

### KEY CONCEPTS

■ Free Reserves ■ Securities ■ Body Corporate ■ Related Party ■ Inter-Corporate Loan ■ Related Party Transaction ■ Arm's length basis ■ Ordinary Course of Business ■ Omnibus Approval ■ Place of Profit

### Learning Objectives

#### To understand:

- Keeping books of account
- Inspection of books of account and other provisions for Financial Statement & Consolidated Financial Statements
- Accounting Standards
- Provisions for audit and auditors, their appointment, qualifications, resignation, removal, duties and liabilities
- Provisions related to Cost Audit, Secretarial Audit and Internal Audit

### Lesson Outline

- Books of Accounts
- Financial Statements
- National Financial Reporting Authority
- Auditors - Appointment, Resignation and Procedure relating to Removal, Qualification and Disqualification
- Auditors-Rights, Duties and Liabilities
- Audit and Auditor's Report
- Cost Audit
- Secretarial Audit
- Internal Audit
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

## REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 128 to 148, 177, 204)
- The Companies (Accounts) Rules, 2014
- The Companies (Indian Accounting Standards) Rules, 2015
- The Companies (Audit and Auditors) Rules, 2014
- The SEBI (LODR) Regulations, 2015

## BOOKS OF ACCOUNTS

All business establishments and companies are required to keep a record of their day to day business and financial transactions in order to know the result of their operations. The said record is referred to as “book of accounts”. For preparation of annual accounts, the maintenance of proper books of account is a must. Section 128 of the Companies Act, 2013 contains the provisions for books of account etc. to be kept by company. The terms “books of accounts”, “book and papers” “financial statement” and “financial year” have been defined under the Companies Act, 2013 as below:

### IMPORTANT DEFINITIONS [SECTION 2]

- **“Book and paper” and “Book or paper”** - As per section 2(12) of the Act, “book and paper” and “book or paper” include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.
- **“Books of Account”** - As per section 2 (13) of the Act, “books of account” includes records maintained in respect of –
  - (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
  - (ii) all sales and purchases of goods and services by the company;
  - (iii) the assets and liabilities of the company; and
  - (iv) the items of cost as may be prescribed under section 148 of the Act in the case of a company which belongs to any class of companies specified under that section.
- **“Financial Statement”** - As per section 2(40) of the Act, financial statement in relation to a company, includes:
  - (i) a balance sheet as at the end of the financial year;
  - (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
  - (iii) cash flow statement for the financial year;
  - (iv) a statement of changes in equity, if applicable; and
  - (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub- clause (iv).
- **“Financial Year”** - According to section 2(41) of the Act “financial year”, in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year:

Provided further that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Act, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement.

Provided also that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.

#### CASE LAW

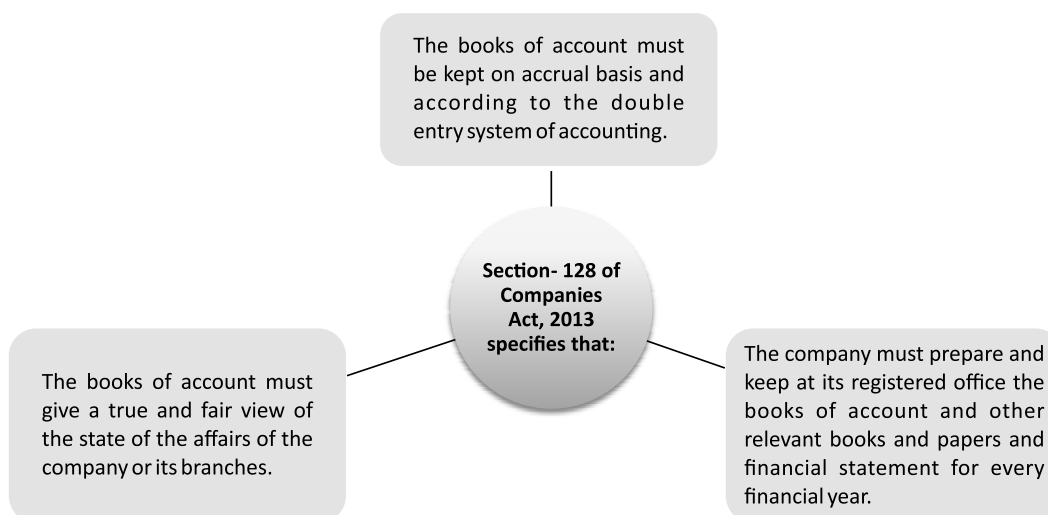
*In Re. Universal Robots (India) Private Limited C.A. No.109/2(41)/CB/2016 NCLT Bengaluru Bench*, it was held that subject to approval of Tribunal, subsidiary company of a foreign company could follow any financial year to align with the financial year of foreign company holding company for consolidation of accounts.

In the case of *Aris Global Software Pvt. Ltd CB/2016 NCLT Bengaluru Bench*, it was held that proviso to section 2(41) of the Act enable subsidiary company to have a different financial year in tune with financial year of its holding company and therefore, petitioner subsidiary company was to be permitted to follow the financial year commencing from January 01st and ending on December 31<sup>st</sup> in tune with its holding company for purpose of consolidation of accounts.

- **“Branch Office”** - According to section 2(14), branch office in relation to a company, means any establishment described as such by the company.

#### REQUIREMENT OF KEEPING BOOKS OF ACCOUNTS (SECTION 128)

Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year.



**CASE LAW**

In *J. K. Industries Ltd. & Anr. vs. Union of India & Ors.* [(2008) 143 Comp Cases 325], the Supreme Court explained the concept of 'accrual accounting' as follows:

"In the conventional sense, amounts which become receivable/recoverable are shown as income actually received and the liabilities incurred are shown as amounts actually disbursed in a given year. Therefore, under the aforesaid system of accounting, entries are posted in the books of accounts on the date of the transaction, i.e., on the date on which rights accrue or liabilities are incurred, irrespective of the date of payment. In such cases, a company has to account for its income or loss as per the above system and not otherwise, if that company has adopted mercantile system of accounting which is also known as accrual system of accounting. However, accrual does not mean confinement of items of revenue/expenditure to a given year. As stated above, mergers and acquisitions are undertaken to defer revenue expenditure over future years by invoking matching principles. Therefore, the said principle form an important part of accrual accounting."

**PLACE OF KEEPING BOOKS OF ACCOUNT**

Section 128(1) of the Act requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides, the company is required within 7 days of such decision to file with the Registrar of Companies a notice in writing giving full address of that other place. Such intimation is to be made in **e-form AOC-5** to the RoC.

**Test Yourself:**

**Question:** ABC Ltd. is having its branch office in Jodhpur, Udaipur and Bhiwadi. Is maintenance of books required at all the branch offices? What is required by Registered office regarding maintenance of Books of Account of branch offices?

**Answer:** As per section 128 of Companies Act, 2013, every branch office should maintain proper books of account. Proper summarized returns periodically are to be sent by the branch office to the Company at its registered office.

**MAINTENANCE OF BOOKS OF ACCOUNT IN ELECTRONIC FORM (RULE 3 OF THE COMPANIES (ACCOUNTS) RULES, 2014)**

The Rule 3 of the Companies (Accounts) Rules, 2014 provides the manner in which the books of accounts needs to be kept. The important provisions with respect to maintenance of books of accounts in electronic form are given below:

- The maintenance of books of account or other relevant papers in electronic mode is permitted. Such books of accounts or other relevant books and papers maintained in electronic mode shall remain accessible in India, at all times so as to be usable for subsequent use.

As per the Information Technology Act, 2000, "Electronic form" with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device.

Further, "Electronic record" means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche.

- For the financial year commencing on or after the 1st day of April, 2023, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.
- The information contained in the records shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.
- The information received from branch offices shall not be altered in any manner and shall be kept where it shall depict what was originally received from the branches.
- The information in the electronic record of the document shall be capable of being displayed in a legible form.
- There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:

However, the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a daily basis.

- The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement -
  - (a) the name of the service provider;
  - (b) the internet protocol address of service provider;
  - (c) the location of the service provider (wherever applicable);
  - (d) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.
- Where the service provider is located outside India, the name and address of the person in control of the books of account and other books and papers in India.

### **BOOKS OF ACCOUNT IN RESPECT OF BRANCH OFFICE**

The branches of the company, if any, in India or outside India shall also keep the books of account in the same manner as specified in sub-section (1) of Section 128 of the Act, for the transaction effected at the branch office. The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours.

The inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors. Where an inspection is made, the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

Further proper summarized return of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and which shall be kept open to directors for inspection.

**Illustration:**

ABC Company Ltd, has its registered office in Delhi and the Branch office in California. The proper books of accounts relating to the transactions effected at the branch office in California are kept at that office and proper summarized returns periodically (quarterly) are sent by that branch office to the company at its registered office.

**Illustration:**

ABC Company Ltd, has its registered office in Delhi and branch office in Mumbai .The proper books of accounts relating to the transactions effected at the branch office in Mumbai are kept at that office and proper summarized returns periodically are sent by that branch office to the company at its registered office.

Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought and the period for which the information is sought.

The company shall produce such financial information to the director within 15 days of the date of receipt of the written request. The financial information required by the director shall be sought for by the director himself and not by or through his holder of power of attorney or agent or any representative.

**CASE LAW**

In *Vakharia v. Supreme General Films Exchange Co. Ltd. (1948)* the judge stated that “..... a person can exercise his right of inspection through his agent only if he is unable effectively to take inspection has any substance in it. Of course it may be that in a proper case it is open to the party opposing inspection to show that the person seeking inspection is guided by improper motives, and if he succeeded in doing so the Court may refuse inspection through an agent. The principles that apply to the right of inspection of a partner are to my mind equally applicable to the right of inspection conferred on a director under Section 130(2) of the Indian Companies Act.

**PRESERVATION OF BOOKS OF ACCOUNTS**

The books of account of every company shall be kept in good order for a period related to not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years along with the vouchers relevant to any entry in such books of account. [Section 128(5)]

However, where an investigation has been ordered in respect of the company, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

**Illustration:**

M/s ABC Limited is registered as a company in the year 2000. In Financial year 2021-22, it must keep the books of accounts from FY 2012-13 to FY 2020-21.

### PERSONS RESPONSIBLE TO MAINTAIN BOOKS

According to section 128(6) of the Act, the following persons are responsible to take all reasonable steps to secure Compliance by the company with the requirement of maintenance of books of accounts etc.

- (i) Managing Director;
- (ii) Whole-Time Director, in charge of finance;
- (iii) Chief Financial Officer; or
- (iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128 of the Act.

### PENALTY

In case the aforementioned persons referred to in Section 128(6) of the Act (i.e. MD, WTD, CFO etc.) contravene such provisions, they shall in respect of each offence, be punishable with fine which shall not be less than: fifty thousand rupees, but which may extend to five lakh rupees.

### FINANCIAL STATEMENT [SECTION 129]

The financial statements shall give a true and fair view of the state of affairs of the company or companies in the form as provided for different class or classes in Schedule III and shall comply with accounting standards notified under section 133 of the Companies Act.

However, insurance companies, banking company, companies engaged in generation/ supply of electricity or any other class of companies shall make financial statements in the form as has been specified in or under the Act governing such class of companies [Proviso to Section 129(1)].

The financial statement shall be laid in the annual general meeting of that financial year [Section 129(2)].

Any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under the Companies Act, 2013.

## Financial Statement Examples



**Balance  
Sheet**



**Income  
Statement**



**Cash Flow  
Statement**



**Statement of  
Profit & Loss**

**FINANCIAL STATEMENT MUST GIVE TRUE AND FAIR VIEW**

As per provisions of sub-sections (1) and (2) of Section 128, every financial statement of the company must give true and fair view of the state of affairs of the company at the end of financial year. True and Fair view in respect of financial statement means-

- Financial statements and items contained should comply with accounting standards notified under section 133 of the Companies Act;
- Financial statement shall be in form or forms as provided for different class or classes of companies in Schedule III;
- In case of financial statement of any insurance or banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by the reason of the fact that they do not disclose –
  - ✓ in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
  - ✓ in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
  - ✓ in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
  - ✓ in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

Where the financial statements of a company do not comply with the accounting standards referred to in Section 129 (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

**PERSONS RESPONSIBLE FOR COMPLIANCE**

The persons responsible to take all reasonable steps to secure compliance by the company with the requirement of Section 129(7) of the Act, are:

- Managing Director;
- Whole-Time Director in charge of finance;
- CFO;
- Other person of a company charged by the Board with the duty of complying with the requirements of section 129.

Where any of the aforementioned officers are absent, all the directors shall be responsible and punishable.

As per MCA vide General Circular No. 08/2014 dated 4th April 2014, the financial statements & reports (Board/Auditor) in respect to the Financial Year, commenced before 01/04/2014 shall be governed by the Companies Act, 1956. However, the provisions of the Companies Act, 2013 shall apply to those companies in respect to the FY commencing on or after 01/04/2014.

### PENALTY

The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

In case persons referred to in section 129 (7) fail to take reasonable steps to secure compliance or contravene provisions of Section 129 of the Act, they shall in respect of each offence be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

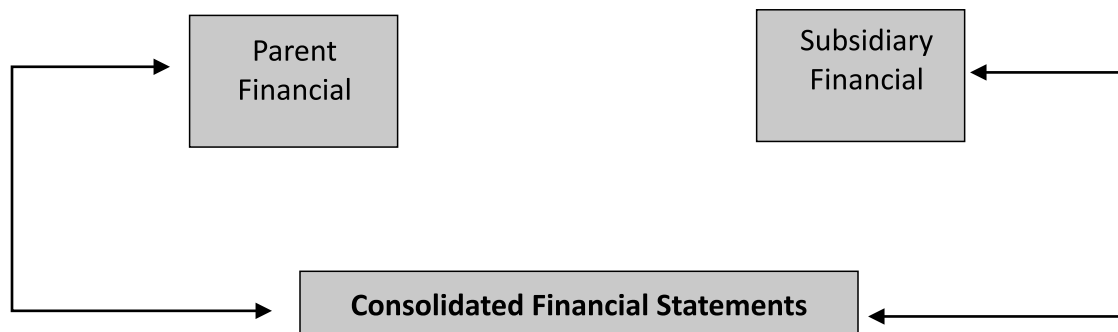
In case of Government Company - Section 129 shall not apply to the extent of application of Accounting Standard 17 (Segment Reporting) to the companies engaged in defense production. - Notification dated 5th June, 2015.

### FORM OF FINANCIAL STATEMENTS (SCHEDULE III)

The financial statements shall be in the form or forms as may be provided for different class or classes of companies. Schedule III contains general instructions for preparation of balance sheet and statement of profit and loss account.

### CONSOLIDATED FINANCIAL STATEMENTS

The Companies Act, 2013 has made preparation of consolidated accounts mandatory for all companies including unlisted companies and private companies having one or more subsidiaries or associates or joint ventures.



According to sub-section 3 of the section 129 of the Companies Act, 2013, where a company has one or more subsidiaries or associates. It shall, in addition to its financial statements for the financial year, prepare a consolidated financial statement of the company and of all the subsidiaries and associates companies in the same form and manner as that of its own and in accordance with applicable accounting standard, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary/ies or associate/s or joint venture/s in **Form AOC-1** (Rule 5 of the Companies (Accounts) Rules, 2014).

**Illustration:**

ABC International has Rs. 5,000,000 of income and Rs. 3,000,000 of assets mentioned in its financial statement. However, ABC International also governs five subsidiaries, which has an income of Rs. 50,000,000 and assets of Rs. 82,000,000. It is not correct to just reveal the parent company financial statements when it's consolidated outcome states a Rs. 55 million company and governs Rs. 85 million of assets.

As per Indian Accounting Standard 21, the parent company shall prepare a consolidated financial statement for its group enterprise. Parent means an enterprise having one or more subsidiaries and a group of enterprise.

### **MANNER OF CONSOLIDATION OF ACCOUNTS [RULE 6 OF THE COMPANIES (ACCOUNTS) RULES, 2014]**

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and the applicable accounting standards.

Provided that in case of a company covered under sub-section (3) of section 129 of the Act, which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:-

- (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
- (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
- (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

### **PERIODICAL FINANCIAL STATEMENTS (SECTION 129A)**

The Central Government may, require such class or classes of unlisted companies, as may be prescribed,—

- (a) to prepare the financial results of the company on such periodical basis and in such form as may be prescribed;
- (b) to obtain approval of the Board of Directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and
- (c) file a copy with the Registrar within a period of 30 days of completion of the relevant period with such fees as may be prescribed.

**RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS (SECTION 130)**

Section 130 of the Act, provides for provisions relating to re-opening or re-casting of books of accounts of the company. Accordingly,

- (i) A company shall not re-open its books of account and shall not recast its financial statements, unless an application to the tribunal or by court of competent jurisdiction, in this regard is made by any one or more of the following -
  - (a) the Central Government, or
  - (b) the Income-tax authorities, or
  - (c) the Securities and Exchange Board of India (SEBI), or
  - (d) any other statutory regulatory body or authority or any person concerned, and
  - (e) An order in this regard is made by a court of competent jurisdiction or the Tribunal.
- (ii) The re- opening and recasting of financial statements is permitted only for the following reasons –
  - (a) the relevant earlier accounts were prepared in a fraudulent manner; or
  - (b) The affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.
- (iii) The Tribunal shall give the notice to-
  - (a) the Central Government,
  - (b) the Income-tax authorities,
  - (c) the Securities and Exchange Board,
  - (d) any other statutory regulatory body or authority concerned or any other person concerned and shall take into consideration the representations, if any, made by Central Government or the authorities, Securities and Exchange Board or the body or authority concerned or any other person concerned before passing any order under this section.
- (iv) The accounts so revised or re-cast under this section shall be final.

No order shall be made under Section 130 (1) in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year.

Provided that where a direction has been issued by the Central Government under the proviso to sub-section of section 128 for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re-opened within such longer period.

**CASE LAW**

**In the matter of *Hari Sankaran (Appellant) vs. Union of India & Ors. (Respondents)* (The Supreme Court of India) dated 04/06/2019**

NCLAT order of allowing re-opening of books and re-casting of financial statements of IL&FS is valid

The Supreme Court of India *inter-alia* observed that the Tribunal may, under Section 130 of the Act, pass an order of re-opening of accounts if it is of opinion that (i) the relevant earlier accounts were prepared in a fraudulent manner; or (ii) the affairs of the company were mismanaged during the relevant period casting a doubt on the reliability of the financial statements. Thus, the Tribunal would be justified in passing the order under Section 130 of the Act upon fulfillment of either of the said two conditions.

In view of the above referred legal position in addition to the reports of SFIO & ICAI, the specific observations made by the learned Tribunal while passing the order under Section 241/242 of the Companies Act and considering the fact that the Central Government has entrusted the investigation of the affairs of the company to SFIO in exercise of powers under Section 242 of the Companies Act, the Apex Court observed that it cannot be said that the conditions precedent while invoking the powers under Section 130 of the Act are not satisfied.

The Supreme Court of India upheld the order passed by NCLAT under Section 130 of the Companies Act for re-opening of the books of accounts and re-casting the financial statements of the Infrastructure Leasing & Financial Services Limited; IL&FS Financial Services Limited and IL&FS Transportation Networks Limited for the last five years, viz. from Financial Year 2012-13 to the Financial Year 2017-18 in larger public interest.

### **VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT [SECTION 131]**

Section 131 of the Act, allows the directors to prepare revised financial statement or a revised Board's report in respect of any of the three preceding financial years after obtaining approval of the Tribunal, if it appears to them that the company's financial statement or the Board's Report has not been complied with the requirements of Section 129 or Section 134 of the Act.

The Tribunal shall give notice to the Central Government and the Income-tax authorities and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section.

Such revised financial statement or report shall not be prepared or filed more than once in a financial year.

The detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in general meeting, the revisions must be confined to—

- (a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134 of the Act; and
- (b) the making of any necessary consequential alternation.

### **CASE LAW**

It was held that in case of *American Road Technology & Solutions Pvt. Ltd. vs. Central Government CP No.43/BB/2020 NCLT Bengaluru Bench*, where company filed application for revision of financial statement in financial year 2017-2018, three preceding years for purpose of revision of financial statements would be 2016-2017, 2015-2016 and 2014-2015 (which was one of year in which incorrect financial reporting has been detected and in respect of which approval for revision has been sought), since, true and fair picture of company's finances would not emerge for financial year 2014-2015 unless financial statements for 2012-2013 and 2013-2014 were also revised, application for revision of financial statements for years 2012 to 2015 was allowed.

### **SIGNING OF FINANCIAL STATEMENT [SECTION 134]**

The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief

Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

The auditors' report shall be attached to every financial statement. A report by its Board of Directors shall also be attached to statements laid before a company in general meeting.

**Test Yourself:**

**Question: Is it mandatory to sign financial statement from the company secretary?**

**Answer:** As per Section 134(1), the company in which the Whole-time Company Secretary is appointed, then it is mandatory that the Financial Statement is signed from the Whole-time Company Secretary. Further if the company appointed Chief Executive Officer or Chief Financial Officer then the financial statement shall also be signed from them.

**RIGHT OF MEMBER TO COPIES OF AUDITED FINANCIAL STATEMENT [SECTION 136]**

According to section 136 of the Act, a copy of financial statements including consolidated financial statement, if any, auditor's report along with every other document required by law to be annexed or attached to the financial statements which are to be laid before a company in its general meeting, shall be sent to every member of the Company, every trustee for the debenture holder and all other persons who are so entitled, not less than twenty one days before the date of the meeting.

The copies of the documents can be sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by members –

- (a) In case of the company having share capital, majority in number entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or
- (b) In case of company not having share capital, not less than ninety-five per cent of the total voting power exercisable at the meeting.

**Exceptions:**

In case of section 8 company - A copy of financial statements including consolidated financial statement, if any, auditor's report along with every other document required by law to be annexed or attached to the financial statements which are to be laid before a company in its general meeting, shall be sent to every member of the Company, to every trustee for the debenture holder and all other persons who are so entitled, not less than fourteen days before the date of the meeting – *Notification dated 5th June, 2015.*

In case of Nidhi company - Section 136 (1) shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent, of the total paid-up share capital whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the Registered Office of the Nidhi is situated stating the date, time and venue of Annual General Meeting and the financial statement with its enclosures can be inspected at the registered office of the company, and the financial statement with enclosures are affixed in the Notice Board of the company and a member is entitled to vote either in person or through proxy – *Notification dated 5th June, 2015.*

### OBLIGATION OF LISTED COMPANY

In the case of a company whose shares are listed on a recognized stock exchange, provisions of section 136 shall be deemed to have been complied with, if the copies of the documents are made available for inspection at its registered office, during working hours, for a period of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form [Form AOC-3] or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty-one days before the date of the meeting.

The Companies which are required to comply with Companies (Indian Accounting standards) Rules, 2015 shall forward their statement in **Form AOC-3A**.

### MANNER OF CIRCULATION OF FINANCIAL STATEMENTS IN CERTAIN CASES – RULE 11 OF THE COMPANIES (ACCOUNTS) RULES, 2014

Further in case of all listed companies and such public companies which have a net worth of more than one crore rupees and turnover of more than ten crore rupees, the financial statements may be sent-

- (a) By electronic mode to such members whose shareholding is in dematerialized format and whose email ids are registered with Depository for communication purposes;
- (b) Where shareholding is held otherwise than by dematerialized format, to such members who have positively consented in writing for receiving by electronic mode; and
- (c) By dispatch of physical copies through any recognized mode of delivery as specified under section 20 of the Companies Act, 2013, in all other cases.

Every listed company is also required to place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

- According to Regulation 29 of SEBI (LODR) Regulations, 2015, the listed entity shall give prior intimation to stock exchange about the meeting of the board of directors regarding financial results viz. quarterly, half yearly, or annual, as the case may be.
- Intimation shall be given at least 2 working days in advance excluding the date of the intimation and date of the meeting.
- Every listed company having a subsidiary or subsidiaries shall place separate audited accounts in respect of each of subsidiary on its website, if any.
- A listed company which has a subsidiary incorporated outside India (herein referred to as “foreign subsidiary”)—
  - (a) where such foreign subsidiary is statutorily required to prepare consolidated financial statement under any law of the country of its incorporation, the requirement of this proviso shall be met if consolidated financial statement of such foreign subsidiary is placed on the website of the listed company;
  - (b) where such foreign subsidiary is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the holding Indian listed company may place such unaudited financial statement on its website and where such financial statement is in a language other than English, a translated copy of the financial statement in English shall also be placed on the website.

## FINANCIAL STATEMENTS OF SUBSIDIARIES

Every company having a subsidiary or subsidiaries shall provide a copy of separate audited or unaudited financial statements, as the case may be, as prepared in respect of each of its subsidiary to any member of the company who asks for it.

### RIGHT TO INSPECT

Every company shall be under an obligation to allow every member or trustee of the holder of any debentures issued by the company to inspect the financial statements and documents to be attached thereto at its registered office during business hours.

In case if the listed company has sent the salient features of financial statements to members and debenture trustees in prescribed form then copy of financial statements including consolidated financial statement, if any, auditor's report along with every other document required by law to be annexed or attached to the financial statements shall be available for inspection at its registered office during working hours for a period of 21 days before the date of meeting.

### PENAL PROVISIONS

If any default is made in complying with the provisions of Section 136 of the Act, the company shall be liable to a penalty of –

- (i) Twenty-five thousand rupees; and
- (ii) Every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

### COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR [SECTION 137]

Section 137 of the Act, requires every company to file the financial statements including consolidated financial statement together with Form AOC- 4 and AOC-4 (CFS) with the Registrar of Companies (RoC) within 30 days from the day on which the annual general meeting held and adopted the financial statements with such fees or additional fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

If the financial statements are not adopted at the annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents be filed with the RoC with in thirty days of the date of annual general meeting. The RoC shall take them in his record as provisional, until the adoption at annual general meeting.

Financial statements adopted in the adjourned annual general meeting shall be filed with the Registrar within thirty days of the date of such adjourned annual general meeting with such fees or such additional fees as may be prescribed.

The One Person Company shall file the copy of financial statements duly adopted by its member within a period of one hundred and eighty days from the closure of financial year.

The company shall also attach the accounts of subsidiaries incorporated outside India and which have not established their place of business in India with the financial statements.

Provided also that in the case of a subsidiary which has been incorporated outside India (herein referred to as "foreign subsidiary"), which is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the requirements of the fourth proviso (accounts of subsidiaries) shall be met if the holding Indian company files such unaudited financial statement along with a declaration to this effect and where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.

Where the annual general meeting of a company for any year has not been held, the financial statements along with the documents required to be attached, duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held and in such manner, with such fees or additional fees as prescribed.

The class of companies as may be notified by the Central Government from time to time, shall mandatorily file their financial statement in Extensible Business Reporting Language (XBRL) format and the Central Government may specify the manner of such filing under such notification for such class of companies [Rule 12(2) of the Companies (Accounts) Rules, 2014].

### **RULE 3 OF THE COMPANIES (FILING OF DOCUMENTS AND FORMS IN XBRL) RULES, 2015**

The following class of companies shall file their financial statements and other documents under section 137 of the Act with the Registrar in e-Form AOC-4 XBRL:

- (i) companies listed with stock exchanges in India and their Indian subsidiaries;
- (ii) companies having paid up capital of five crore rupees or above;
- (iii) companies having turnover of one hundred crore rupees or above;
- (iv) all companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

Provided that the companies preparing their financial statements under the Companies (Accounting Standards) Rules, 2006 shall file the statements using the Taxonomy provided in Annexure-II and companies preparing their financial statements under Companies (Indian Accounting Standards) Rules, 2015, shall file the statements using the Taxonomy provided in Annexure-II A of the Companies (Filing of Documents and Forms in XBRL) Rules, 2015.

Further non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance sector are exempted from filing of financial statements under these rules.

The companies which have filed their financial statements under sub-rule (1) of Rule 3 of XBRL Rules, shall continue to file their financial statements and other documents though they may not fall under the class of companies specified therein in succeeding years.

The companies which have filed their financial statements under the erstwhile rules, namely the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, shall continue to file their financial statements and other documents as prescribed in Rule 3(1) of XBRL Rules though they do not fall under the class of companies specified therein.

### **PENALTY FOR NON COMPLIANCE**

If company fails to comply with the requirement of submission of financial statement with RoC:

- the company shall be liable to a penalty of: Rs.10,000 and in case of continuing failure, with a further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs. 2 lakhs, and
- the Managing Director and the Chief Financial Officer of the company, if any, and, in the absence of the Managing Director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of section 137, and, in the absence of any such director, all the directors of the company, shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with further penalty of Rs.100 for each day after the first during which such failure continues, subject to a maximum of Rs.50,000.

## NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA)

Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Authority for Financial Reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards. It was constituted on 01<sup>st</sup> October, 2018. The erstwhile Companies Act, 1956 has empowered the Central Government to form a Committee for recommendations on Accounting Standards which is National Advisory Committee on Accounting Standards (NACAS). This has now been renamed with enhanced independent oversight powers and authority as National Financial Reporting Authority (NFRA). The National Financial Reporting Authority performs its functions through such divisions as may be prescribed.

NFRA is responsible for monitoring and enforcing compliance of auditing and accounting standards and for that purpose, oversee the quality of professions associated with ensuring such compliances. The Authority has power to investigate professional and other misconducts which may be committed by Chartered Accountancy members and firms. There is also a provision for appellate authority.

The National Financial Reporting Authority is a quasi – judicial body to regulate matters related to accounting and auditing. With increasing demand of non–financial reporting, it may be referred to as a National level business Reporting Authority to regulate standards of all kind of reporting- financial as well as non–financial, by the companies in future.

National Financial Reporting Authority shall give its recommendations on accounting standards and auditing standards. It shall only recommend and it is the Central Government who shall prescribe such standards.

### OBJECTIVES OF NFRA

The objectives of National Financial Reporting Authority *inter alia* shall be as follows:

Make recommendations to the Central Government on formulation of accounting and auditing policies and standards for adoption by companies, class of companies or their auditors;

Monitor and enforce the compliance with accounting standards, monitor and enforce the compliance with auditing standards;

Oversee the quality of service of professionals associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service, and

Perform such other functions as may be prescribed in relation to aforementioned objectives.

### CONSTITUTION OF NFRA

The constitution of National Financial Reporting Authority (NFRA), which is supposed to be constituted as an oversight regulatory body to recommend accounting and auditing standards, is governed by sub-section and (4) of section 132 of the Act. Accordingly,

- (i) It consists of a chairperson, who shall be a person of eminence & having expertise in accountancy, auditing, finance, or law, to be nominated by Central Government, and such other prescribed members not exceeding 15 consisting of part-time and full-time members as prescribed.

- (ii) Each division of the National Financial Reporting Authority shall be presided over by the Chairperson or a full-time Member authorized by the Chairperson.
- (iii) There shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and full-time Members of such Authority for efficient discharge of its functions under sub-section (2) of Section 132 of the Act [other than clause (a)] and sub-section (4) of Section 132 of the Act. Provided that the terms and conditions and the manner of appointment of the chairperson and members shall be such as prescribed.
- (iv) The chairperson and all members shall make a declaration in prescribed form about no conflict of interest or lack of independence in respect of their appointment. The chairperson and all full-time members shall not be associated with any audit firm or related consultancy firm during course of their appointment and two years after ceasing to hold such appointment.
- (v) The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the National Financial Reporting Authority under the Companies Act, 2013 and the terms and conditions of service of the secretary and employees shall be such as prescribed.
- (vi) The head office of National Financial Reporting Authority is at New Delhi and it may, meet at such other places in India, as it deems fit.
- (vii) The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as prescribed.

#### **MAINTENANCE OF BOOKS AND ACCOUNTS**

The National Financial Reporting Authority shall cause to be maintained such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India prescribe.

#### **AUDIT OF NFRA AND ANNUAL REPORT TO CENTRAL GOVERNMENT**

The accounts of the National Financial Reporting Authority is required be audited by the Comptroller and Auditor General of India at such intervals as may be specified by him and such accounts as certified by the Comptroller and Auditor General of India together with the audit report thereon shall be forwarded annually to the Central Government by the National Financial Reporting Authority.

The National Financial Reporting Authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor General of India to be laid before each House of Parliament.

#### **JURISDICTION, POWERS OF AND IMPOSITION OF PENALTIES BY NFRA**

The National Financial Reporting Authority have the power to investigate, either *suo moto* or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

Provide that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under Section 132 of the Companies Act, 2013.

**Powers of National Financial Reporting Authority:**

1. **Power of investigation:** NFRA has the power to investigate either on suo-moto or on reference by Central Government for such class of body corporates or persons as may be prescribed into the matter of professional or other misconduct committed by any member or firm of Chartered Accountants registered under the Chartered Accountants Act, 1949.
2. **Power of civil court:** The Authority shall have powers as are vested in a civil court under Code of Civil Procedure, 1908 in respect of following matters:
  - (a) Discovery and production of books of accounts and other documents at such place and at such time as may be specified by the National Financial Reporting Authority;
  - (b) Summoning and enforcing the attendance of persons and examining them on oath;
  - (c) Inspection of any books, registers and other documents of any person;
  - (d) Issuing commission for examination of witness or documents.
3. **Power of imposing a penalty or debarring a member for professional or other misconduct:** Where professional or other misconduct is proved, the Authority shall have powers to make an order in relation to:
  - A. Imposing penalty of:
    - (i) not less than one lakh rupees which may extend to five times of the fees received in case of individuals; and
    - (ii) not less than five lakh rupees which may extend to ten times of the fees received in case of firms.
  - B. Debarring member or the firm from:
    - (i) being appointed as an auditor or internal auditor or undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or
    - (ii) Performing any valuation as provided under section 247;

for a minimum period of six months or such higher period not exceeding ten years as may be determined by the National Financial Reporting Authority.

**APPEALS AND APPELLATE AUTHORITY**

Any person aggrieved by any order of the National Financial Reporting Authority may prefer appeal before the Appellate Tribunal in prescribed manner and on payment of such fee as prescribed.

**CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS- [SECTION 133]**

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. The Ministry has subsequently clarified that till the Standards of Accounting or any addendum thereto is prescribed by Central Government in consultation and recommendation of the National Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act 1956 shall continue to apply.

On 6th February 2015 the Ministry of Corporate Affairs (MCA), the Central Government, in consultation with the National Advisory Committee on Accounting Standards (NACAS), notified the Companies (Indian Accounting Standards) Rules, 2015. These rules came into force on 1st April 2015.

As a result of this notification, notifying the Companies (Indian Accounting Standards) Rules, 2015, there shall be two separate sets of Accounting Standards –

1. Indian accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015.
2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.

### Indian Accounting Standards (Ind AS)

Indian Accounting Standards (Ind AS) are the accounting standards prescribed under Section 133 of the Companies Act, 2013. Indian Accounting Standards (Ind AS) are specified in the Annexure to the Companies (Indian Accounting Standards) Rules, 2015. These accounting standards are converged with corresponding International Financial Reporting Standards.

### Applicability under Rule 3 of the Companies (Indian Accounting Standards) Rules, 2015

1. Indian Accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015.	<ul style="list-style-type: none"> <li>● Applicable to classes of company specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.</li> </ul>
2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.	<ul style="list-style-type: none"> <li>● Applicable to the companies other than the classes of companies specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.</li> </ul>

<b>Applicability</b>	<b>w.e.f.</b>
Mandatory basis for the accounting periods beginning on or after April 1, 2016 with the comparatives for the periods ending on 31st March, 2016, or thereafter.	<p>Rule 4(1)(ii)- The following companies shall mandatorily comply with Ind AS namely:-</p> <ul style="list-style-type: none"> <li>● Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange (except SME Exchange) in India or outside India and having net worth of rupees five hundred crore or more;</li> <li>● Unlisted companies having net worth of rupees five hundred crore or more;</li> <li>● holding, subsidiary, joint venture or associate companies of companies covered above.</li> </ul>

Mandatory basis for the accounting periods beginning on or after April 1, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter.	<p>Rule 4(1)(iii)- The following companies shall comply Ind AS namely:-</p> <ul style="list-style-type: none"> <li>● Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange (except SME Exchange) in India or outside India and having net worth of less than rupees five hundred crore;</li> <li>● Unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore;</li> <li>● holding, subsidiary, joint venture or associate companies of companies covered above.</li> </ul>
In case of NBFCs, for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018, or thereafter.	<p>Rule (4)(1)(iv)(a) The following NBFCs shall comply with the Ind (AS):</p> <p>(A) NBFCs having net worth of rupees five hundred crore or more;</p> <p>(B) holding, subsidiary, joint venture or associate companies of companies covered under item (A).</p>
In case of NBFCs, for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31st March, 2019, or thereafter.	<p>Rule (4)(1)(iv)(b) The following NBFCs shall comply with the Ind (AS):</p> <p>(A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchange in India or outside India and having net worth less than rupees five hundred crore;</p> <p>(B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and</p> <p>(C) holding, subsidiary, joint venture or associate companies of companies covered under item (B).</p>

### Companies exempted under Rule 5 of the Companies (Indian Accounting Standards) Rules, 2015

The Companies (Indian Accounting Standards) Rules, 2015 shall not be applicable on Banking Companies and Insurance Companies. The Banking Companies and Insurance Companies shall apply the Ind AS as notified by the Reserve Bank of India (RBI) and Insurance Regulatory Development Authority (IRDA) respectively. An insurer or insurance company shall however, provide Ind AS compliant financial statement data for the purposes of preparation of consolidated financial statements by its parent or investor or venturer, as required by the parent or investor or venturer to comply with the requirements of these rules.

Provided that an insurer or insurance company may provide its financial statement as per Ind AS 104 for the

purposes of consolidated financial statements by its parent or investor or venturer till the Insurance Regulatory and Development Authority notifies the Ind AS 117 and for this purpose, Ind AS 104 shall, as specified in the Schedule to these rules, continue to apply.

#### **The Companies (Accounting Standards) Rules, 2021 for Small and Medium sized Companies**

The MCA vide notification dated June 23, 2021 has notified the Companies (Accounting Standards) Rules, 2021 for Small and Medium sized companies (SMCs), with which the turnover and borrowing limits has been revised as well as disclosure requirements has been made less onerous for SMCs.

The revised definition of “Small and Medium Sized Company” (SMC) means, a company-

- (i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- (ii) which is not a bank, financial institution or an insurance company;
- (iii) whose turnover (excluding other income) does not exceed two hundred and fifty crore rupees in the immediately preceding accounting year;
- (iv) which does not have borrowings (including public deposits) in excess of fifty crore rupees at any time during the immediately preceding accounting year; and
- (v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

*Explanation.-* For the purposes of this clause, a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

The main objective was to mirror the existing accounting standards under the Companies Act, 1956, in the 2013 Act, and while doing so, the SMC definition, which has since been revised, has also been revised in the accounting standards.

### **AUDITORS- APPOINTMENT, RESIGNATION AND PROCEDURE RELATING TO REMOVAL, QUALIFICATION AND DISQUALIFICATION**

An auditor is a person who is authorized to review and verify the accuracy of financial records and ensure that the financial statements represent true and fair view of the state of affairs of the company. The Auditor protects businesses from fraud, point out discrepancies in accounting methods and, on occasion, work on a consultancy basis, helping organizations to spot ways to boost operational efficiency. The Auditors work in various capacities within different industries.

#### **APPOINTMENT OF AUDITORS (SECTION-139)**

The Board of Directors of a company shall appoint an individual or firm as the first auditor of a company, other than a Government company, within 30 days from the date of registration of the company. In the case of failure of the Board to appoint the first auditor, it shall inform the members of the company, who shall within 90 days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting of the company.

Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold the office from the conclusion of that meeting till the conclusion of sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

If at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

**MANNER AND PROCEDURE OF SELECTION AND APPOINTMENT OF AUDITORS**

In case of a company that is required to constitute an Audit Committee under section 177 of the Act, such committee, and, in cases where such a committee is not required to be constituted, the Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

- While considering the appointment of auditor, the Audit Committee or the Board, as the case may be, shall consider any pending proceeding relating to professional matters of conduct against the proposed auditor before the ICAI or any competent authority or any Court. Further they may call for such other information from the proposed auditor as it may deem fit.
- Where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.
- If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of auditor to the members in the AGM otherwise; it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- Thereafter if the Audit Committee decides not to reconsider its original recommendation, then Board shall record reasons for its disagreement with the Audit committee and send its own recommendation for consideration of the members in the AGM and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.
- The auditor appointed in the AGM meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

**CONDITIONS FOR APPOINTMENT AND NOTICE TO REGISTRAR [RULE 4 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]**

As per second proviso of section 139(1) of the Act read with rule 4 stipulates that written consent of the auditor must be taken before appointment. The auditor appointed shall submit a certificate that:

- a) the individual/firm is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
- b) the proposed appointment is as per the term provided under the Act;
- c) the proposed appointment is within the limits laid down by or under the authority of the Act;
- d) The list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

The Certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Act.

The Company shall inform the auditor concerned of his or its appointment and also file a notice of such appointment with the Registrar in Form ADT-1 within 15 days of the meeting in which the auditor is appointed.

### APPOINTMENT OF AUDITOR IN GOVERNMENT COMPANY- SECTION 139(5) & 139(7)

The appointment of auditor in Government Company or government controlled (directly/indirectly) company shall be held in accordance with the following provisions:

The First auditor shall be appointed by the Comptroller and Auditor General within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing Government Companies, the Comptroller & Auditor General shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

### MANDATORY ROTATION OF AUDITORS

The Companies Act, 2013 has introduced the system of rotation of auditors under section 139 (2) of the Act and Rule 5 which is applicable to-

- all listed companies;
- all unlisted public companies having paid up share capital of rupees 10 crore or more;
- all private limited companies having paid up share capital of rupees 50 crore or more;
- all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crore or more;
- The concept of rotation of auditors shall not apply to one person companies and small companies;
- All the companies mentioned above shall not appoint or re-appoint an individual as an auditor of the company for more than one term of 5 consecutive years. An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the date of completion;
- All the companies mentioned above shall not appoint or re-appoint an audit firm as an auditor of the company for more than two terms of 5 consecutive years. An audit firm which has completed its two terms of 5 consecutive years shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms.

#### Example:

M/s AD & Associates was auditor of M/s ABC Limited (Listed Company) and has rendered his services for 5 years. The firm is not eligible for reappointment. Even in case where, Mr. D, partner of M/s AD & Associates is also partner of M/s SD & Co. Therefore M/s SD & Co. cannot be appointed as auditor of M/s ABC Limited.

As on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

*The right of the company to remove the auditor or the right of the auditor to resign from such office of the company is not affected by this sub-section. Thus, an auditor can resign or be removed by the shareholders before completion of his term as discussed above. The firm shall include a Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008.*

**ROTATION OF AUDITORS [SECTION 139(3)]**

Members of a company subject to provisions of the Act, can provide for following by passing a resolution:

- (a) In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
- (b) The audit shall be conducted by more than one auditor.

**ROTATION OF AUDITORS ON EXPIRY OF THEIR TERM [SECTION 139 (4) AND RULE 6 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]**

Rotation of auditors on expiry of auditor's term then same procedure will be followed as required for appointment of auditors. The procedure is as under:-

1. The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
2. Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

For the purpose of rotation, the period for which the auditor is holding office prior to the commencement of this Act will also be counted in calculating the period of 5 years or 10 years as the case may be. The incoming auditor/audit firm shall not be eligible if such auditor/audit firm is associated with the outgoing auditor/audit firm under the same network of audit firms i.e. includes the firms operating/ functioning under the same brand name, trade name or common control, hitherto or in future.

If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Where a company has appointed two or more persons as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

**RE-APPOINTMENT OF RETIRING AUDITOR [SECTION 139 (9)]**

At any annual general meeting, a retiring auditor shall be reappointed as auditor of the company except under the following circumstances:

- (a) He is not qualified for re-appointment;
- (b) He has given the company a notice in writing of his unwillingness to be re-appointed; and
- (c) A special resolution has not been passed at that meeting appointing somebody else instead of him or providing expressly that retiring auditor shall not be re-appointed.

Section 139 (10) lays that where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

**CASUAL VACANCY IN THE OFFICE OF AUDITOR [SECTION 139 (8)]**

The provisions for filling of casual vacancy in the office of auditor are as follows:

- (a) The Board of the company shall have power to fill the casual vacancy in the office of auditor within 30 days.

- (b) In case casual vacancy has occurred due to resignation of auditor, such appointment should also be approved by the company in general meeting convened within 3 months of the recommendation of the Board and auditor shall hold the office till the conclusion of the next annual general meeting.
- (c) In case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor General of India, such vacancy should be filled by the Comptroller and Auditor General of India within 30 days. In case the Comptroller and Auditor General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.
- (d) Appointment of auditors to fill casual vacancy shall be made after taking into account the recommendation of the audit committee.

<b>Summary</b>			
<b>Particulars</b>	<b>Non-Government Company/Non Specified Class of Companies</b>	<b>Listed/Specified Class of Companies</b>	<b>Government Company</b>
<b>Appointment of 1<sup>st</sup> Auditor after Incorporation</b>	By BOD (Within 30 days from the date of Registration.)  Or By Members at EGM (Within-90 days of Information)  First auditor shall hold office till the conclusion of the first AGM	BY BOD (Within-30 days from the date of Registration.)  Or By Members at EGM (Within-90 days of Information)  First auditor shall hold office till the conclusion of the first AGM	BY CAG (Within-60 days from the date of Registration.)  Or In case the CAG does not appoint such auditor within the given period BOD (within-30 days)  Or In case of failure of the BoD to appoint such auditor within the given period Member at EGM (Within-60 days of Information)  First auditor shall hold office till the conclusion of the first AGM
<b>Subsequent Auditor</b>  The written consent and a certificate (appointment shall be in accordance with the conditions) from the auditor.	By Members  To hold office till conclusion of every 6th AGM.	By Members  (for maximum one term of 5/10 consecutive years)  Cooling off period of 5 years before next re-appointment	By CAG  (Within-180 days from 1 <sup>st</sup> April)

<b>Casual Vacancy due to</b> <ul style="list-style-type: none"> <li>● Resignation</li> <li>● Other Reasons</li> </ul>	Approved by Members within 3 months of recommendation of Board and hold office till next AGM.	Approved by Members within 3 months of recommendation of Board and hold office till next AGM.	By CAG within 30 days Or By BOD within next 30 days
	BOD within 30 days	BOD within 30 days	

**Illustrations:****A. In case of Non-Government Companies:**

Mr. A is appointed as auditor of M/s XYZ Limited (Non-government Company) on 01st January, 2021. Casual Vacancy is caused due to his resignation on 1st August, 2021.

In this case, casual vacancy shall be filled by the Board till 30th September, 2021. The same must be approved by the company within 3 months of the recommendations of the board.

**B. In case of Government Company:**

Mr. A is appointed as auditor of M/s XYZ Limited (Government Company) on 01st January, 2021. Casual Vacancy is caused due to his resignation on 1st August, 2021.

In this case, casual vacancy shall be filled by the Comptroller and Auditor General of India till 30th September, 2021.

**APPOINTMENT OF AUDITOR OTHER THAN RETIRING AUDITOR BY SPECIAL NOTICE [SECTION 140 (4)]**

Special notice shall be required from members proposing to move a resolution at the next annual general meeting to appoint a person other than the retiring auditor or to provide that the retiring auditor shall not be re-appointed.

Such special notice shall not be required in case where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139. Following points are relevant for the purpose of special notice:

- (i) Company, on receipt of such special notice for removing auditor, should forthwith send a copy of the same to the retiring auditor.
- (ii) If the auditor makes a representation in writing to the company and requests for its notification to the members, the company shall:
  - (a) state the fact of representation in any notice of resolution, and
  - (b) Send copy of representation to members to whom notice of meeting is sent, whether before or after the receipt of representation by the company,
  - (c) If the copy of representation is not so sent, copy thereof should be filed with the Registrar.
- (iii) Such representation should be of a reasonable length and not too long.
- (iv) For circulation to members, it should not be received by the company too late.
- (v) Auditor may require the company to read out the representation in the meeting if it is not so notified to members because it was too late or because of company's default.

Provided that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

**POWERS OF TRIBUNAL [SECTION-140 (5)]**

A National Company Law Tribunal (NCLT) can either:

on <i>suo-moto</i> ; or	on an application from Central Government; or	on an application from person concerned.
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Can direct the company to change the auditor if it is satisfied that the Auditor of a Company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

In the case of application being made by the Central Government and the NCLT being satisfied that change of auditor is required, it shall within 15 days of the receipt of such application, make an order that the Auditor shall not function as an auditor of the company and the Central Government may appoint another auditor in his place. This will happen only when an application is made by the Central Government and not by any other person.

Where the auditor, whether individual or firm, against whom the final order as aforementioned is passed by the NCLT under this section, he shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of passing of such order. Further, the auditor shall also be liable for action under Section 447 of the Act which provides for punishments for frauds.

It has been clarified by way of explanation that in case a firm is appointed as auditor of the company, the liability shall be of the firm and every partner or partners who acted in fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers shall be liable and not be eligible to be appointed as auditor of any company for a period of 5 years.

**CASE LAW**

In the case of *Union of India and another vs. Deloitte Haskins and Sells LLP & Anr.*, Supreme Court Criminal appeal nos. 2305-2307 of 2022, 03.05.2023 the Apex Court held that the subsequent resignation of an auditor after the application is filed under section 140(5) by itself shall not terminate the proceedings under section 140(5). Resignation and/or removal of an auditor cannot be said to be an end of the proceedings under section 140(5).

The Supreme Court upheld the constitutional validity of Section 140(5) of the Companies Act, 2013 and held that the provision is “neither discriminatory, arbitrary and/or violative of Articles 14, 19(1)(g) of the Constitution of India”. It is required to be noted that the role of auditors cannot be equated with directors and/or management. Auditors play very important role in the affairs of the company and therefore they have to act in the larger public interest and all other stakeholders including investors etc. Chapter X of the Act specifically for the “Audit and Auditors” looking to the importance of the auditors. Therefore, section 140(5) cannot be said to be discriminatory and/or violative of Article 14 of the Constitution of India.

**REMOVAL OF AUDITOR [SECTION 140 (1)] AND RULE 7 OF THE COMPANIES (AUDIT AND AUDITORS RULES, 2014]**

The auditor appointed under section 139 of the Act may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the prior approval of the Central Government in that behalf in the manner prescribed in Rule 7.

As per Rule 7, the auditor appointed under section 139 of the Act, may be removed from his office before the expiry of the term only by –

- (i) Obtaining the prior approval of the Central Government by filling an application in **Form ADT-2** within 30 days of resolution passed by the Board.

- (ii) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.
- (iii) The auditor concerned shall be given a reasonable opportunity of being heard.

### CASE LAWS

1. It was held in case of *SPC & Associates (Chartered Accountants) vs. DVAK & Co. (2017) 138 CLA 188 (NCLT Hyd)*, that where company appointed petitioner CA firm as its statutory auditor for the period of 5 years but did not ratify their appointment in its subsequent AGM and appointed another CA firm as its statutory auditor, since company did not obtain prior approval of Central Government, the removal of petitioner was to be held illegal.
2. It was held in the case of *Pipara & Co, LLP vs. Gujarat State Police Housing Corporation Ltd, C/SCA/7342/2021 NCLT Ahmedabad*, that without giving opportunity of hearing CAG appointed statutory auditor cannot be terminated before the term.
3. *HGR Logistics Private Limited vs. Kishor Goyal & Co. Regional Director, North-Western Region, Ahmedabad. Application No. RD (NWR)/Sec.140/113/2020/33* removal of Statutory Auditor of Company by Regional Director upon complaint made by the company against Statutory Auditor for not conducting its audit in time.

#### Facts of the Case :

HGR Logistics Private Limited has filed an online application seeking approval for removal of its Statutory Auditors under Section 140 (1) of the Companies Act, 2013 by filing e-form no. ADT-2 on 20.02.2021. The company has stated in its application that it has faced heavy penalties because the auditor was not able to conduct the audit in timely manner. The company also stated that the auditor was unwilling to visit the company even after multiple request made by the company. This creates the deadlock for the company as the auditor was not completing the audit nor was resigning from the company.

On the other hand, the auditor of the company claimed that they were unable to complete the audit as the company had not provided them with the financial information necessary to conduct the audit.

In this regard, ROC, Ahmedabad has submitted its report in the aforesaid matter vide letter dated 30th March, 2021. ROC in its report stated that the company has filed its last Balance sheet for the year ended as on 31.03.2019 and has failed to file Balance sheet for the year ending as at 31.03.2020 and relevant annual returns as per the requirement of Section 137(1) and Section 92(4) of the Companies Act, 2013. As the company/officers have violated the aforesaid provisions the adjudication u/s 454 of the Act is under process.

#### Decision :

After careful examination of the application made under section 140(1) of the Companies Act and considering all the averments made by both the parties, the application filed by the company for removal of auditor deserves to be approved as the auditor could not establish or satisfy the authority as to why he should not be removed and why he should be continued as the auditor in the company even after complete loss of trust between both the parties. Thus, the matter has been decided on merits and in the interest of justice.

Hence, exercising powers vested with the Regional Director u/s 140 (1) of the Companies Act, 2013 as per the Notification No. S.O. 4090 (E) dated 19-12-2016, and having regards to all the facts & circumstances, the application for removal of statutory auditors, under Section 140 (1) is hereby approved. The application stands disposed of with these orders.

**RESIGNATION OF AUDITOR [SECTION 140(2), 140 (3) AND RULE 8 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]**

The auditor who has resigned from the company shall file a statement in Form **ADT-3** indicating the reasons and other facts as may be relevant with regard to his resignation as follows:

- (i) In case of other than Government Company, the auditor shall within 30 days from the date of resignation, file such statement to the company and the Registrar.
- (ii) In case of Government Company or government controlled company, auditor shall within 30 days from the resignation, file such statement to the company and the Registrar and also file the statement with the Comptroller and Auditor General of India (CAG).

If the auditor does not comply with the provisions of section 140(2) of the Act, he or it shall be liable to a penalty of:

- (i) fifty thousand rupees or
- (ii) an amount equal to the remuneration of the auditor,

whichever is less.

In case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.

**REMUNERATION OF AUDITOR (SECTION 142)**

Section 142 of the Act prescribed that the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. The Board may fix remuneration of the first auditor appointed by it. The remuneration will be in addition to the out of pocket expenses incurred by the auditor in connection with the audit of the company but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

**AUDITOR NOT TO RENDER CERTAIN SERVICES (PROHIBITED SERVICES) [SECTION 144]**

An auditor shall provide to the company only such other services as are approved by the Board of Directors/ the audit committee, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:-

- (a) accounting and book keeping services;
- (b) internal audit;
- (c) design and implementation of any financial information system;
- (d) actuarial services;
- (e) investment advisory services;
- (f) investment banking services;
- (g) rendering of outsourced financial services;
- (h) management services; and
- (i) Any other kind of services as may be prescribed.

**ELIGIBILITY & QUALIFICATIONS OF AUDITOR**

Section 141 (1) & (2) of the Act prescribed the following eligibility and qualifications of auditor which are as under:-

- (i) Only a Chartered Accountant (individual) or a firm where majority of partners practicing in India are Chartered Accountants can be appointed as auditor.
- (ii) Where a firm including a Limited Liability Partnership (LLP) is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

### DISQUALIFICATIONS OF AUDITOR

Section 141 (3) of the Act read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor of a company, namely:

- A body corporate, except LLP;
- An officer or employee of the company;
- A person who is a partner, or who is in the employment, of an officer or employee of the company;
- A person who himself or his relative/partner is holding any security or interest in the company, or its subsidiary, or of its holding or associate company or a subsidiary of such holding company ;
  - However, the relative may hold security or interest in the company of face value not exceeding rupees one lakh. This shall wherever relevant be also applicable in the case of a company not having share capital or other securities.
  - In the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest.
  - A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment.
  - A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment.
- A person or a firm who, whether directly or indirectly, has “business relationship” with the company, or its subsidiary, or its holding or associate company;

The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except –

- commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
  - commercial transactions which are in the ordinary course of business of the company at arm’s length price-like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
- A person whose relative is a director or is in the employment of the company as a director or KMP;
  - A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment

as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

In case of private company a person is ineligible to be appointed as an auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than one hundred crore rupee.

- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- A person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

The term “directly or indirectly” shall include rendering of services by the auditor, -

- (i) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;
- (ii) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

**Illustrations on disqualification of auditors:**

- A) A registered society cannot be appointed as Auditor of the company.
- B) Mr. Arun who is employee of M/s ZXC Limited cannot be appointed as its auditor.
- C) Mr. Sanjay is employee of M/s QWERTY Limited and Mr. Ashish is his partner. Mr. Ashish cannot be appointed as the auditor of M/s QWERTY Limited.
- D) Mr. Sagar is holding an interest of more than Rs. 10,000 in M/s NHS Limited and Mr. Harshit is his partner. Neither Mr. Sagar nor Mr. Harshit can be appointed as the auditor of M/s NHS Limited.
- E) M/s ASD Limited is a subsidiary of M/s EHG Limited. Mr. Abhay is holding interest in M/s ASD Limited and Mr. Tarun is his partner. Neither Mr. Abhay nor Mr. Tarun can be appointed as auditor of M/s ASD Limited or M/s EHG Limited.
- F) Mr. Ratan is auditor of 20 companies and also appointed as auditor of M/s JKS Power Limited. This appointment is not valid and he should vacate the office.
- G) Mr. Rahul was auditor of 2 companies and was convicted for fraud in January 2015. He is appointed as auditor of M/s QST Limited in January, 2021. The appointment is not valid as 10 years have not be lapsed after conviction.

According to section 141 (4) of the Act where a person appointed as an auditor of a company incurs any of the disqualifications mentioned as above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

**AUDITORS – RIGHTS, DUTIES AND LIABILITIES****AUDITOR'S RIGHT TO ATTEND GENERAL MEETING**

According to section 146 of the Act, notice of all the general meetings shall also be forwarded to the auditor of the company and he must attend any general meeting either by himself or through his authorized representative (qualified to be an auditor) and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

**POWERS AND DUTIES OF AUDITORS**

Section 143(1) of the Act provided that every auditor **can access at all times to the books of accounts, vouchers** and seek such information and explanation from the company and enquire such matters as he considers necessary, including the matters specified in sub-Clauses (a) to (f). It is the duty of every auditor to make proper enquiry regarding these matters, besides other matters and if he is satisfied, it is not necessary to disclose this fact in his report. However, on enquiry, if he finds some adverse features, it is his duty to report the same. Specific enquiries to be made by the auditor under this sub-Section are as under–

**(a) Loans and Advances made by the Company**

Auditor shall inquire into “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 interest of the company or its members.” It is applicable to all loans and advances made on the basis of security. The auditor should verify that the security held against the loans and advances made by the company are legally enforceable and also ascertain the valuation of securities to see whether the loan is fully secured or partly secured.

**(b) Transactions represented by book entries**

Auditor is required to inquire “whether the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company”. He should verify the all book entry transactions and determine whether such transactions have actually taken place and are not prejudicial to the interest of the company.

**(c) Sale of investments**

Auditor should inquire, “whether so much of the assets of the company (except an investment company or a banking company) as consists of shares, debentures and other securities, have been sold at a price less than that at which they were purchased by the company”. Auditor must verify the cases where securities are sold at a price less than their cost of acquisition and if he finds that such sale is bona fide and the price realised is considered to be reasonable, having regards to the circumstances of each case, no further reporting is required.

**(d) Loans and Advances shown as deposits**

Auditor must verify “whether loans and advances made by the company have been shown as deposits”. The auditor must inquire in respect of all the deposits shown by the company and satisfy himself that the loans and advances have not been shown as deposits.

**(e) Charging of Personal expenses to revenue account**

Auditor should inquire as to “whether personal expenses have been charged to revenue account”. Auditor must ensure that no personal expenses of directors and officers of the company have been charged to revenue account.

**(f) Allotment of shares for cash**

Auditor should inquire as to “whether cash has actually been received in respect of shares stated to

have been allotted for cash and if no cash has actually been so received, whether the position as stated in the account books and balance sheet is correct, regular and not misleading". In this connection, auditor must ensure in respect of shares allotted in cash by the company that cash has actually been received in respect of such allotment by the company.

He should verify and report the cases where cash was not received and that the position, as stated in books of accounts and balance sheet, is correct, regular and not misleading.

Auditor will have access to books of accounts and vouchers, not only to those kept at registered office of the company but also to those kept at any other place. Such access shall be available at all times. Also, auditor of a holding company shall have access to the books of all of its subsidiary and associate companies for the purpose of consolidation of financial statements of holding company and its subsidiaries and associate companies.

### CASE LAW

In *Re Ministry of Corporate Affairs Vs. Mukesh Maneklal Choksi (CP NO.4365/140(5)/MB/2019 NCLT-Mumbai*, it was held that in case where the family members of statutory auditor were shareholders of respondent company and the statutory auditor has issued audit certificate without examining the books of accounts of the company, provisions of section 143(3)(d) had been violated and statutory auditor would cease to function as statutory auditor of respondent company.

### POWERS OF COMPTROLLER AND AUDITOR GENERAL OF INDIA IN CASE OF GOVERNMENT COMPANY [SECTION 143 (5) to 143 (7)]

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Government, or partly by the Central Government and partly by one or more State Government, the Comptroller and Auditor General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 of the Act, and direct such auditor the manner in which the accounts of the company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The CAG shall have a right to the conduct a supplementary audit of financial statement of the company and comment upon or supplement such audit report within 60 days from the date of receipt of the audit report u/s 143 (5).

Any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements u/s 136 (1) and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

The CAG may, by an order, cause test audit to be conducted of the accounts of company covered u/s 139 (5) or 139 (7) and the provisions of section 19A of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

The National Company Law Appellate Tribunal (NCLAT) held that the auditor cannot be debarred for 5 years under the Companies Act, 2013 in the absence of evidence supporting fraudulent intentions, in the matter of *Mukesh Maneklal Choksi v. Union of India, Company Appeal (AT) No. 89 of 2019*, dated February 17, 2020.

## AUDIT AND AUDITOR'S REPORT

Section 143 (2) of the Act provides that auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required to be laid in the general meeting of the company. The Audit report should take into consideration the provisions of this Act, the Accounting and Auditing standards and matters which are required under this Act or rules made thereunder or under any order made u/s 143(11) of the Act.

The Audit report should state that to the best of his information and knowledge, the said accounts and financial statements give a true and fair view of the state of the company's affair as at the end of the financial year and the profit or loss and the cash flow for the year and such other matters as may be prescribed.

Section 143 (3) of the Act, lay down that auditor's report shall also state other details which are as under:

- (a) whether he has sought and obtained all the information and explanations which were necessary and if not, the details thereof and the effect of such information on the financial statements;
- (b) 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;
- (c) whether the branch audit report prepared by a person other than the company's auditor has been sent to him;
- (d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
- (e) whether, in his opinion, the financial statements comply with the accounting standards;
- (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
- (g) whether any director is disqualified from being appointed as a director under section 164 (2);
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
- (i) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

Clause (i) of Sub-Section (3) of Section 143 related to internal financial controls shall not apply to a private company:-

- Which is an one person company or a small company; or
- Which has turnover of less than Rs. 50 crores as per the latest audited financial statement and which has aggregate borrowings of less than Rs. 25 crores, from banks, financial institutions, or any body corporate, at any point of time during the preceding financial year.

Further, Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribed that Auditor's Report shall also include the views and comments of the Auditors on the following matters, namely:-

- (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company;

- (iv) (a) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities (“Intermediaries”), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (“Ultimate Beneficiaries”) or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;
- (b) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities (“Funding Parties”), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (“Ultimate Beneficiaries”) or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
- (c) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.
- (v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013;
- (vi) Whether the company, in respect of financial years commencing on or after the 1st April, 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

The auditor is required to provide the reasons, where any of the matters required to be included in the Audit Report under this Clause is answered in negative or with a qualification. [Section 143 (4)]

### COMPANIES (AUDITOR'S REPORT) ORDER, 2020

Ministry of Corporate Affairs ‘MCA’ notified Companies (Auditor’s Report) Order, 2020 (CARO 2020) which is applicable for audit of financial statements of eligible companies for the financial years commencing on or after the 1st April, 2021.

CARO 2020 will be applicable to all the companies including foreign companies except banking company, insurance company, section 8 company, OPC [section 2(62)], small company [section 2(85)], certain private limited companies. This order stated that every report of the auditor under Section 143 of Companies Act, 2013 must contain the matters stated in 21 clauses as specified under paragraphs 3 and accord reasons for unfavorable or qualified answer as stated in paragraph 4 of CARO 2020.

CARO 2020 will not be applied with respect to auditor’s report on Consolidated Financial Statements except clause (xxi) of paragraph 3 (Reporting requirements on qualifications or adverse remarks by the auditors in the CARO reports). The order 2020 elaborated on all the matters which are to be included in the auditor’s report. Wherein, the following details of the subject-matter are described:

1. Whether the company is maintaining proper records showing full particulars such as:
  - i. The quantitative detail and situation of property, plant, and equipment,
  - ii. Physical verification of the property, plant, and equipment by the management at reasonable intervals,
  - iii. The details of the title deeds of the immovable properties held in the name of company,

- iv. Revaluation of the property, plant, and equipment or intangible assets or both and if there is more than 10% of the change in the property, plant, and equipment or intangible assets,
2. Details of proceedings against the company on the holding of any Benami property.
3. Physical verifications of inventory by the management at reasonable intervals and proper treatment of any discrepancies of 10% or more found.
4. Quarterly returns or statement filed by company having working capital limit more than 5 crore rupees with such banks or financial institution.
5. Details of the investments made by the company (except companies dealing in loans), security or guarantee given by the company.
6. Details of the payment pertaining to the undisputed statutory dues such as GST, provident Funds, Custom Duty, etc.
7. Details of any default done by the company in making the repayment of the loan.
8. Details of the funds raised by a company by the way of the Initial public offer.
9. Details of fraud done by the company, and many more.
10. The Auditor's Report Order 2020 of any company is supposed to state the reasons for unfavorable or qualified answers.

### **COST AUDIT [RULE 6 OF THE COMPANIES (COST RECORDS AND AUDIT) RULES, 2014]**

A company engaged in production, processing, manufacturing or mining activity, is also required to maintain particulars relating to utilization of material, labour or other items of cost as the Central Government may prescribe for such class of companies. These are known as cost records. In a case the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) of Section 148 of the Act and which have a net worth of such amount as prescribed or a turnover of such amount as prescribed, shall be conducted in the manner specified in the order.

#### **Appointment of Cost Auditor**

The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within 180 days of the commencement of every financial year, shall appoint a cost auditor.

Further, before such appointment is made, the written consent of the cost auditor to such appointment, and a Certificate from him or it is required to be obtained.

The cost auditor appointed shall submit a certificate that-

- (a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;
- (b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;
- (c) the proposed appointment is within the limits laid down by or under the authority of the Act; and
- (d) The list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014.

Every cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report alongwith his or its reservations or qualifications or observations or suggestions, if any, in **Form CRA-3**.

- (a) The cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.
- (b) Every company covered under these rules shall, within a period of 30 days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.
- (c) The Companies which have got extension of time of holding Annual General Meeting under section 96 of the Companies Act, 2013, may file Form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013.

#### **Removal of Cost Auditor/Casual Vacancy**

The cost auditor appointed under the Companies (Cost Records & Audit) Rules 2014, may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing.

Further **Form CRA-2** is required to be filed with the Central Government for intimating appointment of another cost auditor and the relevant Board Resolution to the effect shall be enclosed. However it shall not prejudice the right of the cost auditor to resign from such office of the company.

Any causal vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in **Form CRA-2** within thirty days of such appointments of cost auditor.

#### **Approval of Cost Audit Report**

The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorized by the Board, for submission to the cost auditor to report thereon.

#### **Remuneration of the Cost Auditor (Rule 14 of Companies (Audit & Auditors), Rules, 2014)**

- (a) in the case of companies which are required to constitute an audit committee-
  - i. the Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
  - ii. the remuneration recommended by the Audit Committee under clause (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

- (b) In the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

### SECRETARIAL AUDIT

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organization. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due process. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Considering the increasing importance of Corporate Governance, Section 204 of the Companies Act, 2013 mandates every listed company and such other class of prescribed companies to annex a Secretarial Audit Report, given by a company secretary in practice with its Board's report.

Secretarial Audit is an independent, objective assurance intended to add value and improve an organization's operations. It helps to accomplish the organization's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

### LEGAL FRAMEWORK GOVERNING SECRETARIAL AUDIT UNDER THE COMPANIES ACT, 2013

As per the provision of section 204(1) of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:

1. Every listed company;
2. Every public company having a paid-up share capital of 50 crore rupees or more; or
3. Every public company having a turnover of 250 crore rupees or more; or
4. Every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more.

Require to annex with its Board's Report made in terms of Section 134(3) of the Companies Act, 2013, a Secretarial Audit Report, given by a Company Secretary in practice, in **Form MR- 3**.

MCA has clarified that the paid up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

### APPLICABILITY OF SECRETARIAL AUDIT TO A PRIVATE COMPANY WHICH IS A SUBSIDIARY OF A PUBLIC COMPANY

According to the provisions of section 2(71) of the Companies Act, 2013 "public company" means a company which is not a private company and has a minimum paid-up share capital as may be prescribed.

However, the proviso to the aforesaid definition provides that, "a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of the Companies Act, 2013 even where such subsidiary company continues to be a private company in its articles".

Hence, it is clear from above proviso that Secretarial Audit is also applicable to a private company which is a subsidiary of a public company and which falls under the aforesaid prescribed class of companies.

Reserve Bank of India has come out with a discussion paper on Governance in Commercial Banks in India in the month of June, 2020 with the proposal to introduce Secretarial Audit in all commercial banks both listed and unlisted.

### SECRETARIAL AUDIT UNDER SEBI REGULATIONS

The Committee on Corporate Governance, constituted under the Chairmanship of Shri Uday Kotak, in its report dated October 05, 2017, recommended the following in view of the criticality of secretarial functions to efficient board functioning:

- a) Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"), in line with the provisions of the Companies Act, 2013.
- b) Secretarial Audit to be extended to all material unlisted Indian subsidiaries. This is in line with the theme of strengthening group oversight and improving compliance at a group level for listed entities.

The aforesaid recommendations were accepted by SEBI and in order to implement the same, the SEBI (LODR) Regulations, 2015 have been amended vide Notification dated May 09, 2018 to include Regulation 24A.

Accordingly, as per Regulation 24A of the SEBI (LODR) Regulations, 2015, every listed entity and its material unlisted subsidiaries incorporated in India shall undertake Secretarial Audit by a Secretarial Auditor who shall be a Peer Reviewed Company Secretary and shall annex a Secretarial Audit Report in such form as specified, with the annual report of the listed entity.

#### *Explanation:*

- (i) "Secretarial Auditor" means a Company Secretary in Practice or a firm of Company Secretary(ies) in practice appointed to conduct the Secretarial Audit.
  - (ii) "Peer Reviewed Company Secretary" means a Company Secretary in practice, who is either practicing individually or as a sole proprietor or as a partner of a Peer Reviewed Practice Unit, holding a valid certificate of peer review issued by the Institute of Company Secretaries of India.
- (b) On the basis of recommendation of board of directors, a listed entity shall appoint or re-appoint:
- (i) an individual as Secretarial Auditor for not more than one term of five consecutive years; or
  - (ii) a Secretarial Audit firm as Secretarial Auditor for not more than two terms of five consecutive years,
- with the approval of its shareholders in its Annual General Meeting:

Provided that-

- (i) an individual Secretarial Auditor who has completed his or her term under sub-clause (i) of this clause shall not be eligible for re-appointment as Secretarial Auditor in the same entity for five years from the completion of his or her term;
- (ii) a Secretarial Audit firm which has completed its term under sub-clause (ii) of this clause, shall not be eligible for re-appointment as Secretarial Auditor in the same entity for five years from the completion of such term;
- (iii) Provided further that as on the date of appointment no Secretarial Audit firm having a common partner or partners to the other Secretarial Audit firm, whose tenure has expired in the listed entity immediately preceding the financial year, shall be appointed as Secretarial Auditor of the same listed entity for a period of five years:

- (iv) Provided further that, nothing contained in these regulations shall prejudice the right of the entity to remove Secretarial Auditor with the approval of its shareholders in its Annual General Meeting or the right of the Secretarial Auditor to resign from such office of the listed entity.

(c) The casual vacancy arising out of resignation, death or disqualification of a Secretarial Auditor shall be filled by the board of directors of the listed entity within a period of three months and the secretarial auditor so appointed shall hold office till the conclusion of the next annual general meeting.

**Eligibility, Qualifications and Disqualifications of Secretarial Auditor:**

As per Regulation 24 (1A) of the listing Regulation

- (a) A person shall be eligible for appointment as a Secretarial Auditor of the listed entity only if such person is a Peer Reviewed Company Secretary and has not incurred any of the disqualifications as specified by the Board:

Provided that a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be Secretarial Auditor of the listed entity.

- (b) Where a firm including a limited liability partnership is appointed as Secretarial Auditor of the listed entity, only the partners who are Peer Reviewed Company Secretaries shall be authorised to act and sign on behalf of the firm.

- (c) Where a person appointed as Secretarial Auditor of the listed entity incurs any of the disqualifications as specified by the Board, after appointment, such person shall vacate the office as Secretarial Auditor and such vacation shall be deemed to be a casual vacancy in the office of the Secretarial Auditor.

(1B) Secretarial Auditor not to render certain services:

A Secretarial Auditor appointed under these regulations shall provide to the listed entity only such other services as are approved by the board of directors, but which shall not include any services as specified by the Board in this behalf.

(1C) With effect from April 1, 2025, every listed entity shall ensure compliance with sub-regulation (1), (1A) and (1B) for appointment, re-appointment or continuation of the Secretarial Auditor of the listed entity:

Provided that any association of the individual or the firm as the Secretarial Auditor of the listed entity before March 31, 2025 shall not be considered for the purpose of calculating the tenure under clause (b) of sub-regulation (1).]

Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within sixty days from end of each financial year

Provided that the listed entity shall ensure that with effect from April 1, 2025, the Secretarial Compliance Report submitted to the stock exchange(s) on annual basis is signed only by the Secretarial Auditor or by a Peer Reviewed Company Secretary who satisfies the conditions mentioned in sub-regulations (1A) and (1B) of this regulation.]

Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within sixty days from end of each financial year. *(Amended by the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2021 w.e.f. 5.5.2021).*

SEBI vide its Circular dated February 08, 2019 notified the formats for Annual Secretarial Audit Report and Annual Secretarial Compliance Report for listed entities and their material subsidiaries, effective from the financial year ended March 31, 2019.

Thus, vide above mentioned circular the following key points regarding the same has been clarified:

**Annual Secretarial Audit Report:** The listed entity and its unlisted material subsidiaries shall continue to use the same Form No. MR-3 for (secretarial audit report) as required under the Companies Act, 2013 and the rules made thereunder for the purpose of compliance with Regulation 24A of the SEBI (LODR) Regulations, 2015 as well.

**Annual Secretarial Compliance Report:** While the annual secretarial audit cover a broad check on compliance with all laws applicable to the entity, listed entities additionally, on an annual basis, require a check by the PCS on compliance of all applicable SEBI Regulations and circulars/ guidelines issued thereunder, consequent to which, the PCS need to submit annual secretarial compliance report to the listed entity in the format prescribed under said SEBI circular.

It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

The Board of Directors, in their report, shall explain in full any qualification or observation or other remarks made in the Secretarial Audit Report. The companies which are not covered under section 204 of the Act may obtain Secretarial Audit Report voluntarily as it provides an independent assurance of the compliances of applicable laws of the company.

### THE OBJECTIVES OF SECRETARIAL AUDIT

The objectives of Secretarial Audit may be summarized as under:-

To check & report on compliances of applicable laws and Secretarial Standards;

To point out non-compliances and inadequate compliances;

To protect the interest of various stakeholders i.e. the customers, employees, society etc.;

To avoid any unwarranted legal actions/penalties by law enforcing agencies and other persons as well.

### SCOPE OF SECRETARIAL AUDIT

The scope of Secretarial Audit comprises verification of the compliances under the following enactments, rules, regulations, notifications and guidelines:

**(i) The Companies Act, 2013 (the Act) and the Rules made thereunder:**

On various matters under Companies Act, 2013, Central Government has been empowered to make rules. A perusal of the scheme of the Act makes it clear that compliances under the Act may be divided into two categories. Compliances of the first type are annual and non-event based such as filing of the annual return, annual report including secretarial audit report, wherever applicable, etc. The compliances of second category are event based i.e. on happening of certain event.

These events require compliance of various provisions of the Act.

While secretarial audit envisages the verification of all secretarial records of a company. For ease of presentation, the following key areas have been highlighted for verification:

**Under the Companies Act, 2013**

1. Maintenance of registers and records

2. Filing of forms, returns and documents
3. Memorandum and/or Articles of Association
4. Meetings of directors/committees thereof, shareholders and other stakeholders
5. Secretarial Standards
6. Directors and Key Managerial Personnel (“KMP”)
7. Disclosures
8. Issue of shares and other securities
9. Transfer and transmission of shares and other securities and related matter
10. Dividend
11. Deposits
12. Borrowings
13. Loans, investments, guaranties and securities
14. Loans to directors etc. and Related party transactions
15. Charges
16. Corporate Social responsibility.

**(ii) Other major Acts and Regulations:**

- (a) The Securities Contracts (Regulation) Act, 1956 and the Rules made under that Act; (where applicable): With special reference to listing, delisting and continuous listing of any of the securities
- (b) The Depositories Act, 1996 and the Regulations and Bye-laws framed under that Act; (where applicable)
- (c) The Foreign Exchange Management Act, 1999 and the Rules and Regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings; (where applicable)
- (d) The regulations and guidelines made under the Securities and Exchange Board of India Act, 1992 (where applicable). The various laws/regulations/guidelines which could be considered under this are:
  - (i) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
  - (ii) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;
  - (iii) The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018;
  - (iv) The SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999/ SEBI (Share Based Employee Benefits) Regulations, 2014;
  - (v) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
  - (vi) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

- (vii) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
- (viii) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 2018;
- (ix) SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015 (where applicable).

**(iii) Other Applicable Laws include:**

Reporting on compliance of 'Other laws as may be applicable specifically to the company' shall mean all the laws which are applicable to specific industry for example for Banks- all laws applicable to Banking Industry; for insurance company-all laws applicable to insurance industry; likewise for a company in petroleum sectoral laws applicable to petroleum industry; similarly for companies in pharmaceutical sector, cement industry etc.

The Secretarial Audit or should prepare a list of specific laws as applicable to the company whose secretarial audit is being conducted and verify compliance with the same. SS-1 requires every company to specify list of laws applicable specifically to the company at its Board Meeting.

Examining and reporting whether the adequate systems and processes are in place to monitor and ensure compliance with general laws like labour laws, competition law, and environmental laws.

The provisions relating to audit of accounts and financial statement of a company is dealt in the Statutory Audit, and that relating to taxation is dealt in Tax Audit, the Secretarial Auditor may rely on the reports given by statutory auditors or other designated professionals. However, Secretarial Auditor is expected to report on the Secretarial Compliance of these laws.

**(iv) To examine and report on the compliance with Secretarial Standards issued by ICSI.**

**(v) Adherence to board process and compliance mechanism**

The scope of Secretarial Audit should include the assessment of the adequacy and quality of board process and compliance mechanism. In preparing the Audit Report, the secretarial auditor shall consider the following matters (illustrative):

1. Instances of non-compliance during the defined audit period, in relation to the statutes, rules, regulations, etc. applicable to the company, continuing non-compliance, if any, and the reasons thereof;
2. Significant litigation(s) initiated by the company or filed against the company with brief details of the cases;
3. (a) Board structure –
  - (i) Composition of the Board
  - (ii) Is there a stated process to ascertain the suitability of directors?
  - (iii) Is there a stated process in place for succession planning?
- (b) Deficiencies in the Board systems and processes –
  - (i) In convening meetings.
  - (ii) In the circulation of agenda (whether the agenda is made available to the Board along with supporting papers/presentations sufficiently in advance of the meetings).
  - (iii) In conducting the meetings (frequency and length).
  - (iv) In the decision making process of the Board.

- (v) Adequacy and integrity of minutes recorded.
  - (vi) In the functioning of Board constituted Committees.
4. The existence and adequacy of internal control systems, procedures and processes, commensurate with the size of the company and the nature of its business, for ensuring compliance with laws applicable to the company;
  5. Any material event(s) that have happened, after the end of the financial year but before the date of the report, having a significant impact on any of the above reported items;
  6. Whether any event occurred or action was taken in the audit company which may have bearing on the Compliances under various laws, regulations, guidelines and standards etc.

### NEED FOR SECRETARIAL AUDIT

Secretarial Audit is the process of independent verification, examination of level of compliance of applicable Corporate Laws to a company. The audit process if properly devised ensures timely compliance and eliminates any un-intended non-compliance of various applicable rules and regulations. An action plan of the Corporate Secretarial Department is to be designed so as to ensure that all event based and time based compliances are considered and acted upon. Secretarial Audit is to be on the principle of “Prevention is better than cure” rather than post mortem exercise and to find faults. Broadly, the need for Secretarial Audit is:

- Effective mechanism to ensure that the legal and procedural requirements are duly complied with.
- Provides a level of confidence to the directors & Key Managerial Personnel etc.
- Directors can concentrate on important business matters as Secretarial Audit ensures legal and procedural requirements.
- Strengthen the image and goodwill of a company in the minds of regulators and stakeholders.
- Secretarial Audit is an effective governance and compliance risk management tool.
- It helps the investor in analyzing the compliance level of companies, thereby increases the reputation.

### APPOINTMENT OF SECRETARIAL AUDITOR

As per Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014, read with Section 179 of the Companies Act, 2013, secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting.

On the basis of recommendation of board of directors, a listed entity shall appoint or re-appoint:

- (i) an individual as Secretarial Auditor for not more than one term of five consecutive years; or
- (ii) a Secretarial Audit firm as Secretarial Auditor for not more than two terms of five consecutive years,

with the approval of its shareholders in its Annual General Meeting.

### ROLE OF COMPANY SECRETARY

Company secretary in practice has been exclusively recognized for conducting secretarial audit. The section 204 further provides that Secretarial Audit Report is to be submitted in a format prescribed under rules. As per sub-rule (2) of Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the format of the Secretarial Audit Report shall be in Form MR-3.

Section 134 and Sub-section (3) of Section 204 provides that the Board of Directors, in its report, shall explain

in full any qualification or observation or other remarks made by the company secretary in practice in the secretarial audit report.

If a company or any officer of the company or the company secretary in practice, contravenes the provisions of section 204, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of two lakh rupees.

## INTERNAL AUDIT [SECTION 138]

### Classes of companies requiring Internal Audit

The following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate namely:-

- (a) Every listed company;
- (b) Every unlisted public company having –
  - (i) Paid up share capital of fifty crore rupees or more during the preceding financial year; or
  - (ii) Turnover of two hundred crore rupees or more during the preceding financial year; or
  - (iii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
  - (iv) Outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (c) Every private company having –
  - (i) Turnover of two hundred crore rupees or more during the preceding financial year; or
  - (ii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

#### **Exceptions:**

In case of Specified IFSC Public Company / Specified IFSC Private Company - Section 138 shall apply if the articles of the company provides for the same. - Notification Dated 4th January 2017.

### Who can be an Internal Auditor?

- (a) A Chartered Accountant or;
- (b) A Cost Accountant or;
- (c) Such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company.

For this sub-section, Chartered Accountant means a Chartered Accountant, who is a member of the Institute of Chartered Accountants of India and Cost Accountant means a member of the Institute of Cost Accountants of India as the case may be, whether engaged in practice or not. Other professionals, as may be decided by the company's board, may also be appointed as an internal auditor.

Following classes of companies are required to appoint internal auditor –

<b>Criterion</b>	<b>Listed Companies</b>	<b>Unlisted Public Company</b>	<b>Every Private Company</b>
<b>Paid-up Capital</b>	Internal audit is mandatory for all listed companies, irrespective of any criterion	50 crore rupees or more*	Not Applicable
<b>Turnover</b>		200 crore rupees or more*	200 crore rupees or more*
<b>Outstanding loans and borrowing from bank and PFI</b>		exceeding 100 crore rupees or more**	exceeding 100 crore rupees or more**
<b>Outstanding deposits</b>		25 crore rupees or more**	Not Applicable

\* during the preceding financial year.

\*\* at any point of time during the preceding financial year.

Appointment of internal auditor is mandatory for every producer company irrespective of any criterion.

Further, the proviso provides that any existing company which is covered under any of the above criteria shall comply with the requirements of section 138 and rule 13 within six months of commencement of such section.

### SPECIMEN RESOLUTION/FORMATS

#### Board Resolution for considering and approving place other than the registered office where books of account of the company may be kept

**“RESOLVED THAT** pursuant to the provisions of Section 128 of the Companies Act, 2013 read with Rules made thereunder (including any statutory modification or re-enactment thereof for the time being in force) consent of the Board of Directors of the Company be and is hereby accorded for keeping and maintaining Books of Accounts of the Company at \_\_\_\_\_ along with registered office of the company with effect from \_\_\_\_\_.

**RESOLVED FURTHER THAT** Mr. /Ms. \_\_\_\_\_, director/CS/CFO of the Company be and is hereby authorized to file the necessary documents/ form(s) with the ROC and to do all such acts, deeds, matters and things as may be necessary, desirable, proper or expedient for the purpose of giving effect to this resolution and for matters connected therewith or incidental thereto.”

#### Board Resolution for Appointment of Auditors

**“RESOLVED THAT** pursuant to provision of section 139 of the Companies Act 2013 (as amended or reenacted from time to time) and other applicable provision of the companies Act 2013 and considering the recommendations made by the Audit Committee (mentioned only if applicable), the consent of the Board be and is hereby recommends M/s. \_\_\_\_\_ Chartered Accountants for appointment as the statutory auditor of the company for the financial year \_\_\_\_\_, from the conclusion of the forthcoming annual general meeting till the conclusion of sixth meeting , at a remuneration to be decided in consultation with it.

**RESOLVED FURTHER THAT** the Board of Directors of the Company be and are hereby authorized for and on

behalf of the Company to take all necessary steps and to do all such acts, deeds, matter, filing and things which may deem necessary in this behalf.

**Format of resolution for appointment of Statutory Auditors from the conclusion of this Annual General Meeting until the conclusion of the Sixth consecutive Annual General Meeting and to fixation of their remuneration**

**“RESOLVED THAT** pursuant to Sections 139, 142 of the Companies Act, 2013 (“Act”) and other applicable provisions, if any, of the said Act and Companies (Audit and Auditors) Rules, 2014 made thereunder and other applicable rules, if any, under the said Act (including any statutory modification(s) or re-enactment thereof for the time being in force) M/s. \_\_\_\_\_, Chartered Accountants (Registration No. \_\_\_\_\_), be and is hereby appointed as the Statutory Auditors of the Company commencing from the conclusion of this Annual General Meeting till the conclusion of Sixth consecutive Annual General Meeting at a remuneration to be fixed by the Audit Committee and/or Board of Directors of the Company, in addition to the re-imbursement of applicable taxes and actual out of pocket and travelling expenses incurred in connection with the audit and billed progressively.

**RESOLVED FURTHER THAT** the Board of Directors of the Company be and are hereby authorized for and on behalf of the Company to take all necessary steps and to do all such acts, deeds, matter, filing and things which may deem necessary in this behalf.

**LESSON ROUND-UP**

- As per the Companies Act, 2013, books of account and other books and papers should be available for inspection by any director on working days during business hours.
- The expression ‘annual accounts’ embraces both balance sheet and statement of profit and loss.
- The term ‘Balance Sheet’ means a statement prepared from the books of a concern showing the debit and credit balances after the trading and profit and loss accounts have been prepared – a statement drawn up at the end of each trading or financial period, setting forth the various assets, and liabilities of a concern at a particular date.
- Profit and loss account is a Statement by which the directors disclose to the shareholders of the company the result of the actual working of the company. It serves to give the shareholders an idea of the earning capacity of the company in relation to its capital, and enables them to judge about the administration and management of the affairs of the company.
- The Act provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards.
- The balance sheet and profit and loss account must be approved by the Board of directors and signed by the directors before they are submitted to the auditors for their report. The Act gives other provisions also for authentication of annual accounts. The Act also requires the company to file such annual accounts with the Registrar of Companies.
- The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company. An audit of accounts is conducted with two-fold purpose:

- i. detection and prevention of errors;
- ii. detection and prevention of fraud.

- The Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India within the limits specified.
- The Act provides that the auditors' report shall be signed only by the person appointed as an auditor of the company.
- The Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlight the area of inefficiencies or high costs.
- Secretarial Audit is a compliance audit and it is a part of total compliance management in an organization. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

### GLOSSARY

**Accounts of Companies :** As per section 2(12) of the Act, “book and paper” and “book or paper” include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

**National Financial Reporting Authority (NFRA) :** Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Authority for Financial Reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards.

**Comptroller and Auditor General of India :** The Comptroller and Auditor General (CAG) of India is an authority, established by the Constitution under Constitution of India/Part V - Chapter V/Sub-part 7B/ Article 148. The Comptroller and Auditor-General performs such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made.

**First Auditor :** The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days of the date of registration of the company, and the auditor so appointed shall hold office until the conclusion of the first AGM.

**BoD :** Board of Directors.

### TEST YOURSELF

*(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).*

1. Section 128(1) requires every company to prepare and keep the books of accounts and other relevant books and papers and financial statements at its registered office. State the manner of maintenance of books of accounts in electronic form.
2. What is the procedure to report frauds?

3. ABC Ltd. wants to appoint FMC & Associates as its internal auditor. What are the conditions of such Appointment?
4. A is an auditor of OPR Ltd, a listed public company having paid-up share capital of Rs. 10 crore. Advise him as to whether he can render the following services, keeping in mind, the relevant provisions of the Companies Act, 2013.
  - (i) A wishes to “design and implement one financial system” and offer management services to PQR Ltd, the holding company of OPR Ltd.
  - (ii) A wants to conduct internal audit of OPR. He also wishes to provide actuarial services to XYZ Ltd.
  - (iii) What will be your answer in the above two cases if services are provided to ABC Ltd, a subsidiary Company of OPR Ltd.?
5. Who can appoint Secretarial Auditor of the company: Board of Directors or Shareholders? What is the Duty of Board of Directors towards secretarial auditor and audit report?
6. ABC Ltd. had Rs.7 crore as securities premium in its reserves and surplus account in Balance Sheet as at 31st March, 2020. The Company has incurred significant losses in preceding years and as on 31st March, 2020 it has accumulated losses amounting to Rs. 8 crore in the Balance Sheet. In order to present a true and fair view of the financial results, the company wrote off the losses by reducing the amount standing to the credit of securities premium account. With reference to the provisions of the Companies Act, 2013, decide if the action of the Company is valid?
7. Which of the following statements is/are not correct with regards to the duties of auditor?
  - (a) Physical verification of fixed assets is primarily the responsibility of the auditor.
  - (b) Auditor should ascertain that the assets are in possession of the client company.
  - (c) The auditor should satisfy himself that the assets have been valued in the financial statements according to the accounting principles
  - (d) Ownership of fixed assets should be verified by examining the title deed by the auditor.
8. M/s RJM International Private Limited was incorporated on 15 January, 2022. It needs to appoint its first auditor. Its Board of Directors failed to appoint first auditors by 25 January, 2022.What recourse is available in this case as per Companies Act, 2013?
  - (a) Board of director can appoint first auditors at any time after incorporation.
  - (b) Where Board of directors fails to appoint within 30 days of incorporation, the shareholders will appoint within 90 days in EGM.
  - (c) The auditor will be appointed by CAG in this case.
  - (d) The first auditor needs to be appointed within 120 days.
9. M/s MFSL Limited is an unlisted public company with outstanding deposits of Rs. 35.00 crores. The management is of the view that since company is unlisted, there is no requirement to appoint internal auditor. Suggest:
  - a) Internal auditor is required to be appointed.



