

POWERS OF AUDITORS**1. Rights of access to books and vouchers:**

Sec. 227(1) provides that every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere.

Points to remember:

- Books and accounts include all books, which have any bearing or are likely to have any bearing on the accounts whether these are usual financial books or the statutory or statistical books.
- Voucher includes all or any of the correspondence which may in any way serve to vouch the accuracy of accounts.
- Right of access at all times implies inspection only during normal business hours.
- If auditor is denied access to books, his only remedy would be to report to the members.

2. Right to obtain information and explanation:

Sec. 227(1) provides that auditor is entitled to require from the officers of the company such information and explanations as he thinks necessary for the performance of his duties as auditor.

Points to remember:

- If auditor fails to obtain sufficient information either due to limitation on the scope of duties imposed by management or the auditor is not able to verify books of account due to circumstance beyond one's control, the auditor may state that he is unable to express an opinion.

3. Rights to visit branch offices and access to branch accounts:

Sec. 228(2) provides that where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor

- (i) is entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor, and
- (ii) has a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.

4. Right of auditor to attend general meeting:

Sec. 231 provides the followings:

- (i) All notices of, and other communications relating to, any general meeting of a company which any member of the company is entitled to have sent to him shall also be forwarded to the auditor of the company; and
- (ii) Auditor is entitled to attend any general meeting and to be heard at any general meeting which he attends on any part of the business which concerns him as auditor.

Points to remember:

- The right of the auditor to attend any general meeting and to be heard there is only permissive. It is not his duty to attend or to take part in the discussion.
- If anything comes to the knowledge of auditor after signing audit report, it is advisable for the auditor to attend the meeting with a view to bring the facts to the notice of the shareholders.
- Audit report by itself should be clear, unambiguous and complete.

DUTIES OF AUDITORS**1. Inquiry and Reporting:**

Sec. 227(1A) provides that the auditor shall inquire the followings:

- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the 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 within the meaning of section 372 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 loans and advances made by the company have been shown as deposits;
- (e) whether personal expenses have been charged to revenue account;
- (f) where 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.

Points to remember:

Sec. 227(1A) is only a directive to the auditor to make certain enquiries and he should make a report to the members in case he finds answer to any of these matters in adverse.

2. Reporting on Books of accounts and Financial statements:

Sec. 227 (2) provides that the auditor shall make a report to the members of the company -

Previous Years Questions

Q. No. 1: Write short note on: Personal Expenses of Directors.

[May 03 (4 Marks)]

or

As an auditor, how would you deal with the following: In the audit of ABC Private Limited, auditor came across cases of payments to Directors, whereby, expenses of a personal nature were re-imbursed.

[May 07 (5 Marks)*]

Answer: All payments to Directors as remuneration or perquisites whether in the case of a public or private company need to be authorised in accordance with the Companies Act as well as Articles of Association of the company. If the terms of appointment of a Director include payment of expenses of a personal nature, then such expenses can be incurred by the company; otherwise, no such expense can be incurred or reimbursed by the company.

In the instant case the auditor has to ensure that the payment is authorized by the Articles of Association and the same has been covered by terms of appointment.

Further as this payment is also covered u/s 227 (1A), and hence auditor is also required to inquire into the matter and make a disclosure in his report accordingly.

Q. No. 2: Write short note on: Areas of propriety audit under section 227(1A) of the Companies Act, 1956.

[May 04 (4 Marks)]

- (a) on the accounts examined by him, and
- (b) on every balance sheet and profit and loss account, and
- (c) on every other document declared by this Act to be part of or annexed to the balance sheet or profit and loss account,

which are laid before the company in general meeting during his tenure of office.

Points to remember:

- The auditor's duty to report is on accounts as well as financial statements.
- The auditor's duty to report on financial statements is not with reference to the statements of a particular year, but to all such statements pertaining to any accounting period which are laid before the company in general meeting during his tenure of office.

3. Contents of Audit Report:

- (a) Sec. 227(2) provides that auditor's report shall state whether, in his opinion and to the best of his information and according to the explanations given to him -
 - (i) the said accounts give the information required by this Act in the manner so required; and
 - (ii) 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 the profit and loss account, of the profit or loss for its financial year.
- (b) Sec. 227(3) provides that the auditor's report shall also state the followings:
 - (i) whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit;
 - (ii) 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;
 - (iii) whether the report on the accounts of any branch office audited under section 228 by a person other than the company's 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;
 - (iv) whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns;
 - (v) whether, in his opinion, the profit and loss account and balance sheet complied with the accounting standards referred in Sec. 211(3C).
 - (vi) in thick type or in italics the observations or comments of the auditors which have any adverse effect on the functioning of the company;
 - (vii) whether any director is disqualified from being appointed as director u/s 274(1)(g).
 - (viii) whether the cess payable u/s 441A has been paid and if not, the details of amount of cess not paid.

Points to remember:

- If auditor is unable to obtain necessary information and explanations as required, he may issue qualified opinion regarding the true and fair view of financial statements. Alternatively, he may issue a disclaimer of opinion based on the circumstances.
- Qualifications is required to be indicated in **bold** type or in *italics* type.

Previous Years Questions

Q. No. 3: During the course of statutory audit of an investment company dealing in shares and securities, inspite of repeated reminders by the statutory auditor, the company officials did not provide the investments held by the company at the Balance sheet date for verification and also did not provide the details for valuation of unlisted shares as on the Balance sheet date. The statutory auditor in his final audit report to the shareholders, reported as follows:

“Subject to the verification of the existence and value of the investments, the Balance sheet shows a true and fair view”.

Is the report made by the statutory auditor correct.

[May 03 (6 Marks)]*

Answer: As per Sec. 227 (3) of the Companies Act, 1956, auditor is required to state specifically whether he has obtained all such information and explanation which is required for the purposes of the audit. In the present case, by making a report in the manner as given in question the auditor is not conveying any information, rather he is arousing suspicion to the users of the financial statements. Hence the report made by the auditor is not correct.

Q. No. 4: Section 274 of the Companies Act, 1956 is applicable to appointment of Directors. Briefly explain your duty as a statutory auditor in this connection. *[Nov. 04 (8 marks)]*

Answer: Section 227(3)(f) of the Companies Act, 1956 requires the statutory auditor to state whether any director is disqualified from being appointed as director under Sec. 274 (1)(g).

As per section 274(1)(g) of the Companies Act, 1956, a person is disqualified to be appointed as a director in case such person is a director of a public company which has not filed the annual accounts for any continuous period of 3 years; or such company has failed to repay its deposits or interest thereon on due date or pay dividend and such failure continues for one year or more.

The Ministry of Company Affairs has also issued the Companies (Disqualification of Directors u/s 274(1)(g) of the Companies Act, 1956) Rules, 2003. Rule 4 requires that the statutory auditors of both the appointing as well as the disqualifying company to:

- (a) report under section 227(3)(f) of the Act to the members of the respective companies as to whether any director is disqualified from being appointed as a director u/s 274 (1)(g); and*
- (b) furnish a certificate every year as to whether on the basis of examination of the books and records of the company, any director of the company is disqualified as a director or not.*

The auditor is required to obtain written representation as to names of directors, particulars of appointment, default by the company, etc. The written representation should also be noted and taken on record by the Board. The auditor should also verify the information provided by the management and direction from the information contained in the register mentioned u/s 303(1) of the Act.

Q. No. 5: What are the statements of facts that an auditor has to report u/s 227 of the Companies Act, 1956.

[Nov. 05 (4 Marks)]

Answer: Refer to sec. 227 (2) – Contents of audit Report.

Reasons for negative or qualified remarks:

Sec. 227 (4) provides that where any of the matters referred in Sec. 227(2) or 227(3) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

4. Reporting on matters specified in CARO, 2003:

Sec. 227(4A) provides that the auditor's report shall also include a statement on such matters as may be specified in order issued by Central Government in case of such companies as specified in the order.

5. Signing of Audit Report etc.:

Sec. 229 provides that the person appointed as 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, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.
