

5. COMPANY AUDIT - I

Q.No.1. What are the Qualifications to become company auditor? (A)

(N10 – 5M)

The provisions relating to eligibility, qualifications and disqualifications of an auditor are contained in section 141 of the Companies Act, 2013.

1. QUALIFICATIONS OF COMPANY AUDITOR [Sec 141(1)]:**a) In case of an Individual:**

- i) A Person shall be eligible for appointment as an auditor of a company only if he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.
- ii) Under the Chartered Accountants Act, 1949, only a Chartered Accountant holding the Certificate of practice can practice as an auditor.

b) In case of Firm of Chartered Accountants:

- i) A Partnership Firm or an Limited Liability Partnership (LLP) shall be eligible for appointment as an auditor of a company only if majority of its partners practicing in India are qualified for appointment i.e. they are Chartered Accountants with a valid Certificate of Practice as per Chartered Accountants Act, 1949
- ii) In this case, the appointment is in the name of the firm.

2. SIGNING OF AUDIT REPORT IN CASE OF AUDITOR FIRM [Sec 141(2)]:

If firm of auditors i.e. partnership firm or LLP is appointed as an auditor of a company, then only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of firm.

REFER PRACTICAL QUESTION – 1

Q.No.2. What are the Disqualifications of a Company's Auditor? (A)

(N17 – 6M ,M10 – 6M, N10 – 5M, N15 – 4M)

DISQUALIFICATIONS OF COMPANY AUDITOR [Sec 141(3)]:

As per section 141(3) along with Rule 10 of Companies (Audit and Auditors) Rules 2014, the following persons are not eligible to be appointed as an auditor of a company:

- a) Any Body Corporate other than LLP registered under the Limited Liability Partnership Act, 2008
- b) An Officer or Employee of the company
- c) A person who is a partner of an officer or employee of the company
- d) A person who is in the employment of an officer or employee of the company
- e) A person who, or his relative or his partner—
 - i) Is holding any security or interest in the company or its subsidiary, or its holding or its associate company or subsidiary of its holding company.

Exception: The relatives may hold security or interest in the company of face value not exceeding Rs 1 Lakh.

The limit of Rs.1 lakh also applicable for the companies not having share capital or other securities. For example, in case of company limited by guarantee, Guarantee given to the company also should not exceed Rs. 1 lakh.

- ii) Is indebted to the company or its subsidiary, or its holding or its associate company or subsidiary of its holding company in excess of Rs.5 Lakh (or)

- iii) 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 its associate company or subsidiary of its holding company, for an amount exceeding Rs.1 Lakh
- f) A person or a firm (including LLP) having Business Relationship (whether directly or indirectly) with the company or its subsidiary, or its holding or its associate company or subsidiary of its holding company or subsidiary of its associate company of such nature as may be prescribed;

Exceptions: As per Rule 10, the term "Business relationship" includes any transaction entered for commercial purpose except the following commercial transactions:

- i) Professional services permitted to be rendered by an auditor or audit firm under the Companies Act, 2013 and the Chartered Accountants Act, 1949
- ii) 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.
- g) A person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- h) A person who is in full time employment elsewhere or

A person or partner of a firm holding appointment as an auditor of more than twenty companies at the date of such appointment or reappointment.

NOTE: The following companies are excluded while computing the ceiling limit (i.e. 20) on number of appointments that an auditor can hold at a time.

- i) One person companies
- ii) Small companies
- iii) Dormant companies
- iv) Private limited companies having paid-up share capital less than Rs. 100 crore.
- i) 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;
- j) Any person whose subsidiary or associate company or any other form of entity, is engaged in services as provided in section 144 (Refer Q.No.3)

VACATION OF OFFICE [Sec 141(4)]:

- Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in section 141(3) after his appointment, then he shall vacate his office immediately and
- Such vacation shall be deemed to be a casual vacancy in the office of the auditor.

EXCEPTION FOR IMMEDIATE VACATION: If a Relative acquires any security or interest in the company of face value exceeding Rs. 1 lakh, then the auditor need not vacate his office immediately. He is given a time limit of 60 days, from the date of such excess acquisition, to take corrective action so as to maintain the relative's holdings up to 1 lakh.

ADDITIONAL POINTS:

- a) The above provisions are equally applicable to all types of auditors i.e. statutory auditors, cost auditors and secretarial auditors.
- b) **Definition of "OFFICER" [sec 2(59)]:** The term 'officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

c) **Definition of “RELATIVE”:[sec 2(77)]:** ‘Relative’ with reference to any person, means anyone who is related to another, if

- i) they are members of a Hindu Undivided Family;
- ii) They are husband and wife;
- iii) One person is related to the other in such manner as may be prescribed as follows:

As per Rule 4 of Companies (specification of definition details) Rules, 2014, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:

- | | |
|---------------------------------------|------------------------------------|
| 1) Father (including step- father), | 2) Mother (including step-mother), |
| 3) Brother (including step- brother), | 4) Sister (including step- sister) |
| 5) Son (including step- son), | 6) Son’s wife, |
| 7) Daughter, | 8) Daughter’s husband, |

d) **Additional points with respect to indebtedness:**

- If an auditor purchases goods on credit from the company of a value exceeding Rs. 5,00,000, he shall be indebted to the company, and consequently he shall vacate the office of auditor held by him. It is immaterial that the credit period allowed to the auditor is allowed to all the customers in the ordinary course of business.
- If an auditor recovers fees from the company on a progressive basis, even though the audit has not been completed, he cannot be said to be indebted to the company, and therefore, he shall not vacate the office of auditor held by him

REFER PRACTICAL QUESTION – 2 to 15.

Q.No.3. State the services which an auditor of a company is prohibited to render to the client being audited as per Sec 144 of the Companies Act 2013? (A)

(N15 RTP, N16 – 6M)

PROVISIONS OF SECTION 144:

1. **Permitted services:** An auditor appointed under this Act shall provide to the company only such services as are approved by the Board of directors or the audit committee, as the case may be.
2. **Prohibited services:** However the following services shall not be provided by the auditor either directly or indirectly to the company or its holding company or its Subsidiary company
 - i) Accounting and book keeping services
 - ii) Design and implementation of any financial information system
 - iii) Rendering of outsourced financial services;
 - iv) Investment advisory services;
 - v) Investment banking services.
 - vi) Actuarial services;
 - vii) Internal audit;
 - viii) Management services; and
 - ix) Any other kind of services as may be prescribed

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REFER PRACTICAL QUESTION – 43

Q.No.4. Explain the provisions related to of Audit Committee? (B)

1. **APPLICABILITY:** As per Sec.177 of the Companies Act, 2013 read with Rule 6 of Companies (meetings of board and its powers) Rules, 2014, an Audit Committee has to be formed by following classes of companies:
- All Listed companies
 - All Unlisted public companies which satisfies any one of the following 3 conditions
 - Having paid-up capital of Rs. 10 crore or more (or)
 - Having turnover of Rs. 100 crore or more (or)
 - Having outstanding loans or borrowings or debentures or deposits in aggregate of Rs. 50 crore or more.

Relevant date to compute the above limits: Date of last audited financial statements.

2. **COMPOSITION:** The Audit Committee shall consist of minimum of three directors. Majority of the members of the audit committee shall be
- the independent directors and
 - able to read and understand the financial statements (literate persons only).
3. **RIGHT OF AUDITOR IN AUDIT COMMITTEE MEETINGS:** The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee, when they considering the auditor's report. But even in such case he shall not have the right to vote.
4. **SIGNIFICANCE OF AUDIT COMMITTEE:**
- Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.
 - All the related party transactions shall require the approval of the Audit Committee.

SIMILAR QUESTION:

1. **Audit Committee is to be formed by each and every company and the auditor has right to vote in the meeting of such Audit Committee. Comment. (PM, N16 RTP)**
- A. Refer "Applicability and Right of auditor in audit committee meetings" in the above answer

Q.No.5.Explain the manner and procedure for selection of Auditors? (B)

RULE 3 OF CAAR 2014: Rule 3 of Companies (Audit and Auditors) Rules, 2014 prescribes the following manner and procedure for selection of auditors.

1. **Procedure Before Recommendation:**
- If the company is required to constitute an Audit Committee under section 177, then such committee, or if not, the Board of directors, shall consider
 - The qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether they are adequate with the size and requirements of the company.
 - any order or pending proceedings relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India (ICAI) or any competent authority or any Court.
 - The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.

2. Procedure During Recommendation:

- a) The Audit committee shall recommend the name of an individual or a firm as auditor to the Board for consideration. In other cases; the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.
- b) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the AGM.
- c) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration stating reasons for such disagreement.
- d) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation and the Board continues to disagree with the recommendations of audit committee, then the board shall
 - record reasons for its disagreement with the committee.
 - send its own recommendation for consideration of the members in the AGM.

However If the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.

Q.No.6. Explain the procedure for appointment of the first auditor of a company? (A)
(PM, M15, 16 RTP, N15 – 2M, N09 – 6M)

APPOINTMENT OF FIRST AUDITOR

- a) **In the case of a Non-Government Companies [Sec 139(6)] :** (RTP N17, N16 RTP)
 - i) The first auditor of a Non-Government company shall be appointed by the BOD within 30 days from the date of registration of the company.
 - ii) If Board fails to appoint the Auditor, it shall inform the same to the members of the company. Then the members shall appoint the auditor within 90 days, at an EGM.
- b) **In the case of Government Company [sec 139(7)]:** (RTP N17, MTP N17, M15 RTP)

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the CG, or by any SG(s), or, or partly by the CG and partly by one or more SG(s),

 - a) The first auditor shall be appointed by the Comptroller and Auditor-General of India (CAG) within 60 days from the date of registration of the company.
 - b) If the CAG fails to appoint within 60 days, the BOD shall appoint the first auditor within the next 30 days.
 - c) If the Board fails to appoint the first auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an EGM.

Tenure of first auditor in both the companies: First Auditors shall hold office till the conclusion of the first AGM.

Definition of "Government company" [sec 2(45)]: it refers to a company

- in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and
- Which is a subsidiary company of a Government company.

REFER PRACTICAL QUESTION – 16, 17, 18

Q.No.7. Write a short note on: Appointment of the Subsequent Auditor of a company with reference to Companies act, 2013? (A) (PM, M16 RTP)

APPOINTMENT OF SUBSEQUENT AUDITORS

a) In case of Non - Government Companies [Sec 139 (1)]: (PM, RTP N17)

- i) It provides that every company shall, at the first AGM, appoint an individual or a firm as an auditor who shall hold office from the conclusion of 1st AGM to till the conclusion of its 6th AGM
- ii) After the 1st AGM, when any appointment of auditor is made at any AGM, the auditor so appointed shall hold the office till the conclusion of 6th AGM, with the AGM wherein such appointment has been made being counted as the first AGM.

The following points need to be noted in this regard:

1. The company shall place the matter relating to such appointment for ratification by member at every AGM.
2. If the appointment is not ratified by the members of the company, then it becomes a casual vacancy which is to be filled by the BOD as per Sec. 139(8).
3. Before any appointment is made u/s 139(1), the auditor shall furnish to the company –
 - a) written consent of the auditor to such appointment.
 - b) A Certificate stating that
 - i) The Individual or audit firm is eligible for appointment and is not disqualified.
 - ii) Proposed appointment is as per terms provided under the Act and is within the ceiling u/s 141(3)(g) of the act.
 - iii) The list of pending proceedings against the auditor or audit firm or any of the partners of firm, as disclosed in the certificate is true and correct.
 - iv) The auditor satisfies the other criteria provided in section 141 or not.
4. The company shall inform the appointed auditor of his or its appointment, and also file a notice of such appointment in form ADT-1 with the Registrar. It has to be filed within 15 days of the meeting in which the auditor is appointed.

b) In case of Government Companies [Sec 139(5)]: (RTP N17)

It provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the CG, or by any SG(s), or, or partly by the CG and partly by one or more SG(s), the Subsequent auditors are appointed by the CAG within 180 days from the commencement of the financial year.

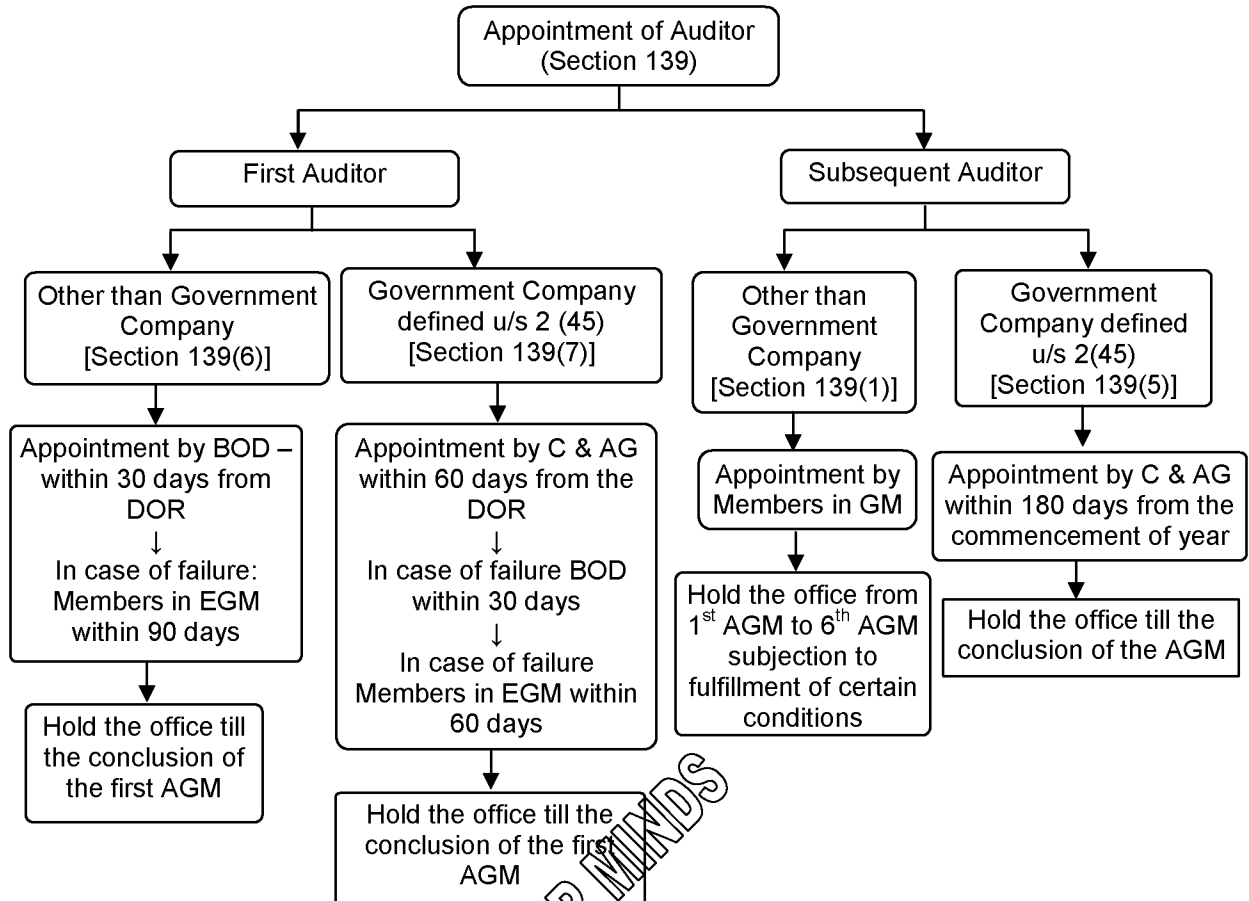
Tenure of subsequent auditors in case of Government Companies: Till the conclusion of the AGM.

SIMILAR QUESTIONS:

1. Discuss the provisions relating to appointment of subsequent auditors of Suruchi Yarns Pvt. Ltd. (PM)
- A. Refer point “a” in the above answer

REFER PRACTICAL QUESTION – 19, 20

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CHART ON APPOINTMENT OF FIRST AND SUBSEQUENT AUDITORS

Q.No.8. Discuss the procedure for filling of a casual vacancy of company auditor and duties of auditor in case of Resignation. (A) (PM, M17 RTP, N 12 - 5M)

CASUAL VACANCY: Vacancy arising in the office of auditor due to any reason except on account of expiry of his term.

FILLING OF CASUAL VACANCY [Sec 139(8)]:

1. **In case of Non-Government Company:** In the case of company whose accounts are not subject to audit by an auditor appointed by the CAG,
 - a) It has to be filled by the BOD within 30 days.
 - b) If such casual vacancy is the result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.
2. **In case of Government company:** In the case of company whose accounts are subject to audit by an auditor appointed by the CAG
 - a) It has to be filled by the CAG within 30 days.
 - b) If CAG fail to do so, then the BOD shall fill the vacancy within next 30 days.
3. **Tenure of auditor appointed in both the cases:** Till the conclusion of the next AGM.
4. **Duty of auditor in case of resignation in any company:**
 - a) **Filing of Form ADT-3 [Sec.140 (2)]:** The auditor who has resigned from the company shall file a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) indicating the reasons and other facts relevant to his resignation, within 30 days from the date of resignation.

- i) with the company,
 - ii) with the ROC and
 - iii) in case of government companies, the auditor shall also file such statement with the CAG.
- b) **Penalties for non-filing ADT-3 [Sec.140(3)]:**
In case of failure, the auditor shall be punishable with fine of
- i) Minimum: Rs. 50,000
 - ii) Maximum: Rs. 5,00,000

SIMILAR QUESTIONS:

1. At the AGM of ICI (P) Ltd., Mr. X was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to give up practice and join industry. State, how the new auditor will be appointed by ICI (P) Ltd. and the conditions to be complied for.
- A. Refer above answer

REFER PRACTICAL QUESTION – 21 to 24

Q.No.9. Explain the provisions relating to Rotation of an Auditor? (A)

- A. **APPLICABILITY:** According to the provisions of section 139(2) of the act read with Rule 5 of the Companies (Audit and Auditors) Rules, 2014, the concept of Rotation is applicable for the following companies. **(PM, M15, N16 RTP)**
1. All Listed companies
 2. All Unlisted Public companies having
 - a) Paid up share capital of Rs. 10 Crores or more (or)
 - b) Borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more.
 3. All Private limited companies having
 - a) Paid up share capital of Rs. 20 crore or more (or)
 - b) Borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more.
- B. **NON APPLICABILITY:**
- a) One Person Company
 - b) Small Company
 - c) Other companies which are not satisfying the above prescribed limits.
- C. **MANNER OF ROTATION OF AUDITORS:**
1. As per Section 139(2) the companies to which the concept of rotation applicable, shall not appoint or re-appoint
 - a) An individual as auditor for more than one term of 5 consecutive years; and
 - b) An audit firm as auditor for more than two terms of 5 consecutive years.
 2. An individual auditor (or) firm who (or) which has completed their terms as above, i.e. one term or two terms of 5 years, shall not be eligible for re-appointment as auditor in the same company for a period of five years from the completion of their respective term.

D. ADDITIONAL POINTS RELATING TO ROTATION:

1. **Firms having common partners:** 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.
2. **Transitional period:** Every company, existing on or before the commencement of this Act, which is required to comply with the provisions of this sub-section, shall comply with the requirements of section 139(2) within three years from the date of commencement of this Act.
3. **Consecutive years:** "Consecutive years" shall mean all the preceding financial years for which the individual auditor has been the auditor until there has been a break by five years or more.
4. **Effect on Right of Removal or Resignation:** It has also been provided that right of the members to remove an auditor or the right of the auditor to resign from such office of the company shall not be affected by the concept of Rotation.
5. **Conditions of Appointment imposed by Members:** Subject to the provisions of this Act, members of a company may resolve to provide that-
 - i) 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
 - ii) The audit shall be conducted by more than one auditor.

REFER PRACTICAL QUESTION – 25**SIMILAR QUESTIONS:**

1. "Provisions regarding rotation of auditors affect only specified class of companies"
Discuss. (PM, M15, N16 RTP)
- A. Refer "Applicability and Non Applicability" in the above answer.

Q.No.10. State the manner of rotation of auditors by the companies on expiry of their term. (C) (PM, M15 - 4M, N16)

ACCORDING TO RULE 6 OF CAAR, 2014, FOLLOWING IS THE MANNER OF ROTATION OF AUDITORS ON EXPIRY OF THEIR TERM:**1. Recommendation of Proposed Auditor:**

- a) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the existing auditor whose term is expired.
The Board shall consider the recommendation of such committee.
- b) 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 AGM.

2. Additional Conditions for the Purpose of Rotation:

- a) **Period of office before commencement of the Act:** In case of an auditor (whether an individual or audit firm), the period for which the individual or firm has held office as auditor, prior to the commencement of the Act, shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be.
- b) **Firms working under Same Network:** The incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

Note: The term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

- c) **Break in the term of office:** A break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation.
- d) **Retired Auditor Joining in another Firm:** 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.
- e) **Manner of rotation in case joint auditors are appointed:** Where a company has appointed joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors do not complete their term in the same year.

**Q.No.11. Under what circumstances the retiring Auditor cannot be reappointed? (A)
(PM, MTP N17, N14 RTP, N13 – 6M)**

1. **IN THE FOLLOWING CIRCUMSTANCES, THE RETIRING AUDITOR CANNOT BE REAPPOINTED [Sec. 139(9)]:**
 - a) The auditor proposed to be reappointed does not possess the qualification prescribed under section 141 of the Companies Act, 2013.
 - b) The proposed auditor suffers from the disqualifications under section 141(3), 141(4) and 144 of the Companies Act, 2013.
 - c) He has given to the company notice in writing of his unwillingness to be reappointed.
 - d) A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed.
 - e) A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 141(3) (g) of the Companies Act, 2013.
2. **WHERE AT ANY AGM, NO AUDITOR IS APPOINTED OR RE-APPOINTED: [Sec. 139(10)]** the existing auditor shall continue to be the auditor of the company.

REFER PRACTICAL QUESTION – 26

Q.No.12. Briefly Explain the provisions relating to Auditor's Remuneration. (C)

AUDITOR'S REMUNERATION: [sec. 142]

1. **Determination of Remuneration:**
 - a) The remuneration of the auditor of a company shall be fixed in the GM or in such manner as may be decided in the general meeting.
 - b) However, board may fix remuneration of the first auditor appointed by it.
2. **Components of Remuneration:**
 - a) **Inclusions:** The remuneration, in addition to the fee payable to an auditor, include
 - i) the expenses, if any, incurred by the auditor in connection with the audit of the company and
 - ii) Any facility extended to him.
 - b) **Exclusions:** It does not include any remuneration paid to him for any other service rendered by him at the request of the company.
3. **Consequences of not fixing the remuneration at the time of re-appointment of retiring auditor:** The existing remuneration will continue.

Q.No.13. Briefly explain the concept of Removal of Auditor before Expiry of Term. (A)
(PM, N 09 - 6M, N10 – 4M, N11 - 5M, N15 – 6M)

REMOVAL OF AUDITOR BEFORE THE EXPIRY OF HIS TERM [SEC. 140(1)]:

1. Authority for Removal:

According to Section 140 (1), the auditor appointed under section 139 may be removed from his office before the expiry of his term.

2. Procedure for Removal:

The following is the procedure prescribed in Rule 7 of CAAR, 2014 for Removal of auditor before the expiry of his term:

- a) First the BOD should pass a board resolution at a board meeting to remove the Auditor.
- b) Later, the application shall be made to the CG in form ADT-2 within 30 days of the resolution passed by the Board to get its approval.
- c) The company shall hold the general meeting within 60 days of receipt of approval of the CG for passing the special resolution.

3. Opportunity of being heard: It is important to note that before taking any action for removal, before expiry of the term, concerned auditor shall be given a reasonable opportunity of being heard.

SIMILAR QUESTIONS:

1. The auditor, CA "Y", appointed under section 139 of the companies act, 2013, was removed from his office before the expiry of his term by an ordinary resolution of the company. Comment explaining clearly the procedure of removal of auditor before expiry of term.

A. Refer above answer

2. ABC Company Ltd. removed its first auditor before the expiry of his term without obtaining approval of the Central Government. Comment. (PM) (N16 RTP, N 09 - 6M)

A. Refer above answer

Q.No.14. Explain Procedure for appointment of auditor other than the Retiring Auditor. (A)
(PM, N16 – 6M)

APPOINTMENT OF AUDITOR OTHER THAN THE RETIRING AUDITOR: [Sec. 140(4)]

1. Requirement of Special notice:

- a) **Contents of Notice:** Special notice shall be required for a resolution at AGM for
 - i) Appointing a person as auditor, other than a retiring auditor, or
 - ii) Providing expressly that the retiring auditor shall not be re-appointed.
- b) **Received from whom:** Members holding not less than one percent of total voting power or holding shares aggregate sum of not less than five lakh Rs. has been paid up on the date of the notice.
- c) **Timing of receipt of Notice:** Not earlier than 3 months but at least 14 days before the AGM date.
- d) **Non requirement of special notice:** Special notice shall not be required if the retiring auditor has completed consecutive terms of 5 years / 10 years as provided u/s 139(2).

2. **Informing Retiring Auditor:** On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
3. **Right of Auditor to make Representation:**
 - a) The Retiring auditor is entitled to make representation against his removal.
 - b) It should be in writing not exceeding a reasonable length and shall be sent to the company
 - c) He may request the company to circulate the representation to the members.
4. **Duty of the company w.r.to representation:**
 - a) The company shall state the fact that the retiring auditor has made representation against his removal, in any notice of the resolution given to members of the company, and
 - b) The company shall send a copy of the representation atleast 7 days before the date of AGM to every member of the company to whom notice of the meeting is sent, unless the representation is received by the company too late.
 - c) If a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, then
 - the auditor may require that the representation shall be read out at the meeting.
 - a copy of representation shall be filed with the Registrar.
5. **Abuse of Right of representation by auditor:**
 - a) If the Tribunal is satisfied that the right to make representation is being abused by the auditor, then the tribunal may order that the copy of the representation need not be sent to the members and need not be read out at the meeting.
 - b) The Tribunal makes such an order either on an application made by the company or any other aggrieved person.

SIMILAR QUESTION:

1. Explain the procedure for not re appointing of Retiring Auditor.
 - A. Same as above
2. You, the auditor of A Ltd., have been considered for ratification by the members in the 4th general meeting as the sole auditor, where you were one of the joint auditors for the immediately preceding three years and the said joint auditors are not re-appointed. (PM)
 - A. Same as above

Q.No.15. Write about ceiling on number of Audits that can be accepted by an auditor. (A) (PM, M17 RTP, N 12 - 5M)

- A. **DISQUALIFICATION AS PER SEC. 141(3)(g):** "A person who is in full time employment elsewhere or a person or a partner of firm holding appointment as an auditor of more than twenty companies at the date of such appointment or reappointment"
- B. **THE FOLLOWING POINTS NEED TO BE NOTED IN THIS REGARD:**
 1. A Chartered Accountant in practice cannot hold appointments as auditor for more than 20 companies at any time.
 2. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere i.e. limit is 20 audits for each partner.

3. Sometimes, a Chartered Accountant is a partner in number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.
4. **COMPANIES EXCLUDED FROM CEILING:** For the purpose of computation of ceiling limits following companies are excluded-
 - a) One person companies,
 - b) Dormant companies,
 - c) Small companies, and
 - d) Private limited companies having a paid capital less than Rs.100 crores.
5. **LIMIT ON TAX AUDIT ASSIGNMENTS:** The specified number of tax audit assignments under section 44AB of Income Tax Act, 1961 that an auditor, as an individual or as a partner of a firm, can accept is 60 numbers.

REFER PRACTICAL QUESTION – 27, 28

Q.No.16. Write about Powers / Rights of an Auditor. (B)

(PM)

1. **RIGHT OF ACCESS TO BOOKS, DOCUMENTS, VOUCHERS etc. [Sec. 143(1)]:**

This right of access can be exercised

- a) At all - time i.e. during Working Days and working Hours
- b) With respect to any books and documents which are necessary for his purpose including statistical records, minutes etc. and need not always to be the financial books.
- c) Even without any prior notice to the company.
- d) With respect to books, documents etc. whether kept at the registered office of the company or at any other place as may be decided by the board as per sec. 128.
- e) With respect to books and documents maintained at branch office (irrespective of branch audit).
- f) By auditor of holding company with respect to books of subsidiary companies in so far it relates to consolidation of financial statements

2. **RIGHT TO OBTAIN INFORMATION AND EXPLANATIONS [Sec. 143(1)]:**

- a) He is entitled to obtain information and explanation which are necessary for his purpose, from the officers or employees of the company.
- b) Deciding the matters in respect of which the auditor is required to obtain information and explanations is a matter of professional judgment of auditor.
- c) If the auditor is unable to get the required information, then he can mention the same in his report.

3. **RIGHT TO RECEIVE NOTICES OF, AND RIGHT TO BE HEARD AT, GENERAL MEETINGS / DUTY TO ATTEND GENERAL MEETINGS [Sec. 146]:**

- a) All notices of general meeting must be send to the Auditor of the company whether the financial statements are discussed or not in that GM.
- b) The auditor shall attend the GM either by himself or through his authorized representative, who shall also be qualified to be an auditor (unless otherwise exempted by the company). It is also the duty of the auditor.
- c) He shall have right to be heard at such meeting on any part of the business which concerns him as the Auditor.

- d) This is to be noted that this right is in respect of General Meetings only and not in respect of any Board Meetings.
4. **RIGHT OF REPRESENTATION:** When the company decides not to re appoint the retiring auditor, then
- The Retiring auditor is entitled to make representation against his removal.
 - It should be in writing not exceeding a reasonable length and shall be sent to the company
 - He may request the company to circulate the representation to the members.

REFER PRACTICAL QUESTION – 29 to 34

Q.No.17. Write a short note on auditor's lien? (B)

(PM, N12 - 4M)

- Lien refers to lawful possession of some others property's.
- Auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.
- The Institute of Chartered Accountants in England and Wales has expressed the following views relating to this right:
The Books & Documents on which Right of Lien is being exercised,
 - Should belong to the client who owes money.
 - Must not have been received through irregular or illegal means.
 - Must have come into auditors possession on the authority of the Client e.g. : BOD in case of company
 - Must be the documents on which he has done some work.
- Practical constraints in exercising this Right:**
 - Under section 128 of the Act, books of accounts of a company must be kept at the registered office.
 - These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents.
 - Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable due to legal and practicable constraints.
- Lien on working papers:** Lien is exercised in respect of client's property. As per SA 230, working papers being his own property, the question of lien does not arise.
- Case Law:** In 'RD Saxena VS Balram Prasad Sharma' case, the Supreme Court had held that "no professional can be given the right to withhold the returnable records relating to the work done by him with his clients matter on the strength of any claim for unpaid remuneration".

REFER PRACTICAL QUESTION – 35

Q.No.18. Explain the auditor's duty to make inquiry as per section 143(1). (A)

(PM, N16 – 4M)

- DUTY TO MAKE INQUIRY:** According to section 143(1) of the act, it is the duty of the Auditor to inquire into the following matters
 - Whether loans and advances made by the company
 - have been properly secured on the basis of security and

- ii) whether the terms on which they have been made are prejudicial to the interests of the company or its members.
- b) Whether transactions of the company which are represented merely by book entries are prejudicial to the interest of the company.
- c) Whether any assets of the company consisting of shares, debentures and other securities have been sold at a price less than its purchase price by the company.

Note: This provision is not applicable in respect of Banking and Investment Companies

- d) Whether loans and advances made by the company have been shown as deposits;
 - e) Whether personal expenses have been charged to revenue account.
 - f) Where it is stated that any shares have been allotted for cash,
 - i) whether cash has actually been received in respect of such allotment.
 - ii) If no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.
2. **Reporting requirements u/s 143(1):** If the auditor is satisfied with explanations to the above inquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor should make a report to the members on the above matters only if he finds any qualifications or adverse remarks in the explanations obtained.

SIMILAR QUESTIONS:

1. **What are the Duties of Companies auditor as per Sec 143(1) of the Companies Act 2013 ?** (PM)

A. Refer Above Answer.

REFER PRACTICAL QUESTION – 36

Q.No.19. State the matters to be specified in Auditor's Report in terms of provisions of Section 143(3) of the Companies Act, 2013. (B) (PM, N15 RTP N14 – 6M)

1. **DUTY AS PER SEC 143(3):** As per sec 143(3), the company's auditors report shall include a statement on the following matters:
- a) Whether he has obtained all the information and explanations
 - i) Which to the best of his knowledge and belief were necessary for the purpose of his audit.
 - ii) 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 and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
 - c) Whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him and how he has dealt with it in preparing his report;
 - d) Whether the company's balance sheet and profit and loss account are in agreement with the books of accounts 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 system in place and the operating effectiveness of such controls.
- j) Such other matters as may be prescribed. [Rule 11 of CAAR, 2014]
- i) Whether the company disclosed the impact of pending litigations on its financial position in its financial statement.
- ii) Whether the company has made provisions, in accordance with Accounting standards or any other law, for material foreseeable losses on long term contracts including derivative contracts.
- iii) Whether there is any delay in transferring the amounts to Investor Education Protection Fund, if required to be transferred.
2. **REPORTING REQUIREMENTS U/S 143(3):** It is mandatory for the auditor to report on the matters specified under section 143(3) irrespective of whether he got clean or adverse observations with respect to those matters.
3. **DUTY TO STATE THE REASON FOR QUALIFICATION OR NEGATIVE REPORT:** As per Section 143(4), where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons there for.

SIMILAR QUESTIONS:

1. What are the matters to be stated or reported in the Company's auditors report as per Sec 143(3) of the Companies Act 2013? (PM)
- A. Refer above answer.

REFER PRACTICAL QUESTION – 37, 41, 42

Q.No.20. write short notes on the following: (C)

1. Duty to sign the audit report
2. Duty to make report
3. Duty to comply with Standards on auditing (SA).

1. **DUTY TO SIGN THE AUDIT REPORT (SEC 145):**

a) Who can sign the Audit Report?

- i) **In case an Individual is appointed as Auditor:** Only the person appointed as an auditor of the company shall sign the auditor's report or any other document of the company.
- ii) **In case a firm of auditors is appointed as auditor:** According to section 141(2), if the firm of auditors i.e. Partnership Firm or LLP is appointed as an auditor of the company, the appointment should be in the name of the firm and the report shall be signed by only those partners who are Chartered Accountants and entitled to sign the report.

b) **The qualifications, observations or comments** on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be:

- i) Read before the company in general meeting and
- ii) Open to inspection by any member of the company.

2. **DUTY TO MAKE REPORT:[Sec. 143(2)]**

- a) The author shall make a report to the members on

- i) The Accounts examined by him; and
 - ii) Financial Statements which are required to be laid before the company in general meeting.
- b) The auditor shall state in his report as to whether the accounts examined by him and financial statements give a true and fair view of –
- i) the state of the company's affairs as at the end of its financial year;
 - ii) the profit/loss for the year; and
 - iii) cash flow for the year.
- c) The auditor shall state in his report such other matters as may be prescribed.
- d) The auditor shall prepare his report after taking into account the provisions of this Act and the Accounting and Auditing Standards.
3. **DUTY TO COMPLY WITH STANDARDS ON AUDITING (SA)[Sec. 143(9)] :**
- a) Every auditor shall comply with the **Standards on auditing (SA)**
 - b) According to the companies act, 2013, only CG has the authority to prescribe the standards of auditing or any addendum there to.
 - c) Procedure for issue of standards on auditing:
 - i) First the ICAI recommends Standards on Auditing.
 - ii) Then these standards are examined by National Financial Reporting Authority (NFRA).
 - iii) NFRA also make its own recommendations.
 - iv) Finally CG examines recommendations made by the NFRA and prescribe the standards after consultation with NFRA.
 - d) But till now no such standards were prescribed by CG. Until any such standards are notified by CG, the Standards on Auditing specified by the ICAI shall be deemed to be the Auditing Standards

REFER PRACTICAL QUESTION – 38, 39

Q.No.21. Write about the Duties of Companies Auditor to Report on Fraud as per Sec 143(12) of the Companies Act 2013? (A) (PM, M 17 RTP)

According to section 143(12) and Rule 13 of the Companies (Audit and Auditors) Rules, 2014, the following are the duties of auditor in relation to any fraud identified during the course of his audit.

A. IF THE AMOUNT OF FRAUD IS RS. 1 CRORE OR MORE

1. **Reporting to the Central Government:** If the auditor has reason to believe that an offence of fraud involving an amount of Rs. 1 Crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the CG in the following manner.
2. **The manner of reporting the matter to the Central Government is as follows: [Rule 13]**
 - a) First, the auditor shall report the matter to the Board or the Audit Committee, as the case may be, within 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days.
 - b) On receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments on such reply or observations to the CG within 15 days from the date of receipt of such reply or observations.

- c) In case the auditor fails to get any reply or observations within the stipulated period of 45 days, he shall forward his report to the CG along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- d) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- e) The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- f) The report shall be in the form of a statement as specified in Form ADT-4.

B. IF THE AMOUNT OF FRAUD IS LESS THAN RS. 1 CRORE

- a) **Reporting to the Audit Committee or Board:** If the auditor has reason to believe that an offence of fraud involving an amount of less than Rs.1 Crore, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board within 2 days of knowledge of fraud, specifying the following:
 - i) Nature of Fraud with description;
 - ii) Approximate amount involved; and
 - iii) Parties involved.
- b) **Disclosure in the Board's Report:** The following details of each of the fraud reported to the Audit committee or the Board shall be disclosed in board's report:
 - i) Nature of Fraud with description;
 - ii) Approximate Amount involved;
 - iii) Parties involved, if remedial action not taken; and
 - iv) Remedial actions taken.

C. ADDITIONAL POINTS:

- a) Punishment for non-compliance with above provisions:
 - i) Minimum fine: Rs. 1 lakh
 - ii) Maximum fine: Rs. 25 lakh
- b) The provisions of section 143(12) are equally applicable to
 - i) cost accountant in practice conducting cost audit under section 148
 - ii) company secretary in practice conducting secretarial audit under section 204.

SIMILAR QUESTIONS:

1. Discuss the procedure to be followed by the auditor in case he has sufficient reason to believe that an offence involving fraud has been committed against the company by its officers.

A. Refer Above Answer

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To **MASTER MINDS**, Guntur

Q.No.22. Write about Audit of Branch Office Accounts. (A)

(PM)

1. **WHO CAN BE APPOINTED AS A BRANCH AUDITOR:** Where a company has a branch office, the accounts of that office shall be audited either by
 - a) The auditor appointed for the company or
 - b) By any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or
 - c) Where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.
2. **WHO CAN APPOINT BRANCH AUDITORS:**
 - a) Usually branch auditors are also appointed by the members.
 - b) However, shareholders in general meeting, instead of appointing branch auditor, may authorize the board of directors to appoint branch auditors.
3. **REPORTING REQUIREMENTS OF BRANCH AUDITORS:**
 - a) The branch auditor shall prepare a report on the accounts of the branch examined by him.
 - b) The branch auditor shall submit his report to the company's auditor.
 - c) The reporting of fraud by the auditor as per section 143(12) shall also extend to such branch auditor to the extent it relates to the concerned branch.

REFER PRACTICAL QUESTIONS – 40

Q.No.23. Briefly discuss the applicable provisions and rules under the companies act 2013 related to "Maintenance of cost records"? (A) (PM)

MAINTENANCE OF COST RECORDS:

1. **CLASSIFICATION OF COMPANIES FOR THE PURPOSE OF APPLICABILITY OF THE RULES:** The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/ industry/ sector/ product/ service prescribed under the said rule are given below:
 - a) **Regulated Sectors:**
 - i) Telecommunication services regulated by the telecom Regulatory Authority of India (TRAI)
 - ii) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003, other than for captive generation.
 - iii) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board.
 - iv) Drugs and Pharmaceutical.
 - v) Sugar and industrial alcohol.
 - vi) Fertilizers.
 - b) **Non - Regulated Sectors:**
 - i) Machinery and mechanical appliances used in defense, space and atomic energy sectors excluding any ancillary item or items.
 - ii) Turbo jets and turbo propellers.
 - iii) Tyres and Tubes.

- iv) Steel; Cement.
- v) Production, import and supply or trading of following medical devices, such as heart valves; orthopedic implants; pacemaker (temporary and permanent), etc. The rule excludes the foreign companies having only liaison offices.
2. **APPLICABILITY:** Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides that the following conditions for companies (including foreign companies) which are required to maintain cost records,
- Company must be engaged in the production of goods or providing services, and
 - It must be having an overall turnover from all its products and services of Rs.35 crore or more during the immediately preceding financial year.
- Exceptions:** Companies classified as a Micro enterprise or a Small enterprise under Micro, Small and Medium Enterprises Development Act, 2006 not required to maintain cost records even it satisfies the above limits.
3. **PRESCRIBED FORM FOR MAINTENANCE OF COST RECORDS:** As per Rule 5 of the companies (Cost Records and Audit) Rules, 2014, cost records shall be maintained in Form CRA – 1.
- The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.
4. **REQUIREMENT AS PER CARO, 2016:** As per clause (vi) to Paragraph of the CARO, 2016, where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

Q.No.24. Briefly discuss the applicable provisions and rules under the companies act 2013 related to “applicability of cost audit” (4) (PM)

1. **APPLICABILITY OF COST AUDIT:** Rule 4 of the companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of the cost audit.
- The applicability of Cost Audit to a company depends upon certain Turnover criteria as follows
- For Companies specified under “Regulated Sectors” :**
 - The overall annual turnover of the company from all its products and services during the immediately preceding financial year is Rs.50 crore or more and
 - The aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is Rs.25 crore or more.
 - For Companies specified under “Non-Regulated Sectors”:**
 - The overall annual turnover of the company from all its products and services during the immediately preceding financial year is Rs.100 crore or more and
 - The aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is Rs.35 crore or more.
2. **NOT - APPLICABILITY OF COST AUDIT:** Sub - rule(3) of Rule 4 provides that the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,
- Whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue
(or)
 - Which is operating from a special economic zone.

Q.No.25. Explain the provisions with respect to appointment and removal of cost auditors. (B) (PM)

A. APPOINTMENT OF COST AUDITOR: SEC 148

1. **Who can be appointed as a cost auditor:** The Cost audit shall be conducted by a Cost Accountant in Practice.

Provided that person appointed under section 139 as an auditor of the company shall not be appointed as its cost auditor.

2. **Who will appoint Cost Auditor:** As per rule 14 of the Companies (Audit and Auditors) Rules, 2014

- a) In case of companies which are required to constitute an audit committee,
- i) The Board shall appoint an individual, who is a cost accountant in practice, 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 (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

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

3. **Procedure of Appointment:**

- a) Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said rules to appoint an Auditor within 180 days of the commencement of every financial year.
- b) Every referred company shall inform the cost auditor concerned of his or its appointment as such and File a notice of such 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.

4. **Tenure of Cost Auditor:** The 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

5. **Casual vacancy in the office of Cost Auditor:** Any casual vacancy in the office of a cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the CG in Form CRA-2 within 30days of such appointment of cost auditor.

(N17 – 2M)

6. **Qualification, disqualification, rights, duties and obligations of Cost Auditor:** Similar to the company auditor appointed under section 139.

- B. **REMOVAL OF COST AUDITOR:** The cost Auditor 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.

Q.No.26. Write about submission of cost Audit Report. (A)

(PM)

PROCEDURE FOR SUBMISSION OF COST AUDIT REPORT:

1. **COST AUDITOR TO BOD:** The cost auditor shall submit the cost audit report along with his his reservations or qualifications, if any, in **Form CRA-3** to the BOD within a period of 180 days from the closure of the financial year.
2. **BOD to CG:**
 - a) The company shall within 30 days from the dated of receipt of a copy of the cost audit report prepared furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein in Form CRA-4.
 - b) If after considering the cost audit report and the information and explanation furnished by the company as above, the central Government may call for any further information or explanation as is necessary,
3. **DUTY TO REPORT ON FRAUD:** The provisions of section 143(12) of the Companies Act, 2013 and the relevant rules on duty to report on fraud shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Q.No.27. Write a short note on Auditor's Independence. (C)

(PM)

AUDITOR'S INDEPENDENCE:

- Independence is the keystone upon which the respect and dignity of a profession is based. Independence implies that the judgment of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.
- In the context of auditors, his independence is necessary so as to enable him to express unbiased opinion on financial statements.
- It should not only to exist in fact, but should also appear to so exist to all reasonable persons.

The Companies Act, 2013, has therefore enacted specific provisions to give concrete shape to this vital concept:

1. The provisions disqualifying certain types of persons from undertaking audit of limited companies.
2. Provisions relating to ceiling on the number of audits that can be undertaken by a Chartered Accountant.
3. Provisions requiring special resolution for appointing auditors in certain cases.
4. Other provisions on appointment, re-appointment and removal of auditors, are designed with sufficient independence to carry out the audit in the larger interest of shareholders and other users.
5. Power to qualify his report is yet another weapon in the armory of the auditor to protect his independence.
6. Provisions relating rotation of auditor/audit firm.

SIMILAR QUESTIONS:

1. **In what way does the company law safeguard the independence of an auditor?**
- A. Refer above answer.

QUESTIONS FOR ACADEMIC INTEREST – SELF STUDY

Q.No.28. Distinguish between AUDIT CERTIFICATE and AUDIT REPORT. (C) (PM)

1. AUDITOR'S CERTIFICATE:

- a) The term 'certificate', is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
- b) When an auditor certifies a financial statement, it implies that the contents of that statement can be measured and that the auditor has vouchsafed the exactness of the data.
- c) An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company.
- d) An auditor's certificate represents that he has verified certain precise figures and is in a position to vouch safe their accuracy as per the examination of documents and books of account.

2. AUDIT REPORT:

- a) An auditor's report, on the other hand, is an expression of opinion.
- b) When we say that an auditor is reporting, we imply that he is expressing an opinion on the financial statements.
- c) The term report implies that the auditor has examined relevant records in accordance with Generally Accepted Auditing principles and that he is expressing an opinion whether or not the financial statements represent a true and fair view of the state of affairs and of the working results of an enterprise.
- d) Since an auditor cannot guarantee that the figures in the Balance Sheet and Statement of Profit and Loss are absolutely precise, he cannot certify them. This is primarily because the accounts itself are product of observance of several accounting policies, the selection of which may vary from one professional to another and, thus, he can only have an overall view of the accounts through normal audit procedures.

CONCLUSION: Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.

Q.No.29. Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term? (C) (PM)

PERMISSION OF CENTRAL GOVERNMENT FOR REMOVAL OF AUDITOR UNDER SECTION 140(1) OF THE COMPANIES ACT, 2013:

1. Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence.
2. Further, in case of conflict of interest the shareholders may remove the auditors in their own interest.
3. Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, they may not give approval.
4. On the other hand if auditor has completed his term i.e. he has submitted his report and thereafter he is not reappointed then the matter is not serious enough for CG to call for its intervention.

CONCLUSION: Therefore, in view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not reappointed after expiry of their term.

Q.No.30. Write about change of auditor by Tribunal.

DIRECTION BY TRIBUNAL IN CASE AUDITOR ACTED IN A FRAUDULENT MANNER:

As per section 140(5),

1. **Application to whom:** The Tribunal
2. **Application by whom:**
 - a) on suo motu or
 - b) by the Central Government or
 - c) by any person concerned,
3. **When can tribunal give directions to change the auditor:** if Tribunal 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, it may, by order, direct the company to change its auditors.
4. **Who can appoint new auditors in case application is made by CG?**
 - if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and
 - The Central Government may appoint another auditor in his place.
5. **Prohibition for Appointment in any company for 5 years:** It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order.

PRACTICAL QUESTIONS

Q.NO.1. Devi, a member of the ICAI, does not hold a certificate of practice. Is her appointment as an auditor is valid?

Provision: As per section 141(1) of Companies Act, 2013, A person shall be qualified for appointment as an auditor of a company, only if one is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, only a Chartered Accountant holding the certificate of practice can engage in public practice.

Analysis: Devi does not hold a certificate of practice and

Conclusion: Hence Devi cannot be appointed as an auditor of a company.

Q.NO.2. Can a director of the company be appointed as an auditor?

Provision: There is no express prohibition that a director cannot be appointed as an auditor. But the below given two provisions of the companies Act prohibits a director to be appointed as an auditor:

- a) Sec.141 enumerates that an officer of the company cannot be appointed as an auditor.
 b) Sec.2 (59) of Companies Act, which defines the officer to include the director.

Conclusion: Hence, director cannot be appointed as an auditor.

Q.NO.3. A, a Chartered Accountant has been appointed as auditor of Laxman Ltd. In the Annual General Meeting of the company held in September, 2015, which assignment he accepted. Subsequently in January, 2016 he joined B, another chartered accountant, who is the manager finance of Laxman Ltd as partner. (PM, M16 RTP)

Provision: As per section 141(3) (c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. section 141(4) provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in Section 141(3), he shall be deemed to have vacated his office as an auditor.

Analysis: In the present case, A, an auditor of M/s Laxman Ltd., joined as partner with B, who is Manager Finance of M/s Laxman Limited, has attracted section 141(3)(c)

Conclusion: Therefore, he shall be deemed to have vacated office of the auditor of M/s Laxman Limited.

Q.NO.4. "Mr. V", a practicing Chartered Accountant, is holding securities of "XYZ Ltd." Having face value of Rs.900/-. Whether Mr. V is qualified for appointment as an auditor of "XYZ Ltd."?

Provision: As per section 141 (3)(d) (i) an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this Section the relative of the auditor may hold the securities or interest in the company of face value not exceeding of Rs 1,00,000.

Analysis: In the present case, Mr. V. is holding security of Rs 900 in the XYZ Ltd,

Conclusion: Therefore he is not eligible for appointment as an Auditor of "XYZ Ltd".

Q.NO.5. "Mr. S" is a practicing chartered accountant and "Mrs. S", is holding securities of "ABC Ltd." Having face value of Rs. 90,000/-. Whether "Mr. S" is qualified from being appointed as an auditor of "ABC Ltd."?

Provision: same as Practical Question no.4

Analysis: In the present case, Mrs S. (relative of Mr. S, an auditor), is having securities of Rs 90,000 face Value in the ABC Ltd., which is as per requirement of proviso to section 141 (3)(d)(i),

Conclusion: Therefore, Mr. S will not be disqualified to be appointed as an auditor of ABC Ltd.

Q.No.6. "BC & CO." is an audit firm having partners "MR. B" AND "MR. C", and "MR.A" the relative of "MR. C", is holding securities of "MWF LTD." having face value of Rs 1,01,000/-. Whether "BC & CO." is qualified from being appointed as an auditor of "MWF LTD."?

Provision: same as Practical Question no.4

Analysis: The relative of Mr. C i.e. partner of BC & Co., is holding the securities in MWF Ltd which is exceeding the limit mentioned in proviso to section 141(3)(d)(i)

Conclusion: In the instant case BC & Co, will be disqualified for appointment as an auditor of MWF Ltd

Q.NO.7. Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as statutory auditor of Krishna Ltd. For the accounting year 2015 - 2016, Mr. Hanuman holds 100 equity shares of Shiva Ltd., a Subsidiary company of Krishna Ltd. Comment (PM)

Provision: same as Practical Question no.4 and

Also Section 141(4) of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sec 141(3) 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

Analysis: In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd.

Conclusion: Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partners Mr. Hanuman is holding equity shares of its subsidiary.

Q.NO.8. M/s RST & co., A firm of chartered accountants, has three partners, namely, Mr. R, Mr. S & Mr. T. The firm is allotted the audit of Ashiana ltd. Mr. T subsequently holds 200 shares in Ashiana ltd. Comment.

Provisions of Law: same as Practical Question no.4

Analysis: here one of the partners acquires securities in the company after appointment.

Conclusion: Therefore M/s RST & co should vacate office and it shall be deemed to be a casual vacancy.

Q.NO.9. An auditor purchased goods worth Rs 5,00,001 on credit from a company being audited by him. The company allowed him one month's credit, which it normally allowed to all known customers. (PM, M15, 16 RTP)

Provision: As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, for an amount exceeding Rs. 5,00,000, then he is not qualified for appointment as an auditor of a company.

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds Rs. five lakh, he is disqualified for appointment as an auditor of the company.

Analysis: It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business.

Conclusion: The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

Q. NO.10. Sri & company, a firm of Chartered accountants was appointed as statutory auditors of Aaradhana Company Ltd. Aaradhana Company Ltd. holds 51% shares in Sarang Company Ltd. Mr. Sri, one of the partners of Sri & company, owed Rs. 1,500 as on the date of appointment to Sarang Company.Ltd for goods purchased in normal course of business. Comment. (PM, N15, N16 RTP)

Provision: Same as Practical Question.No.9

Analysis: In the given case, Sri & Company, a firm of Chartered Accountants was appointed as statutory auditors of Aaradhana Company Ltd. where the company holds 51% shares in Sarang Company Ltd. Mr. Sri, one of the partners of Sri & Company owed Rs. 1,500 as on the date of appointment to Sarang Company Ltd. for goods purchased.

Conclusion: Accordingly, the partner Mr Sri is not disqualified to be appointed as auditor of the company as he is indebted to the company for an amount not exceeding Rs. 5,00,000.

Due to this, Sri & Company, is not disqualified to be appointed as an auditor of Aaradhana Company Ltd.

Q.NO.11. 'B' owes Rs 5,01,000 to 'C' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses? (PM)

Provision: same as Practical Question no.9

Analysis: Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not valid because in such a case also the auditor shall be indebted to the company.

Conclusion: The auditor is entitled to recover fees on a progressive basis only.

Q.NO.12. Mr. Amar, a Chartered Accountant, bought a car financed at Rs. 7,00,000 by Chandra finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. And continues to be to even after taking the loan. (PM)

Provision: same as Practical Question no.9

Analysis: In the given case Mr. Amar is disqualified to act as an auditor under section 141 (3)(d) (ii) as he is indebted to M/s Chandra Finance Ltd. for more than Rs 5,00,000 Also according to Section 141 (3)(d) (ii) he cannot act as an auditor of any subsidiary of Chandra Finance Ltd. i.e. he is also disqualified to work in Charan Ltd. & Das Ltd.

Conclusion: He has to vacate his office in Das Ltd. Even though it is a subsidiary of Chandra Finance Ltd.

Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd must have to appoint any other CA as an auditor of the company.

Q.NO.13. B is appointed as an auditor of PQR Ltd., at a total remuneration of Rs.10,00,000, classified as under: (i) for unit X of the company Rs.6,00,000; (ii) for unit Y of the company Rs.2,00,000 and (iii) for Head office Rs. 2,00,000. As per terms of appointment, B can collect his fees on progressive basis, on completion of audits of unit X and /or Y. B completed the audit of unit Y and recovered Rs.6,00,000 on account of the audit fees though the entire audit is not completed. Explain whether B is indebted to the company for an amount exceeding Rs.5,00,000 and therefore disqualified. (or) Will an auditor who received the audit fees from the Co on progressive basis, is called Indebted.

Provision: Auditor cannot be said to be indebted to the Company at any stage if he recovers his fees on a progressive basis. As and when a part of the work is done, he can recover his fees in accordance with the terms of his engagement with the client, without waiting for the completion of the whole job.

Analysis: In the given case, Mr.B a Chartered Accountant taking his remuneration in accordance with terms of engagement and there is no indebtedness attracted to him.

Conclusion: Hence, B is not indebted to the Company and is qualified to act as its Statutory Auditor.

Q.No.14. Mr. Y was appointed as an auditor of PQR Ltd. For the year ended 31.3.2016 at the annual general meeting held on 16.08.2015. Mr. Y has been indebted to the company for sum of Rs 5,10,000 as on 01.04.2015, the opening date of accounting year which has been subject to his audit. However, Mr. Y having come to know that he might be appointed as auditor, he repaid the amount on 10.8.2015. One of the shareholders complains that the appointment of Mr. Y as an auditor was invalid because he incurred disqualification u/s 141 of the companies act, 2013. Comment. (PM)

Provision: same as Practical Question no.9

Analysis: However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, Mr. Y was appointment as an auditor of PQR Ltd. for the year ended 31.03.2016 at the Annual General Meeting held on 16.08.2015. He repaid the loan amount fully to the company on 10.8.2015 i.e. before the date of his appointment.

Conclusion: Hence, the appointment of Mr. Y as an auditor is valid and the shareholder's complaint is not acceptable.

Q.NO.15. Whether the following persons can be appointed as the auditor of a company?

- a) Prasad, a person who is a chartered accountant of the Canadian Institute of Chartered Accountants but is not a member of the Institute of Chartered Accountants of India.
- b) Mrs. P is a member of the Institute of chartered accountants of India. The directors of a limited company say that she being a lady cannot be appointed as an auditor of the company.
- c) Mr. Krishna owes Rs.10,00,000 to a Ltd. To which he is an auditor.
- d) Mr. Ramu, a member of the ICAI, does not hold a Certificate of Practice.
- e) Mr. Nani, who was a member of the ICAI, is of unsound mind.
- f) Mr. Hrithik, who was a member of the ICAI, is of insolvent/bankrupt.
- g) ABI Consultants Ltd is a registered company with A, B and I as its directors. All the three directors are chartered accountants. Can the Company be appointed as auditor of another company?
- h) A, a partner in the firm of M/s Balaji & co., Chartered accountants, is the secretary of C Ltd. Can A or Balaji & co., be appointed as the company auditor?
- i) B, chartered accountant, is the partner of N, who is a director in P Ltd. Can B be appointed as statutory auditor?

- a) He cannot be appointed an auditor of a limited company in India. He must be a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.
- b) Mrs. P can be appointed as an auditor of the company. There is no bar on a lady.
- c) Mr. Krishna is disqualified. He will be disqualified if he owes an amount in excess of Rs.5,00,000
- d) Ramu does not hold a COP and hence cannot be appointed as an auditor of a company.
- e) Mr. Nani, being of unsound mind, cannot continue himself to be a member of this Institute. Therefore, he cannot be appointed as the auditor of any company.
- f) Mr. Hrithik, being insolvent, cannot continue himself to be a member of this Institute.

Therefore, he cannot be appointed as the auditor of any company.

- g) A Body Corporate cannot be appointed as Statutory Auditor of a Company. In the above case, the Company cannot be appointed as Statutory Auditor of another Company.
- h) A, being an Officer of the Company is disqualified. Also, M/s Balaji & Co., is not qualified to be appointed as auditor as one of its partners is an employee of the Company.
- i) B is not qualified to be appointed as auditor, as u/s 141, a person who is a partner of an officer of a Company cannot be appointed as its auditor.

Q.NO.16. Managing director of PQR Ltd. himself wants to appoint Shri Ganpati, a Practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the managing director. (PM)

Provision: Refer Q.No.6 in Class room discussion questions.

Analysis: In the instant case, the appointment of Shri Ganpati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company.

Conclusion: In view of the above, the Managing Director of PQR Ltd should be advised not to appoint the first auditor of the company.

Q.NO.17 .The first auditor of M/s Healthy Wealthy ltd., a Government company, was appointed by the Board of directors. (PM)

Provision: Refer Q.No.6 in Class room discussion questions.

Analysis: Hence in the case of M/s Healthy Wealthy Ltd., being a government company, the first auditors shall be appointed by the Comptroller and Auditor General of India.

Conclusion: Thus, the appointment of first auditors made by the Board of Directors of M/s Healthy Wealthy Ltd is null and void.

Q.No.18. White Star Ltd. was incorporated on 01.08.2015 and Mr. T, who is a relative to the chairman & Managing Director (CMD) of the company, appointed as auditor by the Board of directors in their meeting on 04.09.2015. Comment. (PM)

Provision: There are two issues arising out of this situation, viz.,

1. Appointment of first auditor by the Board of Directors; and
2. Relation of such an auditor with the Chairman of the company.

Regarding the first issue relating to appointment of auditor, particularly, in this case relating to appointment of first auditors, it may be noted as per the provisions of Section 139(6) of the Companies Act, 2013, the first auditor of a company shall be appointed by the BOD within 30 days from the date of registration of the company.

If the Board fails to appoint the first auditor, it shall inform the members of the company, who shall within 90 days at an extraordinary general meeting has to make the appointment.

Analysis: As per the facts given in the case, the Board has failed to appoint the first auditor within 30 days from the registration of company because the date of incorporation of White Star Ltd. is 01-08-2015 and the date of appointment of auditors by the Board of Directors is 04-09-2015.

Accordingly if the Board fails to appoint the first auditor, it shall inform the members of the company, who shall within 90 days at an extraordinary general meeting has to make the appointment.

Conclusion: Thus the appointment of Mr. T is not valid. Under the circumstances, the second issue relating to relationship of auditor with the Chairman & Managing Director (CMD) becomes redundant.

Q.No.19. Chairman and Managing director (CMD) of BHEL, a Government company, appointed its auditors on the authority of board of directors given to him. Comment.

Provisions of Law: Refer Q.No.7 in Class room discussion questions

Analysis: In the given case, the Chairman and Managing Director (CMD) of BHEL, a Government Company, has appointed the auditor for the company on an authority given to him by the Board of Directors.

Conclusion: Keeping in view the above provisions, appointment made by the CMD is invalid even if he has the authority of Board of Directors.

Q.No.20. Nickson Ltd. is a Subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nickson Ltd appointed Mr. P as statutory auditor for the year. (PM)

Provision: Refer Q.No.7 in Class room discussion questions

Analysis: In the given case Ajanta Ltd is a Government Company as its 20% shares have been held by CG, 25% by Uttar Pradesh SG and 10% by Madhya Pradesh SG. Total 55% shares have been held by CG and SG. Therefore, it is a Government company.

Nickson Ltd. is a subsidiary company of Ajanta Ltd. Hence Nickson Ltd. covers in the definition of a Government Company. Hence the Auditor of Nicksons Ltd. can be appointed only by C & AG.

Conclusion: Therefore, appointment of 'P' is invalid and 'P' should not give acceptance to the Directors of Nicksons Ltd.

Q.No.21. Mr. A was appointed auditor of AAS Ltd. by board to fill the casual vacancy that arose due to death of the auditor originally appointed in AGM. Subsequently, Mr. A also resigned on health grounds during the tenure of appointment. The board filled this vacancy by appointing you through duly passed board resolution. Comment. (PM)

Provision: Refer Q.No.8 (point: 1, 2, 3) in Class room discussion questions

Analysis and conclusion:

In the present case, the auditor Mr. A resigned and the vacancy had been filled in by Board. But, the vacancy caused by resignation cannot be filled by Board itself, such appointment shall also be approved by the company at general meeting.

The fact that the Mr. A was appointed by Board originally is a matter irrelevant in this situation. If the cause of vacancy is resignation, then the power of appointment shall vest with the general meeting only. As such, the appointment made by Board is invalid.

Q.No.22. M/s Young & co., a Chartered accountant firm, and Statutory auditors of OLD Ltd, is dissolved on 1.4.2014 due to differences of opinion among the partners. The board of directors of OLD Ltd. In its meeting on 6.4.2014 appointed another firm M/s Sharp & co. as their new auditors for one year. (PM)

Provision: Refer Q.No.8 in Class room discussion questions

Analysis: The expression "casual vacancy" has not been defined in that Act. Talking its natural meaning it may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firm etc. Furthermore Section 139(8) stipulates that any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

Conclusion: In the instant case the action of the board of directors in appointing M/s Sharp & Co. to fill up the casual vacancy due to dissolution of M/s Young & Co., is correct. However, the board of directors are not correct in giving them appointment for one year. M/s Sharp & Co. can hold office until the conclusion of next AGM only.

Q.No.23. A vacancy arose in the office of an auditor of XYZ Ltd due to death of the Auditor Mr Z and the managing director of the company filled that vacancy. Comment (M15 RTP, N16 RTP)

Provision: Refer Q.No.8 in Class room discussion questions

Conclusion: Appointment made by the Managing Director of the Company is not valid.

Q.No.24. Comment on the following:

Due to the resignation of the existing auditor(s), the Board of directors of X Ltd appointed Mr. Hari as the auditor. Is the appointment of Hari as auditor valid? (PM, M16 RTP)

Provision: Refer Q.No.8 in Class room discussion questions

Analysis: In the given case, the Board of directors of X Ltd. has appointed Mr. Hari as the auditor due to resignation of the existing auditor(s). The appointment made by the Board is correct, however, such appointment should be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and newly appointed auditor shall hold office till the conclusion of the next annual general meeting.

Conclusion: Appointment is valid if then board have obtained the approval of members as said in the section 139(8).

Q.No.25. The balance sheet of XYZ Ltd, an Unlisted Public Company, shows paid up share capital of Rs.5 crore and Public deposits of Rs.100 crore. The company appointed CA Ananya as the statutory auditor in its annual general meeting held at the end of September, 2015 for 6 years.

Comment upon the facts of the case with respect to applicability of provisions related to rotation of auditors and cooling off period as per the section 139(2) of the companies act, 2013.

Provision: Refer Q.No.9 in Class room discussion questions

Analysis: In the given case, XYZ Ltd. is an unlisted public company having paid up share capital of Rs.5 crore and public deposits of Rs. 100 crore. The company appointed CA. Ananya as the statutory auditor in its AGM held at the end of September, 2015 for 6 years.

The provisions relating to rotation of auditor will be applicable as the public deposits exceeds Rs. 50 crore. Therefore, XYZ Ltd. can appoint CA. Ananya as an auditor of the company for not more than one term of five consecutive years and CA. Ananya will hold office of auditor from the conclusion of this meeting upto conclusion of sixth AGM i.e. AGM to be held in the year 2020. As a result, the appointment of CA. Ananya made by XYZ Ltd. for 6 years is void.

Cooling-Off Period: As per the proviso to section 139(2) of the Companies Act, 2013 an individual auditor who has completed his respective term shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term.

Conclusion: Therefore, CA. Ananya shall not be re-appointed as auditor in XYZ Ltd. for further term of five years i.e. she cannot be appointed as auditor upto year 2025.

Q.No.26. No Annual General Meeting (AGM) was held for the year ended 31st march, 2016, in XYZ Ltd., NINU is the auditor for the previous 3 years, whether she is continuing to hold office for current year or not. (PM)

Provision: Refer Q.No.11 in Class room discussion questions

Analysis: In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded.

Conclusion: Therefore, Ninu shall continue to hold office till the conclusion of the annual general meeting.

Q.No.27.“ABC & Co.” is an audit firm having partners “Mr. A”, “Mr. B” and “Mr. C”, chartered accountants. “Mr. A”, “Mr. B” and “Mr. C” are holding appointment as an auditor in 4, 6 and 10 companies respectively.

1. Provide the maximum number of audits remaining in the name of “ABC & Co.”
2. Provide the maximum number of audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.

Provision: Refer Q.No.15 in Class room discussion questions

Conclusion: Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

Mr. A can hold: $20 - 4 = 16$ more audits

Mr. B can hold $20 - 6 = 14$ more audits and

Mr. C can hold $20 - 10 = 10$ more audits.

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Q.No.28. KBC & Co. a firm of chartered accountants has three partners, K, B & C; K is also in whole time employment elsewhere and Mr. B & Mr. C do not hold any audit in their personal capacity or as a partners of other firms. The firm is offered the audit of ABC Ltd. and is already holding audit of 40 companies. (PM)

Provision: Refer Q.No.15 in Class room discussion questions

Analysis: In the firm of KBC & Co., K is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, and in the given case company is already holding forty audits,

Conclusion: therefore, KBC & Co. can't accept the offer for audit of ABC Ltd.

Q.No.29.While conducting the audit of a limited company for the year ended 31st march, 2016, the auditor wanted to refer to the minute books. The board of directors refused to show the minute books to the auditor. (PM)

Provision: Refer Q.No.16 in Class room discussion questions “Right of access to books, documents, vouchers etc.”

Analysis: It is, therefore, essential for the auditor to refer to the Minute Books. In the absence of the Minute Books, the auditor may not be able to vouch/verify certain transactions of the company.

Conclusion: In case the directors have refused to produce the Minute Books, the auditor may consider extending the audit procedure as also consider qualifying his report in any appropriate manner.

Q.No.30. A is appointed as the auditor of X Ltd. On 26th July, 2014. He informs the company that he will visit its head office on August 15, 2014 (a holiday for the company) and examine the cash book. The accountant argues that he should come after March 31, 2015 when the accounts are closed. Moreover, he should not come on Sunday as the office is closed on that day. Is the position taken by the accountant legally correct?

Provision: Refer Q.No.16 in Class room discussion questions “Right of access to books, documents, vouchers etc.”

Analysis: This implies that he can examine them at any time after assuming his office as the auditor and he need not to wait for the closing of the accounts i.e. March 31st, 2015.

However, the expression “at all times” refers to only the normal business hours on any working day.

Conclusion: A cannot examine the books on a holiday.

Q.No.31. The Company had also appointed a cost auditor and therefore, the management had requested you not to review the cost records. Comment. (PM)

Provision: Refer Q.No.16 in Class room discussion questions “Right of access to books, documents, Vouchers etc.”

Conclusion: Accordingly, the auditors cannot be requested not to review the cost records as a cost auditor has been appointed by the company. The statutory auditor’s duties cannot be limited in any way either by the Articles or by the Directors or members. *This is confirmed by the judgement given in Newton vs. Birmingham small arms co. case*

Q.No.32. M/s Seeman & Co. had been the company auditor for Amudhan Company limited for the year 2015-16. The company had three branches located at Chennai, Delhi and Mumbai. The audits of branches Chennai, Delhi were looked after by the company auditors themselves. The audit of Mumbai branch had been done by another auditor M/s Vasan & co., a local auditor situated at Mumbai. The branch auditor had completed the audit and had given his report too. After this, but before finalization, the company auditor wanted to visit the Mumbai branch and have access to the inventory records maintained at the branch. The management objects to this on the grounds of the company auditor is transgressing the scope of audit areas agreed. Comment. (PM)

Provision: The audit of the branch of a company is dealt with in Section 143(8) of the Companies Act, 2013. According to this section, the audits of the branches can be done by the company auditor himself or by another auditor. Even where, the branch accounts are audited, the company auditor has right to visit the branch if he deems it necessary to do so for the performance of his duties as auditor.

He has also right of access at all times to the books and accounts and vouchers of the company maintained at the branch office. He can appropriately deal with the report of the branch auditor in framing his main report. He will disclose how he had dealt with the branch audit report.

Analysis: In this case, the audits of two branches were done by the company auditor and one branch was done by a separate branch auditor.

Applying the above provisions, to the instant case, management’s objection that the company auditor is transgressing the scope of audit areas agreed, is absolutely, wrong. The right of company auditor in visiting and accessing the records of branch cannot be forfeited.

Conclusion: Even where the branch accounts are audited by another local auditor, the company auditor has right to visit the branch and can have access to the books and vouchers of the company maintained at the branch office.

Q.No.33. Mr. B, Statutory auditors of Secret Ltd. was not permitted by the Board of directors to give notice of attend general meeting of the company on the ground that his right to receive notice of general meetings is restricted only to those meetings at which the accounts audited by him are to be presented and discussed. (PM)

Provision: Section 146 - Refer Q.No.16 in Class room discussion questions “**Right to receive notices of general meetings**”

Analysis: In the instant case, the board of directors of Secret Ltd., have no right to restrict Mr. B from attending the general meeting and Mr. B has every right to attend such meeting as conferred by Section 146.

Conclusion: Thus, the action of the board of directors is contrary to the provisions of law and curtails the right of the auditor.

Q.No.34. The Board of directors of a company have filed a complaint with the Institute of chartered accountants of India against their statutory auditors for their failing to attend the annual general meeting of the shareholders in which audited accounts were considered. (PM)

Provision: Refer Q.No.16 in Class room discussion questions “**Right to receive notices of general meetings**”

Analysis: As per above provision it is the duty of the statutory Auditors to attend general meeting.

Conclusion: Statutory auditor failing to attend general meeting so, he is guilty of misconduct.

Q.No.35. You have not been paid the fees for audit of a company. You are asked by the Managing director of the company to send him the papers relating to the Tax computations of his own proprietorship business, the taxation work of which is looked after by you. The auditor wants to exercise his lien.

Provision: Refer Q.No.17 in Class room discussion

Analysis: In the given case, the auditor of a company exercised lien on paper relating to tax computations of Managing Director’s own proprietorship business for the non receipt of fees for audit of the company. The fees for which lien is exercised is in respect of some unrelated work.

Conclusion: The lien exercised by the auditor is not valid.

Q.No.36. The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1) of section 143 of the Companies Act, 2013, as he was satisfied that no comment is required. (PM, MTP N17)

Provision: Refer Q.No.18 in Class room discussion

Conclusion: Therefore, the auditor of Trilok Ltd. is correct in non-reporting on the matters specified in Section 143(1).

Q.No.37. Mr. X, a director of M/S KP Private Ltd, is also a director of another company viz., M/s GP Private Ltd., which has not filed the financial statements and annual return for last three years 2013-14 to 2015-16. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the companies act, 2013, and auditor should not mention disqualification remark in his audit report. (PM, M16 MTP1, 2 – 6, 4M)

Provision:

Disqualification of a Director Under Section 164(2) of the Companies Act, 2013: Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director under section 164(2) of the Companies Act, 2013. As per provisions of Section 164(2), if a director is already holding a directorship of a company which has not filed the financial statements or annual returns for any continuous period of three financial years shall not be eligible to be reappointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Analysis: In this case, Mr X is a director of M/s KP Private Ltd. as well as of M/s GP Private Ltd., and, M/s GP Private Ltd., has not filed the financial statements and annual return for last three years. Hence the provisions of section 164(2) are applicable to him and as such he is disqualified from directorship of both the companies.

Conclusion: Therefore, the auditor shall report about the disqualification under section 143(3)(g) of the Companies Act, 2013.

Q.No.38. Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, working as Manager of Shrivastav and Co., a Chartered accountant firm, signed the audit report of OM Ltd on behalf of Shrivastav & co. (PM)

Provision: Refer Q.No.20 in Class room discussion “Duty to sign the audit report”.

Analysis: Therefore, Mr. Rajendra, a fellow member of the Institute and a manager of M/s Shrivastav & Co., Chartered Accountants, cannot sign on behalf of the firm in view of the specific requirements of the Companies Act, 2013.

Conclusion: The act of Rajendra is not valid.

Q.No.39. M/s XYZ & Co, Auditors of Goodwill Education foundation, a Recognized Non-Profit Organisation feels that the Standards on Auditing need not to be applied as Goodwill education foundation is a non-profit making concern. (PM)

Provision: Refer Q.No.20 in Class room discussion “Duty to comply with standards on auditing”.

Further, the Preface to Standards on Auditing gives the scope of the Standards on Auditing. As per the Preface, the SAs will apply whenever an independent audit is carried out; that is, in the independent examination of financial statements/information of any entity; whether profit oriented or not and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon.

Also while discharging their attest function; it is the duty of the Chartered Accountant to ensure that SAs are followed in the audit of financial information covered by their audit reports.

Conclusion: In the given case, even though the client is a non-profit oriented entity the SAs shall apply and the auditor shall be guilty of professional misconduct for failing to discharge his duty in case of non-compliance with SAs.

Q.No.40. During the year 2015-16, it was decided for the first time that the accounts of the branch office of AAS limited be audited by qualified chartered accountants other than the company auditor. Accordingly, the board had appointed branch auditors for the ensuing year. One of the shareholders complained to the central government that the appointments was not valid as the board of directors do not have power to appoint auditors, be they company auditor or branch auditors? (PM)

Provision: Refer Q.No.22 in Class room discussion

Analysis: The shareholders in general meeting, instead of appointing branch auditor, may authorize the board of directors to appoint branch auditors.

In the present case, the board has appointed branch auditors without obtaining authorization from the shareholders in general meeting. The board had appointed the auditor where it did not have authority to do so.

Conclusion: As such, the appointment is invalid. The shareholder's complaint is right. The branch auditor should ascertain before accepting the audit whether his appointment is valid.

Q.No.41. Mr. Y is the auditor of X Pvt Ltd in which there are four shareholders only, who are also the directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Mr. Y to accept a reduced fee and for that he has been offered not to carry out such full audit as he has done in the past. Y accepted the suggestions of the directors. (PM)

Analysis: Y may agree to temporary reduction in audit fees, if he so wishes, in view of the suggestions made by the directors (perhaps in accordance with the decision of the company taken in general meeting). But his duties as a company auditor are laid down by law and no restriction of any kind can restrict the scope of his work either by the director or even by the entire body shareholders.

Since the scope is determined by relevant Act, but remuneration is purely a matter of personal contract between auditor and client.

Conclusion: Under the circumstances, Y is violating the provisions of the Companies Act, 2013.

Q.No.42. The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the Audit report to them. (PM)

Provision: Section 143 of the Companies Act, 2013 lays down the powers and duties of auditor. As per provisions of the law, it is not part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company.

Conclusion: Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.

Q.NO.43. Mr. Aditya, a Practicing Chartered accountant is appointed as a "Tax consultant" of ABC Ltd., in which his father Mr. Singhvi is the managing director. (PM)

Provision: A chartered accountant appointed as an auditor of a company, should ensure the independence in respect of his appointment as an auditor, else it would amount to "misconduct" under the Chartered Accountants Act, 1949 read with Guidance Note on Independence of Auditors.

Conclusion: In this case, Mr. Aditya is a "Tax Consultant" and not a "Statutory Auditor" or "Tax Auditor" of ABC Ltd., hence he is not subject to the above requirements.

SA 700 FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

A. DEFINITIONS:

- 1. General purpose financial statements:** Financial statements prepared in accordance with a general purpose framework.
- 2. General purpose framework:** A financial reporting framework designed to meet the common financial information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.

3. Fair presentation framework:

- i) it refers to a financial reporting framework that requires compliance with the requirements of the framework and may provide disclosures beyond those specifically required by the framework or
- ii) to depart from a requirement of the framework to achieve fair presentation of the financial statements.

4. Compliance framework: It refers to a financial reporting framework that requires compliance with the requirements of the framework as it is, without any deviation.

B. OBJECTIVES OF THE AUDITOR:

1. To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
2. To express clearly that opinion through a written report.

C. FORMING AN OPINION:

1. Obtaining Reasonable assurance: The auditor shall form an opinion after having obtained reasonable assurance regarding whether the financial statements are

- a) prepared, in all material respects, in accordance with the applicable financial reporting framework,
- b) free from material misstatement, whether due to fraud or error.

2. Evaluation to be made by auditor: The auditor shall evaluate whether:

a) Accounting policies:

- i) Selection and application of accounting policies are made as per applicable financial reporting framework and
- ii) They have been adequately disclosed in the financial statements.

b) The accounting estimates made by management are reasonable;

c) The terminology used in the financial statements, including the **title** of each financial statement, is appropriate.

d) Disclosures in financial statements:

- i) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- ii) The financial statements provide adequate disclosures relating to material transactions and events.

3. Form or Types of opinion:

1. Unmodified opinion: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

2. Modified opinion: the auditor shall modify the opinion in the auditor's report in accordance with SA 705, If the auditor:

- i) concludes that, based on the audit evidence obtained, the financial statements are not free from material misstatement; or
- ii) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement.

D. REPORTING AN OPINION: The auditor's report shall be in writing.

BASIC ELEMENTS OF AUDIT REPORT:

1. Title: The auditor's report shall have a title with the heading "Independent auditor's report" to distinguish it from reports issued by others.

2. **Addressee:** The auditor's report is normally addressed to those for whom the report is prepared.

For example, shareholders or those charged with governance of the entity.

- It is determined as per applicable Laws and regulations or as per the terms of the engagement.

3. **Auditor's opinion:** The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

This section of the auditor's report contains **Two sub sections** within it:

- a) **Introduction lines:** It shall

- Specify the name of the entity whose financial statements have been audited;
- State that the financial statements have been audited;
- Specify the titles of each financial statement
- Specify the date or period covered by each financial statement comprising the financial statements
- Refer to summary of significant accounting policies and other explanatory information; and

For example: "We have audited the financial statements of UV Limited, which comprise the balance sheet as at 31st March 2018, and the statement of Profit and Loss and statement of cash flows for the year then ended 31st March 2018, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information".

- b) **Expressing of Opinion:**

Wording of Unmodified opinion: If financial statements prepared in accordance with

- i) **Fair presentation framework:** The auditor's opinion shall use any one of the following phrases, which are regarded as being equivalent:

- "In our opinion, the accompanying financial statements **present fairly**, in all material respects, in accordance with the applicable financial reporting framework"

(or)

- "In our opinion, the accompanying financial statements **give a true and fair view** in accordance with the applicable financial reporting framework".

- ii) **Compliance framework:** "In our opinion, the accompanying financial statements **are prepared**, in all material respects, in accordance with the applicable financial reporting framework"

4. **Basis for Opinion:** The auditor's report shall include a section, immediately after the Opinion section, with the heading "Basis for Opinion", by stating that the:

- Audit was conducted in accordance with Standards on Auditing;
- Auditor has complied with all the relevant Ethical requirements including independence as per Code of ethics issued by ICAI and other applicable laws and regulations. E.g. Companies Act, 2013.
- Auditor believes that the Audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.
- Responsibilities of Auditor are further described in "Auditor's Responsibilities for the Audit of the Financial Statements" para of the report.

5. **Going Concern:** In this section of the auditor's report, the auditor shall disclose material uncertainty, if any relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570.
6. **Key Audit matters:** This section shall describe that the
- "Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and These matters were addressed in the context of the audit of the financial statements and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters" and
 - Description of each Key Audit Matter as per SA 701.

7. Responsibilities of Management for the Financial Statements:

This section of the auditor's report shall describe management's responsibility for:

- a) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern.
- b) Preparing the financial statements in accordance with the applicable financial reporting framework,
- c) Designing and implementing such internal controls to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error,

Note: In case of Corporate entities, the matters prescribed under "Director's responsibility statement" as per section 134(3) of the Companies Act, 2013 shall also be described in this section in addition to the above matters.

8. Auditor's Responsibilities for the Audit of the Financial Statements:

This section of the auditor's report shall:

1. **Objectives of the auditor:** State that the objectives of the auditor are to:
 - a) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
 - b) Issue an auditor's report that includes the auditor's opinion.
2. **Reasonable assurance:** State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
3. **Misstatements:** State that misstatements can arise from fraud or error, and they are considered material, either individually or in the aggregate, if they could to influence the economic decisions of users taken on the basis of these financial statements.

State further description of the responsibilities of the auditor for the audit of financial statements which can be included in appendix of auditor's report such as exercising professional judgment and maintains professional scepticism throughout the audit.

9. **Report on Other Legal and Regulatory Requirements:** These are specific reporting responsibilities of auditor required by any act or regulation.

E.g.: CARO, 2016 or section 143(3) of the companies act, 2013

10. **Signature of the auditor:** The Auditor's report shall be signed.

11. **Date of the auditor's report:** The date of auditor's report shall be after the date on which the auditor has obtained sufficient appropriate audit evidence based on which the auditor has formed an opinion on the financial statements.

12. **Place of signature:** The auditor's report shall name specific location. Generally, it is the city where the audit report is signed.

EXAMINATION QUESTIONS:

1. **State the basic element / contents of auditor's report?** (OLD PM, RTP N14, N12 6M)
 - A. Refer point no. D in above.
2. **What is the evaluation to be made by the auditor before forming an opinion on financial statements?** (RTP N14)
 - A. Refer point no. C (2) in above.
3. **Write short note on Opinion paragraph in the auditor's report?** (M14 – 4M)
 - A. Refer point no. D (3) in above.
4. **Draft Unmodified opinion as per SA 700.**
 - A. Refer point no. D(3)(b) in above.

SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

A. CIRCUMSTANCES WHEN A MODIFICATION TO THE AUDITOR'S OPINION IS REQUIRED:

The auditor shall modify the opinion in the auditor's report when:

- a) **Financial statements are materially misstated:** The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement may be due to the following reasons:
 - i) The selected accounting policies are not consistent with the applicable financial reporting framework; or
 - ii) When management has not applied the selected accounting policies consistently with the financial reporting framework,
 - iii) The financial statements not included all of the disclosures or disclosures presented are not in accordance with the applicable financial reporting framework.
- b) **Inability to obtain audit evidence:** The auditor is unable to obtain sufficient appropriate audit evidence, to conclude that the financial statements as a whole are free from material misstatement.

The auditor's inability to obtain sufficient appropriate audit evidence may arise from:

- i) Limitations imposed by management. For example, management prevents the auditor from requesting external confirmation of specific account balances.
- ii) Circumstances beyond the control of the entity. For example, entity's accounting records have been destroyed or seized by governmental authorities.
- iii) Circumstances relating to the nature or timing of the auditor's work. For example, timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.

B. DETERMINING THE TYPE OF MODIFICATION TO THE AUDITOR'S OPINION:

Nature of Matter Giving Rise to the Modification	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

1. **Qualified Opinion:**

The auditor shall express a qualified opinion when:

- i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
 - ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.
2. **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
 3. **Disclaimer of Opinion** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- C. **FORM AND CONTENT OF THE AUDITOR'S REPORT WHEN THE OPINION IS MODIFIED:**

1. **Opinion Paragraph:** When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified opinion", "Adverse opinion", or "Disclaimer of opinion", as appropriate, for the opinion paragraph.

2. **Basis for modified opinion paragraph:**

- i) The auditor shall Amend the heading "Basis for Opinion" Para of SA 700 to "Basis for Qualified opinion", "Basis for Adverse opinion", or "Basis for Disclaimer of opinion", as appropriate.
- ii) He shall describe the matter giving rise to modification including quantification of financial effects of matter unless impracticable. If auditor is unable to quantify the effect he should state that fact.
- iii) This shall be placed immediately after the opinion paragraph.

3. **Wordings of Qualified opinion:**

"Except for the effects of the matter(s) described in the basis for qualified opinion paragraph, In our opinion

- "the accompanying financial statements **present fairly**, in all material respects, or **give a true and fair view** in accordance with the applicable financial reporting framework", when reporting in accordance with a fair presentation framework; or
- "the accompanying financial statements **are prepared**, in all material respects, in accordance with the applicable financial reporting framework", when reporting in accordance with a compliance framework;

Note: When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "Except for the possible effects of the matter(s)" for the qualified opinion.

4. **Wording of Adverse opinion:**

"Because of the effects of the matter(s) described in the Basis for Adverse opinion paragraph: In our opinion

- The accompanied financial statements **do not present fairly** (or **not giving a true and fair view**) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
- The accompanied financial statements **have not been prepared** in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework".

5. **Wordings of Disclaimer of opinion:** "Because of the possible effects of the matter(s) described in the basis for disclaimer of opinion paragraph,

- the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and,
- accordingly, the auditor does not express an opinion on the accompanied financial statements”.

Note: The auditor shall also amend the introduction lines in opinion paragraph of the auditor’s report which indicates that financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

D. CONSEQUENCE OF LIMITATION IMPOSED BY MANAGEMENT AFTER THE AUDITOR HAS ACCEPTED THE ENGAGEMENT:

1. **Requesting management:** If management has imposed a limitation on the scope of the audit after accepting the engagement, and the auditor believes that such limitation leads to expressing a qualified opinion or to disclaim an opinion on the financial statements, then
 - The auditor shall request that management remove the limitation.
2. **Communicating to TCWG:** If management refuses to remove the limitation, the auditor
 - shall communicate the matter to those charged with governance and
 - determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
3. **Analysing the effects of limitation:** If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:
 - If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
 - If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - i) Resign from the audit, where practicable and not prohibited by law or regulation; or
 - ii) If resignation is not possible, then disclaim an opinion on the financial statements.
4. **Resigning from audit:** If the auditor wants to resign from the audit, then the auditor shall communicate, to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion, before resigning.

EXAMINATION QUESTIONS:

1. **State briefly the circumstances when an auditor issues a disclaimer of opinion.**
 - A. Refer point no. B (3) in above. (N10 – 4M)
2. **Differentiate between Qualified report and Adverse report.** (M10 – 4M)
 - A. Refer point no. B (1), B (2) and D (3), D (4) in above.
3. **Write a short note on: Disclaimer of opinion. (PM)**
 - A. Refer point no. B (3), D (5) and E (2) in above.
4. **Auditor’s report is considered to be modified under certain circumstances. Comment.** (N10 4M, M15 5M)
 - A. Refer point no. A in above.

5. What is qualified report? Under what circumstances a qualified report is issued.

A. Refer point no. B (1), D (3) and C (1) in above.

6. Write short note on a qualified opinion?

(N 15 – 4M)

A. Refer point no. B (1) in above.

7. State the circumstances which could lead to any of the following in an Audit report:

i) A modification of opinion

ii) Disclaimer of opinion

iii) Qualified opinion

iv) Adverse opinion.
M13 8M)

(OLD PM,

A. Refer point no. A (a) & (b) without sub points and B in above.

SA 706 EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

A. EMPHASIS OF MATTER PARAGRAPHS:

1. **Contents of the para:** If the auditor considers it necessary to draw users' attention

- to a matter presented or disclosed in the financial statements that,
- in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the "financial statements".

2. **Heading of para:** "Emphasis of Matter";

3. **Conditions for usage of the para:** The auditor can include those matters in this section of audit report, provided

- The auditor would not be required to modify the opinion in accordance with SA 705 because of the matter; and
- The matter has not been determined to be a key audit matter to be communicated in the auditor's report as per SA 701.

4. **Other disclosures in the para:**

- Reference to FS:** Include in the paragraph a clear reference to the matter being emphasized can be found in the financial statements.
- Not modified:** Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

5. **Place of para:** It shall be placed immediately after the "Basis for Opinion" para but may be before or after the "Key Audit Matter" para.

6. **Example:** *We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.*

B. OTHER MATTER PARAGRAPHS:

1. **Contents of the para:** If the auditor considers it necessary to draw users' attention

- to a matter other than those that are presented or disclosed in the financial statements that,
- in the auditor's judgment, is relevant to users' understanding of the audit.

2. **Heading of Para:** "Other Matter";

3. **Conditions for usage of the Para:** The auditor can those matters in this section of audit report, provided

- i) This is not prohibited by law or regulation; and
 - ii) the matter has not been determined to be a key audit matter to be communicated in the auditor's report as per SA 701.
4. **Place of para:** It shall be placed immediately after the "Basis for opinion" para, "Emphasis of Matter" para and also after "Key Audit Matter" para, if any.
5. **Example:** *The financial statements of ABC Company for the year ended March 31, 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on March 31, 20X1*

C. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE: *If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph.*

EXAMINATION QUESTIONS:

1. Write a short note on: Emphasis of matter paragraph as per SA 705.

A: Refer point no. A in above.

2. What are the conditions for use of Emphasis of matter and Other matter paragraphs as per SA 706?

A: Refer point no. A(3) and B(3) in above.

COMPANIES (AUDITOR'S REPORT) ORDER, 2016

INTRODUCTION:

The Companies (Auditor's Report) Order, 2016 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(1) of the Companies Act, 2013.

It requires the auditor to report on 16 specified matters in his audit report under the paragraph "Other Reporting Responsibilities".

A. **APPLICABILITY OF CARO, 2016** (M10 – 6M, N11 – 8M, N14 – 4M, N16 – 6M)

CARO - 2016 applies to every company including a foreign Company, **except the following:**

- a) A Banking company;
- b) An Insurance Company;
- c) A company licensed to operate under **section 8 of the Companies Act, 2013**
- d) A **One Person Company** as defined under clause (62) of section 2 of the Companies Act and
- e) A **small company** as defined under clause (85) of section 2 of the Companies Act; and
- f) A **private limited company** which satisfies all the following 4 conditions:
 - i) It should not be a subsidiary or holding company of a public company
 - ii) Paid up capital and reserves and surplus not exceeding rupees **1 crore** as on the balance sheet date
 - iii) Total borrowings does not exceeding rupees **1 crore** from any bank or financial institution at any point of time during the financial year
 - iv) Total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) does not exceeding rupees **10 crore** during the financial year as per the financial statements.

NOTE: All the above 4 conditions are required to be satisfied to get exemption from CARO. Even one is not satisfied, then CARO is applicable.

B. POINTS TO BE KEPT IN MIND FOR CARO 2016 APPLICABILITY W.R.T THE PRIVATE COMPANIES:

1. W.r.t paid up share capital:

- i) **Inclusions:** It includes both equity share capital as well as the preference share capital.
- ii) **Exclusions:** It excludes share application money received pending allotment, calls in arrears and calls in advance.
 - It means that it includes every amount which has been credited as amount paid up in respect of shares of the company but does not includes any other amount received in respect of shares by whatever name called.

2. W.r.t Reserves and surplus:

- i) It includes all the reserves (whether capital or revenue reserves) as disclosed in the Schedule III of the companies act, 2013.
- ii) Revaluation reserve, if any, should be taken into consideration while determining the applicability of CARO.
- iii) The debit balance of the profit and loss account, if any, should be reduced from the figures of Reserves & Surplus same as per Schedule III.
If there any excess debit balance of profit and loss account after adjustment to Reserves & Surplus, then such excess can be netted off against Paid up Capital also.
- iv) Provisions are excluded whether they are made for depreciation or for Diminution in the value of assets or for any known liability.

3. W.r.t Borrowing:

- i) Loans taken from a private bank or a Foreign Bank would also to be considered.
- ii) The term "**Financial institution**" includes a scheduled bank and also NBFC's.
- iii) Loans from Banks or Financial Institutions shall include term loans, demand loans, working capital loans, cash credits, and overdraft, bills purchased and discounted.
- iv) Loans includes all loans whether secured or unsecured.
- v) The limit shall be computed with reference to the aggregate borrowings from all banks and financial institutions cumulatively but not as per each bank or financial institute basis.
- vi) The limit shall be considered at any point of time during the financial year i.e. on any day during the year but need not on the date of balance sheet.
- vii) Where the company has taken any overdraft facility against Fixed Deposits, the gross amount outstanding in overdraft facility (without adjusting Fixed Deposit) shall be considered for the purpose of CARO.
- viii) Amounts outstanding in respect of credit Cards also would also be considered.

4. W.r.t Revenue:

- i) Revenue means the aggregate amount of sales affected by the company including the revenue from discontinuing operations.
- ii) It should be computed as per Schedule III. i.e. it includes sale of goods, services & any other operating revenues earned by the company.
- iii) Excise duty, Sales tax shall be deducted from the Turnover, if credited separately to such account.

iv) It excludes sales returns and trade discounts, if any.

5. Additional points:

i) In the case of holding and subsidiary companies:

- CARO, 2016 reporting shall not apply to the Auditor's Report on Consolidated Financial Statements. and also
- the limits for applicability of CARO should be computed on the basis of standalone financial statements of holding and subsidiary companies separately but not on the basis of consolidated financial statements.

ii) In the case of companies having branches:

- The limits for the purpose of Applicability of CARO shall be computed from the entire company's view including the amounts from all the branches but not w.r.t each branch wise.
- Once it is applicable to the company as a whole, then each and every branch of the company will be covered under CARO. Therefore all the branch auditors of the company are also required to report on these 16 matters in their branch audit report w.r.t the concerned branch.

iii) CARO is applicable to Private unlimited Companies irrespective of the size of their Paid-Up capital, Reserves and surpluses, Revenue, borrowings etc.

Exemption is given only for Private **Limited** companies.

CARO, 2016 REPORTING REQUIREMENTS

Clause 3 (i) Fixed Assets

- a) Whether the company is maintaining **proper records** showing full particulars including
- Quantitative details and
 - Situation of fixed asset.
- b) Whether these fixed assets have been **physically verified** by the management at reasonable intervals;
- c) Whether any **material discrepancies** were noticed on such verification and if so, whether the same have been properly dealt with in the books of accounts.
- d) Whether the **title of immovable properties** are held in the name of the company. If not provide the details of the same.

Clause 3(ii) Inventories

- a) Whether **physical verification of inventory** has been conducted at reasonable intervals by the management.
- b) Whether any **material discrepancies** if any, were noticed on physical verification and if so, whether the same have been properly dealt with in the books of accounts.

Clause 3(iii) Loans to Directors and Interested parties:

Whether the company granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintains under section 189 of the Co.'s Act, 2013.

- a) If so, verify the number of parties and the amount involved in the transaction?
- b) Whether the **terms & conditions** of grant of such loans are not prejudicial to the company's interest.
- c) Whether the schedule of **repayment** of principal & payment of interest has been stipulated & Whether the same are **regular**?

- d) If amount is overdue, state the amount overdue for **more than 90 days**, whether **reasonable steps** have been taken by the company for **recovery** of the principal and interest.

Note: it should be noted that CARO 2016 consider only loans granted, but not loans taken.

Clause 3(iv) loans, Investments, Guarantees made by company:

In respect of loans, Investments, Guarantees, and securities provided by company, whether **provisions of section 185 & 186** have been complied with? If not, provide the details thereof.

Clause 3(v) Deposits:

In case the company has accepted deposits from the public,

- a) verify the compliance with the following:
- whether the directives issued by the **RBI** and
 - the provisions of **Sections 73 to 76** of the Co.'s Act, 2013 or
 - An **order passed by CLB or RBI** or any court or any other Tribunal, if any.
 - any other relevant provision of the Act and the rules framed
- b) If there is any Non-compliance, the nature of contraventions should be stated;

Clause 3(vi) Cost Records

- a) Whether **maintenance of cost records** has been prescribed by the Central Government under sub section (1) of section 148 of the Co.'s Act, 2013 is applicable.
- b) If applicable, whether such accounts and records **have** made and maintained.

Clause 3(vii) Statutory Dues

a) Undisputed dues:

- Is the company **regular in depositing undisputed statutory dues** e.g. provident fund, ESI, Income Tax, service tax and any other statutory dues with the appropriate authorities and
- if not, the extent of the **arrears of outstanding** statutory dues as at the last day of the financial year concerned for a period of **more than six months** from the date they became payable, shall be indicated by the auditor.

b) Disputed dues:

- i) In case dues have not been deposited on account of any **dispute**, the auditor shall indicate
- the amounts involved in dispute and
 - the forum where dispute is pending.
- ii) A mere representation to the concerned department shall not constitute a dispute.

Clause 3(viii) Default in repayment of dues:

- a) Whether the company has defaulted in repayment of borrowings of loans to
- a financial institution or
 - bank or
 - debenture holders.
- b) If yes, the period and amount of default to be reported
- c) In case of defaults to banks, financial institutions, & government, lender wise details to be provided.

Clause 3(ix) Application of funds:

- a) Whether the money raised by way of initial or further public offer (including debt instruments) & term loans were **utilized for the purposes for which those are raised**.

- b) If not, the details along with the defaults, delays & subsequent rectifications, if any, to be reported.

Clause 3(x) Reporting of Frauds:

- a) Whether any fraud **by or on** the company by its officers or employees has been noticed or reported during the year;
- b) If yes, the nature and the amount involved is to be indicated.

Clause 3(xi) Managerial Remuneration

- a) Whether managerial remuneration has been paid or provided in accordance with the provisions of section 197 read with Schedule V?
- b) If not, state the amount involved & steps taken by company for refund of the same.

Clause 3(xii) Nidhi Company

- a) Whether Nidhi company has complied with the net owned funds (i.e. net worth) to deposits in the ratio of **1:20** to meet out the liability.
i.e. for every one rupee of net owned funds, nidhi company cannot accept more than 20 rupees of deposits.
- b) Whether Nidhi Company is maintaining 10% Unencumbered term deposits as specified in Nidhi Rules, 2014 to meet out the liability

Clause 3(xiii) Related Party Transaction:

Whether all transaction with related parties are

- a) In compliance with section 177 & 188 where applicable.
- b) Details have been disclosed in the financial statements etc., as required by applicable accounting standards.

Clause 3(xiv) Preferential allotment:

Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review &

- a) If so, verify the following:
- Compliance with section 42 of the act. and
 - the amount raised have been used for the purpose for which they are raised.
- b) If not provide the details in respect of the amount involved & nature of non-compliance

Clause 3(xv) Non-Cash Transaction: Whether Company has entered into any Non-Cash Transactions with directors or persons connected with him, & if so provisions of **section 192** have been complied with.

Clause 3(xvi) Non-Banking Financial Institution:

- a) Whether the company is required to be registered under section 45-IA of Reserve Bank Of India Act 1934, and
- b) If so, whether the registration has been obtained.

REPORTING REQUIREMENTS:

- a) Where in the Auditor's report, the answer to any of the questions referred above is Qualified or unfavorable, the report shall also state the reasons for such answers which are given as qualified or unfavorable.
- b) Where the auditor is unable to express an opinion on a particular question, he shall report such fact along with the reasons thereof as to why it is not possible to give an answer to such clause.

PRACTICAL QUESTIONS

Q.No.1. Keshav Pvt Ltd has a balance of Rs.30 Lakhs as Capital Reserve, Rs. 30 Lakhs as Revenue Reserves, Rs.40 Lakhs as Revaluation Reserve and Rs.20 Lakhs as Paid-Up Share Capital as on 31st March. Comment on the applicability of CARO to this Company.

- 1) Reserves includes all types of Reserves (Capital Reserves, Revenue Reserves, Revaluation Reserve, etc.)
- 2) Here, Paid-Up Capital + Reserves = Rs.20 Lakhs (Paid – Up Capital) + Rs.100 Lakhs (Capital Reserve + Revenue Reserve + Revaluation Reserve) = Rs 120 Lakhs. Hence, CARO is applicable for this Company, since this exceeds the limit of Rs 1 Crore.

Q.No.2. Mahath Pvt Ltd provides the following information for the financial year ending 31st March. Comment whether CARO is Applicable for this Company.

	(Amounts in Rs Lakhs)
Paid Up Share Capital	Rs. 70.00
Capital Reserve	Rs. 14.00
Revaluation Reserve	Rs. 20.00
General Reserve	Rs.20.00
Profit and Loss (Dr.)	Rs.24.00

1. As per Schedule III Requirements, Debit balance of P&L A/c, should be reduced from the figure of Reserves.
2. In the present case,

a) Paid-Up Capital	= Rs.70 Lakhs
b) Reserves = 14 + 20 + 20	= Rs.54 Lakhs
Less: P&L (Dr)	= (Rs.24 Lakhs)
	= <u>Rs.30 Lakhs</u>
Paid Up Capital + Reserves	= Rs.100 Lakhs
3. Since Aggregate of Paid Up Capital and Reserves does not exceed Rs. 1 Crore, CARO is not applicable for this Company. (assuming other 3 conditions of exemption are satisfied.)

Q.No.3. Anand Pvt Ltd is incorporated on 1st July 2015. During the year ended 31st March 2016, it had issued Shares (fully paid up) of Rs.80 Lakhs, had borrowed Rs.25 Lakhs each from 2 Financial Institutions and its Total Revenue (Net of Excise of Rs.50 Lakhs which is credited to a separate account) is Rs.975 Lakhs. Will CARO be applicable to Anand Pvt Ltd?

Analysis:

Condition	Analysis
a) Not a Holding or Subsidiary of a Public Company	Assumed satisfied
b) Paid up Capital and R&S on B/s date ≤ Rs.1 Crore	Satisfied, since Rs.80 Lakhs ≤ Rs.1 Crore.
c) Bank / Fin.Instn Borrowings at any time, ≤ Rs.1 Crore	Satisfied, since 25×2= Rs. 50 Lakhs ≤ Rs.1 Crore.

d) Total Revenue \leq Rs.10 Crores	If Excise Duty is taken / credited to a separate account, it shall not form part of the Total Revenue. So, Total Revenue for this Co. = Rs.9.75 Crores, i.e. \leq Rs.10 Crores.
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Conclusion: CARO does not apply to Anand Pvt Ltd, since **all** the conditions relating to exemption are satisfied.

Q.No.4. Tarun Pvt Ltd's Paid Up Capital and Reserves are less than Rs.100 Lakhs and it has no Borrowings from any Bank or Financial Institution. Its Sales are Rs.12 Crores before deducting Trade Discount Rs. 20 Lakhs and Sales Returns Rs.190 Lakhs. The services rendered by the Company amounted to Rs.20 Lakhs. Comment on applicability of CARO to this Company.

Principles: Total Revenue = [Sales Rs.12 Crores (-) Trade Discount Rs.20 Lakhs (-) Returns Rs. 190 Lakhs] + Services Income Rs.20 Lakhs = Net Rs.10.10 Crores

Analysis:

Condition	Analysis
a) Not a Holding or Subsidiary of a Public Company	Assumed satisfied
b) Paid up Capital and R&S on B/s date \leq Rs.1 Crore	Satisfied, since it is given as \leq Rs.1 Crore.
c) Bank / Fin.Instn Borrowings at any time, \leq Rs.1 Crore	Satisfied, since there are no Borrowings.
d) Total Revenue \leq Rs.10 Crores	Not satisfied, Since Total Revenue $>$ Rs.10 Crores.

Conclusion: CARO applies to Tarun Pvt Ltd, since the Total Revenue **exceeds** Rs. 10 Crores.

Q.No.5. Samraksha Pvt Ltd is the Holding Company of Suraksha Ltd. And the following are the details w.r.t Samraksha Pvt Ltd:

The Paid Up Capital and Reserves Rs.30 Lakhs.

The Borrowings from SBI is Rs.60 Lakhs.

Total Revenue from Operations (including from Discontinuing Operations) are Rs.8 Crores.

The Auditors of Samraksha Pvt Ltd is of the view that CARO is not applicable since it is a Private Limited Company satisfying the condition relating to Paid up Capital, Borrowings and Total Revenue. Is their contention valid?

Whether CARO reporting is applicable for reporting on Consolidated Financial Statements?

Principle: Refer Q. No. 1 on the 4 conditions, all of which have to be satisfied by a Private Limited Company, to be exempt from CARO Reporting.

Analysis: In this case, Samraksha Pvt Ltd is the Holding Company of Suraksha Ltd, a Public Company.

Conclusion:

- Hence, CARO is applicable for Samraksha Pvt Ltd. [Monetary Limits in other 3 conditions are **not relevant** in this case].
- CARO 2016 Reporting shall **not apply** to the Auditor's Report on Consolidated Financial Statements.

Q.No.6. APPLICABILITY OF CARO 2016

The following particulars are given in relation to private companies.

Sales	– 9 crore.
Excise duty collected and accounted separately	– 50 lakh.
Sales tax collected and accounted separately	– 75 lakh.
Sales return	– 20 lakh.
Commission paid to third party	– 30 lakh.

Excise Duty and Sales Tax are recorded separately. Hence should not be considered for turnover. Sales Return should be deducted from sales. Commission on the sales should not be considered. Therefore, CARO 2016 is not applicable.

Q.No.7. For the year 2015-16, the company has taken a loan of 110 lakh from a bank on 01-06-2015. It repays the loan on 30-6-2015. On the balance sheet date, no amount is due. Is CARO applicable?

CARO 2016 will be applicable if the condition is satisfied at any time during the year.

Q.No.8. CA Vishwam is appointed as the Branch Auditor of VVK Ltd. Is he required to comply with the CARO when issuing his Branch Audit Report, or is CARO applicable only with respect to the Audit Report issued by the Principal Auditor?

The Report submitted by the Branch Auditor should contain a statement on all the matters specified in CARO, to enable the Company's Auditor to consider the same.

Hence, CARO is **applicable** for Branch Audits also.

Q.No.9. BK Ltd, a Benefit Fund, registered under NBFC Regulations, is in existence for the past two decades. On 31st December 2015, this Company is converted into a Bank. You have been appointed as an Auditor for the Financial Year 2015–2016. Comment whether CARO is applicable for this Company.

1. Banking Companies are exempted from CARO Reporting Requirements.
2. As on the date of B/Sheet, the Company is a Banking Company. Hence, CARO is **not applicable**, irrespective of the fact that the Company was converted from NBFC during the year.

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To **MASTER MINDS**, Guntur

THE END