

BRANCH AUDIT

Who can be a branch auditor: As per Sec. 228 (1) where a company has a branch office, the accounts of that office shall be audited

- by the company's auditor appointed under section 224 or
- by a person qualified for appointment as auditor of the company under section 226, or
- where the branch office is situate in a country outside India, either by the company's auditor or a person qualified as aforesaid or by an accountant duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

Rights of company auditor: 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 -

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

Exception: However in the case of a banking company having a branch office outside India, it shall be sufficient if the auditor is allowed access to such copies of, and extracts from, the books and accounts of the branch as have been transmitted to the principal office of the company in India.

Appointment of Branch Auditor: Sec. 228 (3) provides that Where a company in general meeting decides to have the accounts of a branch office audited otherwise than by the company's auditor, the company in that meeting shall for the audit of those accounts appoint the auditor or authorise the Board of directors to appoint such a person in consultation with the company's auditor;

Rights and Duties of Branch Auditor: Sec. 228 (3) provides the followings:

- branch auditor shall have the same powers and duties in respect of audit of the accounts of the branch office as the company's auditor has in respect of the same;
- the branch auditor shall prepare a report on the accounts of the branch office examined by him and forward the same to the company's auditor who shall in preparing the auditor's report, deal with the same in such manner as he considers necessary;
- the branch auditor shall receive such remuneration and shall hold his appointment subject to such terms and conditions as may be fixed either by the company in general meeting or by the Board of directors if so authorised by the company in general meeting.

Exemption of Branch Audit: Sec. 228 (4) provides that the Central Government may make rules providing for the exemption of any branch office from the provisions of this section to the extent specified in the rules and in making such rules the Central Govt shall have regard to all or any of the following matters, namely:

- (a) the arrangement made by the company for the audit of accounts of the branch office by a person otherwise qualified for appointment as branch auditor even though such person may be an officer or employee of the company;
- (b) the nature and quantum of activity carried on at the branch office during a period of three years immediately preceding the date on which the branch office is exempted from the provisions of this section;
- (c) the availability at a reasonable cost of a branch auditor for the audit of accounts of the branch office;
- (d) any other matter which in the opinion of the Central Government justifies the grant of exemption to the branch office from the provisions of this section.

COMPANIES (BRANCH AUDIT EXEMPTION) RULES, 1961

Exemption based on quantum of activity: (Rule 3)

Where a company carrying on any manufacturing, processing or trading activity has a branch office whose average of the quantum of activity during the relevant financial year does not exceed rupees two lakhs or two per cent of the average of the total turnover of the company including all its branch and other offices and the earning from services rendered and from any other source during the same period whichever is higher, the branch office shall be exempt from provisions of section 228.

The average quantum of activity shall be taken to be:

- (a) the average of the quantum of activity during the three financial years immediately preceding the relevant financial year, or
- (b) if three financial years have not been completed since the establishment of the branch office the average of the quantum of activity during the two financial years or, as the case may be, the quantum of activity during the year, immediately preceding the relevant financial year, or
- (c) in other cases, the quantum of activity during the relevant financial year.

Quantum of activity: It means:

- (a) the aggregate value of the goods or articles produced, manufactured or processed, or
- (b) the aggregate value of the goods or articles sold and of services rendered, or

(c) the amount of the expenditure, whether of a revenue or capital nature, incurred by a branch office of a company during a financial year, whichever is higher

Grant of exemption in other cases: (Rule 4)

The Central Government on application made to it in this behalf may, after making such inquiry, as it may think fit, by order in writing, exempt the branch office of a company from the provisions of section 228 on any of the following grounds, namely:

- (a) that a company carrying on activities other than those of manufacturing or processing or trading has made satisfactory arrangements for the scrutiny and check at regular intervals, of the accounts of the branch office by a responsible person who is competent to scrutinize and check accounts ;
- (b) that a company has made arrangements for the audit of the accounts of the branch office by a person otherwise qualified for appointment as branch auditor, even though such person is an employee of the company ;
- (c) that having regard to the nature and the quantum of activity carried on at the branch office or for any other reason, a branch auditor is not likely to be available at a reasonable cost ; and
- (d) that, for any other reason, the Central Government is satisfied that exemption may be granted.

Audit report to refer exemption: (Rule 7)

Where, in any financial year, the accounts of the branch office of a company have not been audited by an auditor mentioned in sub-section (1) of section 228, the auditor of the company shall expressly state in the audit report that the branch office is exempt from the requirements of section 228 by virtue of rule 3 or that an exemption has been granted under rule 4.

Previous Years Questions

Q. No. 1: Comment on the following: A company has a branch office which recorded a turnover of Rs. 1,90,000 in the financial year 2008-09. No audit of the branch has been carried out. The statutory auditor of the company has made no reference of the above branch in his report. The total turnover of the company is Rs.10 crores for the year 2008-09. [May 05 (6 marks)]

Answer: Rule 3 of Companies (Branch Audit) Exemption Rules, 1961 provides that where a company carrying on any manufacturing, processing or trading activity has a branch office whose average of the quantum of activity during the relevant financial year does not exceed Rs. 2,00,000 or 2 % of the average of the total turnover of the company including all its branch and other offices and the earning from services rendered and from any other source during the same period, whichever is higher, the branch office shall be exempt from provisions of section 228.

Hence the company is entitled for exemption of branch audit.

Further Rule 7 provides that where, in any financial year, the accounts of the branch office of a company have not been audited, the auditor of the company shall expressly state in the audit report that the branch office is exempt from the requirements of section 228 by virtue of rule 3 or that an exemption has been granted under rule 4.

Hence in the present case, auditor is required to mention the fact of exemption in his audit report.

Q. No. 2: As a Statutory Auditor, how would you deal with the following: P Ltd. of whom you are the Statutory Auditor appoints M/s XYZ as Branch Auditors for one of its branches. M/s XYZ conducted the audit of the branch without visiting the branch and instead getting the books at the H.O. M/s XYZ has submitted their Branch Audit Report to you. [Nov. 05 (5 Marks)]*

Answer: As per Sec. 228 (1) of the Companies Act, 1956, the accounts of a branch office of a company may be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. It is however not necessary for branch auditor to visit the branch and conduct the audit only at branch's premises. It is a matter of professional judgement for the branch auditor to decide as to whether he needs to visit the branch.

At the same time, the statutory auditor has the right to visit branch offices and to have access to the books of accounts and vouchers maintained at the branch office u/s 228 (2).

Under the present circumstances the statutory auditor is entitled to rely on the work of branch auditor unless there are special circumstances to make it essential for him to visit the branch and examine the books of account and voucher records. As per SA 200 "Basic Principles Governing an Audit, the principal auditor is entitled to rely upon the work performed by others provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. Further as per SA 600 "Using the work of another auditor", the principal auditor is not required to evaluate professional competence because branch auditor happens to be member of ICAI. The statutory auditor is also required to deal with the Branch Auditor's report in the manner, he considers necessary. Therefore, the statutory auditor is required to deal with branch auditor's report in the manner it considers fit under the circumstances.

SPECIAL AUDIT

Sec. 233A provides the following:

- (a) Where the Central Government is of the opinion -
 - that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or
 - that any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
 - that the financial position of any company is such as to endanger its solvency;the Central Government may at any time by order direct that a special audit of the company's accounts for such period or periods as may be specified in the order, shall be conducted.
- (b) For this purpose Central Government may appoint either a chartered accountant (whether or not such chartered accountant is in practice) or the company's auditor himself to conduct such special audit.
- (c) The special auditor shall have the same powers and duties in relation on the special audit as an auditor of a company has u/s 227 except for the fact he must report to the central Government in place of members of the company.
- (d) On receipt of the report, the Central Government may take such action as circumstances might warrant. In case the Central Government does not take any action within four months from the receipt of the report, it must send the report to the company either to circulate the copy among the members or to get it read before the company in its general meeting.

COST AUDIT

Cost Audit is covered by section 233B of the companies Act, 1956. The relevant provisions are:

- (a) The Central Government may by order direct that audit of cost accounts of a company shall be conducted in the manner, as may be specified in the order by a cost accountant. Provided that if Central Government is of opinion that sufficient number of cost accountants are not available the Government may direct that, such chartered accountant, as possesses the prescribed qualifications, may also conduct the audit of the cost accounts of companies
- (b) The cost auditor shall be appointed by the Board of Directors of the company with the previous approval of the Central Government.
- (c) Before the appointment of the cost auditor by the Board, a written certificate shall be obtained by the Board from the auditor proposed to be appointed to the effect that if the appointment is made, it will be as per section 224 (1B).
- (d) Cost audit shall be in addition to an audit under section 224.
- (e) A cost auditor shall have the some powers and duties as that of a statutory auditor, the cost auditor shall make his report to the Central Government in the prescribed form and within the prescribed time. A copy of the report shall be forwarded to the company.
- (f) The company shall within 30 days from the date of receipt of a copy of the report furnish the Central Government with full information and explanations on every reservations and qualifications contained in such report.
- (g) The Central Government has issued Cost Audit (Report) Rules specifying the form of the report and additional information to be included therein in the form of annexure.
- (h) The auditor must further report on the adequacy of cost accounting records mentioned by the company under section 209(1)(d) of the Act to confirm that they give a true and fair view of the cost of production, processing, manufacturing, or mining activities as the case may be.