

- Auditor of a company not to provide following services to a company or its holding company / subsidiary, either directly or indirectly;
  - Accounting & book keeping
  - Internal audit
  - Design / implementation of any financial information system
  - Actuarial services
  - Investment advisory services
  - Investment banking services
  - Rendering of outsourced financial services
  - Management services
  - Services prescribed (no services prescribed under Rules)
- Directly / indirectly includes through firm / partner / relative / common trade name / brand / entity in which partner has significant control / influence

## Auditors – other aspects

- Audit report to be signed by Auditor
- Qualifications / observations / comments on financial transactions which have adverse effect on company's functioning to be read at AGM and kept for inspection
- Auditor has to attend AGM – he can also be represented by a representative and has a right to be heard (Sec 146)

## INTERNAL AUDIT

## Section 138 – Internal Audit

- ✓ Rule 12 – Appointment of Internal Auditor necessary for –
  - All listed companies
  - Unlisted companies with paid up capital of Rs.50 crores or Turnover of Rs.200 crore or Borrowings of Rs.100 Crores or outstanding deposits of Rs.25 crores at any point during the preceding year.
  - Private companies with Turnover of Rs.200 Crores and outstanding loans of Rs.100 crores

## Section 138 – Internal Audit

- ✓ Internal Auditor can be an employee, CA, ICWA, Any other professional as decided by the Board.
- ✓ Audit Committee or Board in consultation with Internal Auditor to formulate the scope, functioning, periodicity and methodology for conducting the Internal Audit.

## PENALTIES

## Consequences of default – Chapter X

Section & Default	Party in default	Imprisonment term	Fine range (Rupees '000s)
Sec 140 (3) – Resigning auditor	Auditor	NA	50 – 500
Sec 143 – Fraud reporting	Auditor	NA	100 – 2500
Sec 139 to Sec 146	Company	NA	25 – 500
	Officer in default	1 year	10 – 100
Auditor – no fraudulent intention		NA	25 – 500
Auditor – with fraudulent intention		1 year	100 – 2500

- Consequences of default in the above cases are either imprisonment or fine or both
- In case where auditor has been convicted for intention to deceive, he has to refund remuneration and pay damages for losses arising out of misleading financial statements – this liability is of the partner & of the firm jointly & severally.

## CLASS ACTION SUITS



### **Class Action – Implication for Auditors**

- **What is Class action?** – A lawsuit filed or defended by an individual or small group acting on behalf of a large group
- **Who can sue?** – Shareholders (at least 100 shareholders) or depositors (at least 100 depositors) or an association representing such affected persons
- **What can they claim from auditors?** – damages / compensation / any other suitable action
- **Compensation for what?** – improper / misleading statement of particulars made in audit report or for any fraudulent, unlawful or wrongful act or conduct
- **Who is liable to pay?** – In case of audit firm, the firm itself as well as each partner who was involved in making improper / misleading statements or who acted fraudulently
- **What about frivolous applications?** – Tribunal can reject application & direct applicant to pay Rs. 1 lakhs to other party

THANK YOU!