CHAPTER VIII: DECLARATION AND PAYMENT OF DIVIDEND

DIVIDEND

The word "dividend" has origin from the Latin word “dividendum”. It means a thing to be divided. It is a return on investment made by the shareholders. Dividend is paid by a company to its shareholders on a particular date (book closure date) either out of profits or out of reserves.

Definition of dividend:

As per definition u/s 2 (35) of the New Act dividend includes any interim dividend.

Provisions relating to payment of dividend:

1. Deprecation must be provided:

Companies cannot declare or pay dividend for any financial year unless it is paid

- Out of profits for that year arrived at after providing depreciation in accordance with provisions sub section 2 of Section 123 or
- Out of accumulated profits of the company for any previous financial year or years arrived at after providing depreciation and remaining undistributed or
- Out of both above or
- Out of money provided by the CG or a SG for payment of dividend in pursuance of a guarantee given by that government

Students may note that similar provisions exist in Old Act also

2. Transfer to Reserves for declaration of dividend. A company may, before declaration of any dividend transfer such percentage of its profits for that financial year as it may consider appropriate. The Board of directors is given freedom to decide the percentage of transfer of profits to reserves before declaring a dividend {First proviso to section 123(1).

In the Old Act the transfer of profits to reserves is governed by Companies (Transfer of Profits to Reserves) Rules 1975 and the slab mandated was as follows: -

If proposed dividend is	Minimum amount of transfer to reserves
Up to 10%	Nil
Above 10.00% but within 12.50%	2.5%
Above 12.50% (but within 15.00%	5.00%
Above 15.00% (but within 20.00%	7.50%
Above 20%	10.00%

Now the above restrictions are removed. This matter is entirely left to the discretion of the Board of directors. The compulsory transfer to reserves enables companies to pay dividend out of accumulated profits when profits are lean and a consistency in the rate of dividend can be maintained.

3. Declaration of dividend out of accumulated profits

Second proviso stipulates that in case of inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.

Let us see the conditions provided by the rules:

As per Rule no. 3, the very first condition is that the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year.

Further it requires that the amount to be utilised from reserves shall not exceed 1/10th of total paid up capital and reserves.

After drawing reserves for dividend, the balance reserves shall not fall below 15% of its paid-up capital.

Dividend can be declared only after loss or depreciation in the previous years whichever is less is provided

The third proviso stipulates that no dividend shall be declared or paid by a company from its reserves other than free reserves.

The word "**Free reserves**" has been defined by Section 2(43) to mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. However, the following shall not be treated as free reserves:

- any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

4. Manner of depreciation:

Section 123(2) clarifies that for the purposes of clause (a) of sub-section (1), depreciation must be provided in accordance with the provisions of Schedule II.

5. Interim dividend:

The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared. In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years. {Section 123(3)}. This restriction ensures financial prudence.

6. Time limit for deposit of dividend:

The amount of the dividend, including interim dividend, must be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend. Dividend once declared by the shareholders becomes a debt and payable unlike in the case of interim. But the restriction to deposit within 5 days of declaration even the interim also ensures that the Board cannot go back on the commitment made by its declaration. {Section 123(4)}

7. Dividend to be paid to registered shareholders:

No dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash. Proviso however clarifies that capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount is permissible. {Section 123(5)}.

8. Mode of payment of dividend:

Any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

9. Prohibition on payment of dividend - Section 123(6)**:**

If a company violates the provisions of sections 73 and 74 with regard to acceptance of deposits from public, it shall not declare any dividend on its equity shares till such noncompliance exists. In the old Act, there is prohibition for payment of dividend, if violation of Section 80-A (redemption of preference shares within stipulated time) continues.

Punishment for failure to distribute Dividend - Section 127

This section corresponds to section 207 of the Old Act and states that where dividend has been declared but not paid or warrants have not been posted within 30 days of declaration, every director who is knowingly a party to the default shall be punishable with imprisonment up to 2 years and with a fine of one thousand for every day during which the default continues and company shall be liable to pay simple interest @18% p.a. However, immunity can be claimed from the punishment, if the default in payment is due to operation of any law, dispute about the claim, incorrect mandate.

8. In case of joint shareholding dividends shall be payable to the first holder as per the register of members or to such joint holder as all the joint holders may direct.

The Companies (Declaration and Payment of Dividend) Rules, 2014

As per these rules, dividends can be declared, from drawing from the general reserves, in case of absence of profits or inadequacy of profits subject to the following conditions:

(a) the rate of dividend declared shall not exceed the average rate of dividend for the last 3 years.

(b) the total amount that can be drawn from the general reserves shall not exceed 10% of the paid up capital and free reserves and the amount so drawn shall be first utilized to set off the losses and to pay preference dividend.

(c) the balance of reserves after such withdrawal shall not fall below 15% of the paid-up share capital.

2. Where the declaration of dividend is not within the parameters laid down in these rules, the Company is required to obtain prior approval of the Central Govt. before declaration of dividends out of reserves.

Declaration of Dividend in GM

The rate of dividend is recommended by the BODs and is declared by the shareholders in an AGM. The shareholders cannot insist on either declaration of dividend or on increasing the rate recommended by the BODs. They may, however, lower the rate recommended by the BODs.

2. A Company can declare dividend at an EGM, unless Articles specifically provide that dividend cannot be declared at an EGM. However, where a Company has declared a dividend at a general meeting, neither the Company nor its directors can declare a further dividend for the same year.

3. As a rule final dividend can be declared only after the annual accounts are presented to the members at AGM. However, a situation may arise where the AGM may not adopt the annual accounts for specified reasons but nothing prohibits it from declaring dividend at the rates recommended by the Board/lower rates.

4. Normally dividend once declared at AGM cannot be revoked because it acquires the character of debt due from the Company. However, with the consent of the shareholders in general meeting such a decision can be revoked before actual payment in extraordinary events or circumstances like fire, war, imposition of new killing tax burden etc.

Declaration of dividend (Section 123, notified on 26.03.2014)	
123(*1*)	No dividend shall be declared or paid by a company for any financial year except— (*a*) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (*2*), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both; **Provided that in computing profits any amount representing unrealized gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded; or** (*b*) out of money provided by the CG or a SG for the payment of dividend by the company in pursuance of a guarantee given by that Government:

	Provided that a company may, before the declaration of any dividend in any financial year, **transfer such percentage of its profits for that financial year** as it may consider appropriate to the free reserves of the company: Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf: Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.
123(*2*)	For the purposes of clause (*a*) of sub-section (*1*), depreciation shall be provided in accordance with the provisions of Schedule II.
	Interim Dividend
123(*3*)	**The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the annual general meeting out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend:** **Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during immediately preceding three financial years.**
123(*4*)	The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.
	Dividend to be paid in cash only
123(*5*)	No dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker and shall not be payable except in cash: Provided that nothing in this sub-section shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company:

	Provided further that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.
123(*6*)	A company which fails to comply with the provisions of sections 73 and 74 shall not, so long as such failure continues, declare any dividend on its equity shares.
Unpaid Dividend Account (Section 124)	
124(*1*)	Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.
124(*2*)	The company shall, within a period of 90 days of making any transfer of an amount to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the CG for this purpose, in such form, manner and other particulars as may be prescribed.
124(*3*)	If any default is made in transferring the total amount referred above to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12 % p.a. and the interest accruing on such amount shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.
124(*4*)	Any person claiming to be entitled to any money transferred above to the Unpaid Dividend Account may apply to the company for payment of the money.
124(*5*)	Any money transferred to the Unpaid Dividend Account, which remains unpaid or unclaimed for a period of **seven years** from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund u/s 125(1) and the company shall send a statement in the prescribed form of the details of such transfer to the authority and the authority shall issue a receipt to the company as evidence of such transfer.
124(*6*)	All shares in respect of which unpaid or unclaimed dividend has been transferred shall also be transferred by the company in the name of IEPF along with a statement containing such details as may be prescribed: Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from IEPF in accordance with such procedure and on submission of such documents as may be prescribed.
124(*7*)	**If a company fails to comply with any of the requirements of this section, such company shall be liable to a penalty of Rs. 1,00,000 and in case of continuing failure, with a further penalty of Rs. 500 for each day after the first during which such failure continues, subject to a maximum of Rs. 10,00,000 and every officer of the company who is in default shall be liable to a penalty of Rs. 25,000 and in case of continuing failure, with a further**

	penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 2,00,000.
Investor Education and Protection Fund (Section 125)	
125(*1*)	The CG shall establish a Fund to be called the IEPF.
125(*2*)	There shall be credited to the Fund— (*a*) the amount given by the CG by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund; (*b*) donations given to the Fund by the CG, SG(s), companies or any other institution for the purposes of the Fund; (*c*) the amount in the Unpaid Dividend Account of companies transferred to the Fund u/s 124(5); (*d*) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (*5*) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act; (*e*) the amount lying in the IEPF u/s 205C of the Companies Act, 1956; (*f*) the interest or other income received out of investments made from the Fund; (*g*) the amount received under sub-section (*4*) of section 38; (*h*) the application money received by companies for allotment of any securities and due for refund; (*i*) matured deposits with companies other than banking companies; (*j*) matured debentures with companies; (*k*) interest accrued on the amounts referred to in clauses (*h*) to (*j*); (*l*) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years; (*m*) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and (*n*) such other amount as may be prescribed: Provided that no such amount referred to in clauses (*h*) to (*j*) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.
125(*3*)	The Fund shall be utilised for— (*a*) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon; (*b*) promotion of investors' education, awareness and protection; (*c*) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement; (*d*) reimbursement of legal expenses incurred in pursuing class action suits u/s 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and (*e*) any other purpose incidental thereto, in accordance with such rules as may be prescribed: Provided that the person whose amounts referred to in clauses (*a*) to (*d*) of sub-section (*2*) of section 205C transferred to IEPF, after the expiry of the period of 7 years as per provisions of the Companies Act, 1956, shall be entitled to get

	refund out of the Fund in respect of such claims in accordance with rules made under this section.
125(*4*)	Any person claiming to be entitled to the amount referred in sub-section (*2*) may apply to the authority constituted under sub-section (*5*) for the payment of the money claimed.
125(*5*)	The CG shall constitute, by notification, an authority for administration of the Fund consisting of a chairperson and such other members, not exceeding 7 and a chief executive officer, as the CG may appoint.
125(*6*)	The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed.
125(*7*)	The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed.
125(*8*)	The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the CAG of India.
125(*9*)	It shall be competent for the authority constituted to spend money out of the Fund for carrying out the objects specified in sub-section (*3*).
125(*10*)	The accounts of the Fund shall be audited by CAG at such intervals as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the CG.
125(*11*)	The authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the CG and the CG shall cause the annual report and the audit report given by the CAG to be laid before each House of Parliament.
Right to dividend, rights shares and bonus shares to be held in abeyance pending registration of transfer of shares (Section 126, section notified on 26.03.2014)	
126	Where any instrument of transfer of shares has been delivered to any company for registration and transfer of such shares has not been registered by the company, it shall, notwithstanding anything contained in any other provision of this Act, — (*a*) transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer; and

	(*b*) keep in abeyance in relation to such shares, any offer of rights shares under clause (*a*) of sub-section (*1*) of section 62 and any issue of fully paid-up bonus shares in pursuance of first proviso to sub-section (*5*) of section 123.
Punishment for failure to distribute dividends (Section 127, notified on 12.09.2013)	
127	Where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration to any shareholder entitled to the payment of the dividend, **every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than Rs. 1,000 for every day during which such default continues** and the **company** shall be liable to pay **simple interest at the rate of 18 per cent p.a.** during the period for which such default continues: Provided that no offence under this section shall be deemed to have been committed: — (*a*) where the dividend could not be paid by reason of the operation of any law; (*b*) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him; (*c*) where there is a dispute regarding the right to receive the dividend; (*d*) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or (*e*) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

Q 1. ***YZ Ltd is a manufacturing company & has proposed a dividend @ 10% for the year 2017-18 out of the current year profits. The company has earned a profit of Rs. 910 crores during 2017-18. YZ Ltd. does not intend to transfer any amount to the general reserves of the company out of current year profit. Is YZ Ltd. allowed to do so? Comment.*** ***(3 Marks) (Nov. 2018)***

Answer: Transfer to reserves (Section 123 of the Companies Act, 2013): A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Therefore, the company may transfer such percentage of profit to reserves before declaration of dividend as it may consider necessary. Such transfer is not mandatory and the percentage to be transferred to reserves is at the discretion of the company.

As per the given facts, YZ Limited has earned a profit of Rs. 910 crores for the financial year 2017-18. It has proposed a dividend @ 10%. However, it does not intend to transfer any amount to the reserves of the company out of current year profit.

As per the provisions stated above, the amount to be transferred to reserves out of profits for a financial year is at the discretion of the YZ Ltd. acting vide its Board of Directors.

Q 2. Karan was holding 5000 equity shares of Rs. 100 each of M/s. Future Ltd. A final call of Rs. 10 per share was not paid by Karan. M/s. Future Ltd. declared dividend of 10%. Examine with reference to relevant provisions of the Companies Act, 2013, the amount of dividend Karan should receive.

(3 Marks) (November 2018)

Answer:

As per the proviso to section 127 of the Companies Act, 2013, no offence will be said to have been committed by a director for adjusting the calls in arrears remaining unpaid or any other sum due from a member from the dividend as is declared by a company. Thus, as per the given facts, M/s Future Ltd. can adjust the sum of Rs. 50,000 unpaid call money against the declared dividend of 10%, i.e., 5,00,000 x 10/100 = 50,000. Hence, Karan's unpaid call money (Rs. 50,000) can be adjusted fully from the entitled dividend amount of Rs. 50,000/-.

CHAPTER IX: ACCOUNTS OF COMPANIES

Sections 128 to 138 under Chapter IX deal with Accounts of companies in the CA, 2013.

Books of Accounts	
Section 128	(*1*) Every company shall prepare and keep **at its registered office** books of account and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branches, if any, and such books shall be kept **on accrual basis** and **according to the double entry system** of accounting: Provided that the BoD of the Company may keep these books of accounts at another place in India, as decided by them and inform the ROC within seven days thereof. Provided further that the company **may keep such books of account or other relevant papers in electronic mode** in such manner as may be prescribed. (*2*) Where a company has a branch office in India or outside India, it shall be deemed to have complied with the above provisions, if proper books of account relating to the branch office are kept there and proper summarised returns periodically are sent by the branch office to the company at its RO or the other place referred to in sub-section (*1*). **Inspection of books of account: Section 128(3)** (*3*) These books of account and other papers, in India shall be open for inspection at the RO or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as may be prescribed: Provided that the inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors. **Duty of officers to cooperate Inspection of books: Section 128(4)** (*4*) Where an inspection is made, the officers, other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give. **Preservation of books of account**: **Section 128(5)** (5) The company has to preserve the books of account for a period of not less than 8 financial years immediately preceding the year, if company has been in existence for more than 8 years. The period can be longer, if the company is subjected to an investigation under Chapter XIV and CG directs the company by its order. **Penalty for violation of Section 128 (*6*):** (6) If the MD, the WTD in-charge of finance, CFO or any other person of a company charged by the Board with duty of complying with provisions of this section, contravenes such provisions, such person shall be punishable ~~with imprisonment for a term which may extend to 1~~ **year** ~~or~~ with **fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5,00,000** ~~or with both~~.

Q 3. ***A newly formed Company wants to maintain its Books of Accounts on mixed system of Accounting Cash Basis for Receipts and Mercantile Basis for expenses.***

Ans.: As per section 128(*1*) of the Companies Act, 2013, every company shall prepare and keep **at its registered office** books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, and such books shall be kept **on accrual basis** and **according to the double entry system** of accounting.

Therefore, it shall be deemed that books of accounts have not been maintained properly:

a. When double entry system of Book keeping is not followed.

b. When Books are not maintained on accrual basis of accounting.

c. When the book of accounts does not enable a Company to prepare a true and financial statement.

Q 4. ***An allegation was leveled against PQR Ltd. that the funds of the Company are misused. Mr. Z, one of the Directors of the Company wants to inspect the books of account of the Company in order to ascertain whether the allegation was true. But since Mr. Z does not have the knowledge of accounting, he appoints Mr. A, his friend and a practicing Chartered Accountant to go through the books of account of the Company on his behalf.***

The Company seeks your advice as to whether Mr. A may be allowed to inspect the books of account of the Company on behalf of Mr. Z. You are required to give your advice to the Company on behalf of Mr. Z. You are required to give your advice to the Company keeping in view the provisions of the Companies Act, 1956.

What would be your advice if Mr. Z would have been a shareholder only and not a Director of the Company? (May 2007)

Answer:

Section 128(3) of the CA, 2013 provides that the books of account shall be open to inspection by any director during the business hours. The right of inspection is not so restricted that it can only be exercised personally by the director.

In ***Vakharia Vs Supreme General Film Exchange CO. Ltd*** it was held that a director is entitled to take inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilize the information obtained by him for any purpose other than the purpose of his principal.

In ***Sugrabai Alibhain v. Amtee Properties (P) Ltd. [1984]*** *55 Comp Cas. 734 (Bom.),* the Bombay HC observed that a director is entitled to ask for inspection of books **either personally or through an agent** subject to the condition that the agent must give an *undertaking to the Company that he shall not pass on any information to any person other than the director who had appointed him to carry out the inspection*.

As the right of inspection is a statutory right given under this sub-section, a director who is prevented from or refused inspection may enforce his right through court.

As such, Mr. Z being the director can appoint Mr. A to inspect the Books of accounts of the Company.

In case Mr. Z is the member of the Company

As per the provisions of the Act, the board shall from time to time determine whether and to what extent and at what times and places and under what conditions, the accounts and books, or any of them, shall be open to inspection of members not being directors.

No member (Not being a director) shall have any right to inspection any account or books or document of the Company except as conferred by law or authorized by the board or by the Company in general meeting.

In case Mr. Z is a member of the Company, he shall be able to inspect the books of account only if he is given such a right by ordinary resolution of the members or if authorized by the board. But even in such case Mr. Z would have to exercise the right personally and not through a proxy i.e. he can himself inspect the books but cannot ask Mr. A to inspect the books in his behalf.

Q 5. ***The BoDs of M/s Bharat Ltd. has a practical problem. The RO of the Company is situated in a classified backward area of Maharashtra. The Board wants to keep the account books of the Company at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the Company. Advice.***

(November, 2008)

Answer: Yes, the Company can maintain it accounting records at Mumbai.

Q 6. ***State with reasons (in short) whether the following statement is correct or incorrect: The Auditor of a Limited Company wanted to refer to the Minute Books during audit, but Board of Directors refused to show the Minute Books to the Auditors. (Nov 2015) (2 marks)***

Uniform Accounting Year

It may be noted that for the first-time new section 2(41) defines the term "Financial Year" to mean the period ending on 31st March of every year. Therefore, every company will now be required to maintain accounts from 1st April to 31st March which is the accounting year to be adopted for Income tax purpose. There is only one exception to this rule in the case of a holding company or subsidiary company incorporated outside India which is required to maintain its accounts for a financial year which is different from April to March. In such a case, different financial year can be adopted by getting approval of the National Company Law Tribunal (Tribunal).

Further, if any existing company is adopting different financial year it will have to fall in line with the new provision within a period of two years from the date on which the new Companies Act comes into force.

Financial Statement	
Section 129	(*1*) The financial statements **shall give a true and fair view** of the state of affairs of the company, **comply with the ASs notified u/s 133** and shall be in the form

	or forms as may be provided for different class or classes of companies in **Schedule III**. The term 'Financial Statement' is defined in the new section 2(40) to include balance sheet, profit and loss account/income and expenditure account, cash flow statement, statement of changes in equity and any explanatory note annexed to the above. Provided further that **nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company:** **By virtue of notification dated February 23, 2018, the Central Government has exempted the companies engaged in defence production to the extent of application of relevant Accounting Standard on segment reporting.** (*2*) **At every AGM, the Board of Directors of the company shall lay before such meeting financial statements for the financial year**. (*3*) Where a company has one or more subsidiaries, it shall, in addition to financial statements, **prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner** as that of its own **which shall also be laid before the AGM along with the laying of its financial statement** under sub-section (*2*). It may be noted that in the new schedule III the provisions for preparation of balance sheet and statement of profit and loss have been given which are on the same lines as in the old schedule VI. Further, in the new Schedule III detailed instructions have been given for preparation of consolidated financial statements as consolidation of accounts of subsidiary companies is now made mandatory in section 129. Provided that the company shall also attach along with its financial statement, a separate statement containing **the salient features of the financial statement of its subsidiary (s) in such form as may be prescribed**: **Provided further that the CG may provide for the consolidation of accounts of companies in such manner as may be prescribed.** *Explanation*. —For the purposes of this sub-section, the word "subsidiary" shall include associate company and joint venture. (*4*) The provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, *mutatis mutandis,* apply to the consolidated financial statements referred to in sub-section (*3*). **(*5*) Where the financial statements of a company do not comply with the ASs, the company shall disclose in its financial statements, the deviation from the ASs, the reasons for such deviation and the financial effects, if any, arising out of such deviation.** (*6*) The CG may, on its own or on an application by a class or classes of companies, by notification, **exempt companies from complying with any of the requirements of this section or the rules made thereunder**, in the public interest, unconditionally or subject to such conditions as may be specified.

	(7) If a company contravenes the provisions of this section, **the MD, the WTD in charge of finance, the CFO or any other person charged by the Board** with the duty of complying with the requirements of this section and **in the absence of any of the officers mentioned above, all the directors** shall be punishable with **imprisonment for a term which may extend to one year or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 Lakh, or with both**.

Section 129A:

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

(a) to prepare the financial results of the company on such periodical basis and in such form as may be prescribed

(b) to obtain approval of the Board of Directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and

3(c) file a copy with the Registrar within a period of thirty days of completion of the relevant period with such fees as may be prescribed.

Q 7. Can the BOD of a Company decide to prepare the balance sheet and profit and loss account for a financial year exceeding 12 months?

Ans.: The period for which profit and loss account is prepared shall be referred to as a financial year. As per section 129 of the CA, 2013, financial year will be from Ist April to 31st March. Thus, in the given case, the B/s & P&L a/c cannot be prepared for a period exceeding 12 months.

However, as per the Companies Act, 1956, the financial year may be less or more than a calendar year, but it shall not exceed 15 months. However, it may extend to 18 months with the special permission of the registrar (Sec. 210).

Q 8. A Company has established several plants at different places and ends the accounting year on 31st March. Recently it established another plant, which went into production on 1st July and wants to adopt a separate accounting year for that. How would you deal with the above situation?

Ans.: The period for which profit and loss account is prepared shall be referred to as a financial year. **As per section 129 of the Companies Act, 2013, financial year will be from Ist April to 31st March.** There is no scope to adopt different accounting years for the different segments of the Company. In the above case, the new plant, which went into production, is a part and parcel of the existing Company. Hence, a business segment/ plant cannot have a different accounting year other than the one adopted by the Company.

Financial statement, Board's report, etc.	
Section 134	**(1) The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is**

	authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon." (2) **The auditors' report shall be attached to every financial statement.** (3) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include— (a) **the web address, if any, where annual return referred to in subsection (3) of section 92 has been placed;** (b) number of meetings of the Board; (c) Directors' Responsibility Statement; (d) a statement on declaration given by independent directors u/s 149(6); (e) in case of a company covered u/s 178(1), company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided section 178(3); (f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made— (i) by the auditor in his report; and (ii) by the company secretary in practice in his secretarial audit report; (g) particulars of loans, guarantees or investments under section 186; (h) particulars of contracts or arrangements with related parties referred to in section 188(1) in the prescribed form; (i) the state of the company's affairs; (j) the amounts, if any, which it proposes to carry to any reserves; (k) the amount, if any, which it recommends should be paid by way of dividend; (l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report; (m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed; (n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company; (o) the details about the policy developed and implemented by the company on CSR initiatives taken during the year; (p) in case of a listed company and every other public company having such PUC as may be prescribed, a statement indicating the manner in which formal

	annual evaluation **of the performance of the Board, its Committees and of individual directors;** (q) such other matters as may be prescribed. **(3A) The Central Government may prescribe an abridged Board's report, for the purpose of compliance with this section by One Person Company or small company.".** (4) The report of the BoD to be attached to the financial statement under this section shall, in case of an OPC, **mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.** **(5) The Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that—** (a) in the preparation of the annual accounts**, the applicable ASs had been followed** along with proper explanation relating to material departures; (b) the directors had **selected such accounting policies and applied them consistently** and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period; (c) **the directors had taken proper and sufficient care for the maintenance of adequate accounting records** in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities; (d) the directors had **prepared the annual accounts on a going concern basis**; and (e) **the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.** Explanation. —For the purposes of this clause, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information; (f) the directors had **devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.** **Authentication of the Board Report** (6) **The Board's report and any annexures thereto under sub-section (3) shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, where there is one director.**

	(7) A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of— (a) any notes annexed to or forming part of such financial statement; (b) the auditor's report; and (c) the Board's report referred to in sub-section (3). (8) **If a company is in default in complying with the provisions of this section, the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.**

Penalty on officer on default:	Rs. 50,000/-
Penalty on the Company	Rs. 3,00,000/-

Q 9. ***Discuss the provisions of Section 134 of the Companies Act, 2013 regarding the authentication of Financial Statements.*** ***(May 2016, 6 M)***

Q 10. ***Explain the following in brief:***

Director's Responsibility Statement. ***(4 Marks) (Nov 2007)***

Q 11. ***What are the matters included in Director's Responsibility Statement? (M 16, 6 M)***

Deviation from Accounting Standards

According to Section 129 of the Companies Act, 1956, where the profit and loss and the balance sheet do not comply with the ASs, such companies shall disclose in its profit and loss and balance sheet, the following, namely:

(a) the **deviation**
from the accounting standards;
(b) the **reasons** for such deviation; and
(c) the **financial effect**, if any, arising due to such deviation.

Earlier the meaning of expression "Accounting Standards" was given u/s 211(3C) of the Companies Act, 1956 but this section has been repealed by MCA vide Circular No. 16/2013 dated 18th September, 2013 and a new section 133 of the Companies Act, 2013 came into force on 12th September, 2013 which provides the provisions for CG to prescribe ASs.

The MCA vide General Circular No. 15/2013 dated 13.09.2013 has clarified that till the Standards of Accounting or any addendum thereto are prescribed by CG in consultation and recommendation of the NFRA, the existing ASs notified under the Companies Act, 1956 shall continue to apply.

According to section 133 of the CA, 2013: "Accounting Standards" means the standards of accounting as recommended by the ICAI, as may be prescribed by the CG in consultation with and after examination of the recommendations made by the National Financial Reporting Authority constituted u/s 132 of the CA, 2013.

Section 129(1) of the CA, 2013 **mandates** that the financial statements be prepared in prescribed form **(New Schedule III)** and they shall give a true and fair view and comply with ASs. Any deviations from ASs must be disclosed with reasons for such deviation and impact on profit in the financial statements {Section 129(5)}.

Q 12. ***XYZ Ltd. while preparing the Balance Sheet and Statement of Profit and Loss for the financial year ended 31st March, 2010 did not comply with the Accounting Standards. State the consequences that follow in case of Non-compliance.***

(8 Marks) (Nov 2010)

Q 13. ***The Profit and Loss Account and Balance Sheet of Acre Limited has been signed by two directors A and B. The Board comprises of a third director C, who is also the Managing Director. The Company has also employed a Full Time Secretary. Examine whether the authentication of the financial statements is in accordance with law.***

(May 2000)

Answer: As per Section 134(1) of the Companies Act, 2013, the financial statement, including consolidated financial statement, if any, shall be approved by the Board before they are **signed on behalf of the Board**, at least by

- the Chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director and
- the Chief Executive Officer, if he is a director in the company,
- the Chief Financial Officer and the CS of the company, wherever they are appointed,

In the case of a One Person Company, only by one director, for submission to the auditor for his report thereon.

In the instant case, the profit and loss and balance sheet have been signed by A and B, the directors. Thus, as per Section 134(1) C, the MD should be one of the two signing directors. Since the Company has also employed a secretary, he should also sign in addition to the MD C, and one of the directors, either A or B.

Right of member to copies of audited financial statement – Section 136 &

Copy of financial statement to be filed with Registrar – Section 137

New section 136 provides for right of members to get copies of audited financial statements, auditors' report, Board Report etc. at least 21 days before the date of AGM. In the case of a listed company, it will be sufficient if a statement containing the salient features of such documents in the prescribed form is sent to the members at least 21 days before the AGM. Further, new section 137 provides for filing of the financial statement etc. with ROC.

(2) Where the AGM of a company for any year has not been held, the financial statements duly signed along with the statement of facts and reasons for not holding the AGM shall be filed with the Registrar within 30 days of the last date before which the AGM should have been held.

(3) If a company fails to file the copy of the financial statements under sub-section (1) or sub-section (2), the company shall be liable to a penalty of Rs. 10,000 and in case of continuing failure, with a further penalty of Rs. 100 for each day during which such failure continues, subject to a maximum of Rs. 2,00,000, and the MD and the Chief Financial Officer of the company, if any, and, in the absence of the MD and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be shall be liable to a penalty of Rs. 10,000/- and in case of continuing failure, with a further penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 50,000.

These provisions are similar to existing sections 219 and 220.

Sections 132, 133 and 143(10) provide for issue of Accounting and Auditing Standards

Constitution of National Financial Reporting Authority

Section 132 provides for constitution of NFRA, its functions and powers:

(i) The CG will constitute NFRA consisting of a Chairperson, who shall be a person of eminence and having expertise in accounting, auditing, finance or law and such other full-time or part-time members, not exceeding 15, as may be prescribed.

(ii) Terms and conditions and the manner of appointment of chairperson and members of NFRA and other related matters shall also be prescribed.

Central Government to prescribe Accounting Standards

Section 133 provides that the CG will prescribe the Standards of Accounting as recommended by the ICAI in consultation with and after examination of recommendations made by NFRA. These will be binding on the companies as well as their auditors.

Central Government to prescribe Standards of Auditing

Section 143(10) provides that the CG will prescribe standards of Auditing in a similar manner. It is also provided that until such auditing standards are notified by the Government, the existing Auditing Standards issued by ICAI will be binding on the auditors.

The functions of NFRA:

Section 132 provides for functions of NFRA as under: -

(a) to recommend to the CG about formation of Accounting Standards and Auditing Standards for adoption by Companies and their auditors.

(b) to monitor and enforce the compliance with the accounting and auditing standards in such manner as is prescribed in the Rules.

(c) to oversee the quality of service of the profession associated with ensuring compliance with such standards.

(d) to suggest measures required for improvement in the quality of service by the professionals (i.e., CA/ CS/ CMA) and such other related matters as may be prescribed.

(e) to perform such other functions relating to the above matters as may be prescribed by the Rules.

The powers which NFRA can exercise are as under:

(a) Power to investigate, either on its own or on a reference made by the CG, in cases of such bodies corporate or persons, as may be prescribed, into the matters of performance or other misconduct committed by a CA or a Firm of CAs. Once NFRA initiates this investigation, ICAI will have no authority to initiate or continue any proceedings in such matters.

(b) NFRA shall have the same powers as vested in a Civil Court under Code of Civil Procedure, 1908. In other words, it can issue summons, enforce attendance, inspect books and other records, examine witness etc.

(c) If any **professional or other misconduct** is proved, NFRA can impose penalty as under.

• In the case of an Individual CA minimum penalty of Rs. 1 lakh which may extend to 5 times of the fees received by the Individual.

• In the case of a CA Firm, minimum penalty of Rs. 10 lakh which may extend to 10 times the fees received by the Firm.

• NFRA can debar any CA or a CA Firm from practice for a minimum period of six months or for such higher period not exceeding 10 years.

Any person/firm aggrieved by any order of NFRA can file appeal before the Appellate Authority. The CG has been empowered to appoint such Appellate Authority consisting of the chairperson and not more than two other members. The qualifications of those constituting the AA and all other related matters will be prescribed by the Rules.

The above provisions in section 132 will override any provisions contained in any other statute. This will mean that the council of ICAI will not be able to exercise its powers relating to disciplinary action against auditors of companies. Even powers to formulate auditing standards, ensure quality of audit etc. are now vested in NFRA.

Notification of Section 130 & 131

The MCA vide Notification dated 1st June 2016 notified sections 130 and 131 of the Companies Act, 2013 with effect from the date of publication of the notification.

Section 130: Re-opening of Accounts on Court's or Tribunal's Orders

(1**) Apply to court for re-opening of accounts-** A company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by-

(a) the Central Government,

(b) the Income-tax authorities,

(c) the Securities and Exchange Board,

(d) any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements:

Provided that the court or the Tribunal, as the case may be, shall give notice to the CG, the Income-tax authorities, the SEBI or any other statutory regulatory body or authority concerned and shall take into consideration the representations, if any, made by that Government or the authorities, SEBI or the body or authority concerned before passing any order under this section.

(2) **Revised accounts shall be final:** Without prejudice to the provisions contained in this Act the accounts so revised or re-cast under sub-section (1) shall be final.

(3) No order shall be made under sub-section (1) in respect of reopening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year:

Provided that where a direction has been issued by the Central Government under the proviso to sub-section (5) of section 128 for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re -opened within such longer period."

Section 131: Voluntary Revision of Financial Statements or Board's Report

(1) Preparation of revised financial statement or revised report: If it appears to the directors of a company that—

(a) the financial statement of the company; or

(b) the report of the Board,

do not comply with the provisions of section 129 or section 134, they may prepare revised financial statement or a revised report in respect of any of the 3 preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar:

Tribunal to serve the notice: Provided that the Tribunal shall give notice to the CG and the Income tax authorities and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section:

Provided further that such revised financial statement or report shall not be prepared or filed more than once in a financial year:

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

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

(a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and

(b) the making of any necessary consequential alternation.

(3) **Framing of rules by the CG in relation to revised FS & BR:** The CG may make rules as to the application of the provisions of this Act in relation to revised FS or a revised BR such rules may, in particular—

(a) make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the corrections to be made;

(b) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or report;

(c) require the directors to take such steps as may be prescribed.

Q 14. The directors of Element Ltd. want to voluntary revise the financial statements of the company. They have approached you to state to them the provisions of the Companies Act, 2013 regarding voluntary revision of financial statements.

Answer: Preparation of revised financial statement or revised report on the approval of Tribunal: If it appears to the directors of a company that—

(a) the financial statement of the company; or

(b) the report of the Board,

do not comply with the provisions of section 129 or section 134, they may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar:

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

Number of times of revision and recast: Provided further that such revised financial statement or report shall not be prepared or filed more than once in a financial year:

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

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

(a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and

(b) the making of any necessary consequential alternation.

(3) Framing of rules by the CG in relation to revised financial statement or director's report: The Central Government may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, in particular—

(a) make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the corrections to be made;

(b) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or report;

(c) require the directors to take such steps as may be prescribed.

CORPORATE SOCIAL RESPONSIBILITY

Corporate Social Responsibility (CSR) has gained tremendous momentum in today's economic and social environment. The traditional approach of corporates that 'the business of business is to do business' has changed and now business goals are inseparable from the societies and environment within which business operate. Whilst short-term economic gain can be pursued through traditional approach, the failure to align the business goals with social and environmental factors will make those businesses unsustainable in the long term. CSR, which has earlier been a voluntary contribution, by corporates has now been made mandatory.

CSR can be understood as **a management concept and a process that integrates social and environmental concerns in business operations and a Company's interactions with the full range of its stakeholders.** These days, Companies are encouraged to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

Following are some of the approaches for defining CSR:

- CSR is a responsibility, **beyond that required by the law, for a business to pursue long term goals that are good for society.**
- CSR is a means by which a Company manages its business **to produce an overall positive impact on society.**
- CSR is coming out of the purview of **'doing social good'** and is fast becoming a 'business necessity'.

METHODS OF CSR

CSR activities can be conducted through the following methods:

Charity and Donation	Contract	Own initiatives
Companies donate funds to charitable institutions e.g. donation to UNICEF, Red Cross, etc.	Companies hire agencies / Non-governmental Organizations which in turn carry out the activities/ projects for the Companies and the Companies bear the cost.	Companies create a separate administrative machinery and staff of its own to perform the CSR activities e.g. large Companies like Tata, Microsoft, IBM, GMR, Cairn India, Polaris Software etc have separate administrative department to deal with CSR activities.

CSR under the Companies Act, 2013

Section 135 **(under Chapter IX – Accounts of Companies)** of the Companies Act, 2013 deals with CSR, while Schedule VII of the new Act lists out the CSR activities which may be undertaken by the Companies.

Applicability **[Sec.I35(I)]**	Every Company having - 1. **Net Worth** ≥ Rs.500 Crores, or 2. **Turnover** ≥ Rs. 1,000 Crores, or 3. **Net Profit** ≥ Rs.5 Crores during any of three preceding financial years. CSR applies to every Company including its Holding or Subsidiary, and a Foreign Company as per Sec. 2(42] having its Branch Office or Project Office in India, which fulfils the above criteria.
CSR Committee	1. Such Company shall constitute a Corporate Social Responsibility (CSR] Committee of the Board consisting of 3 or more Directors, out of which atleast one Director shall be an Independent Director. 2. But if Company is not required to appoint Independent Director, it shall have in its CSR committee minimum 2 or more directors.
Duties of CSR Committee [Section 135(3)]	The CSR Committee shall — 1, formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the Company as specified in Schedule VII, 2. recommend the amount of expenditure to be incurred on the activities referred above. 3. Monitor the Corporate Social Responsibility Policy of the company from time to time.

Q 1. **A Ltd. Is having turnover of more than Rs. 1000 crores or more but has incurred loss in any of the preceding three financial years then whether such company is required to comply with the provisions of section 135 of the Companies Act, 2013?**

Answer: As per the provisions of section 135 of the Act, one of the three criteria has to be satisfied to attract Section 135. Therefore, if a company satisfies the criterion of turnover although it does not satisfy the criterion of net profit, it will have to comply with the provisions of Section 135 and the Companies (CSR Policy) Rules, 2014.

Role of Board of Directors

Section 135(4) of the new Act, specifies the role of the Board with respect to CSR as under:-

- review the recommendations made by the CSR Committee;
- approve the CSR Policy for the Company;
- disclose contents of the Policy in the Company's report/ website; and
- ensure that the Company spends in every financial year, at least two percent of the average net profits made during the three immediately preceding financial years of the Company in CSR activities in pursuance of the CSR Policy of the Company.

(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year**, at least two per cent of the average net profits of the company made during the three immediately preceding financial years** or where the

company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years], in pursuance of its CSR Policy:

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount and, unless the unspent amount relates to any ongoing project referred to in sub-section (6), transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year].

[Explanation.—For the purposes of this section "net profit" shall be calculated in accordance with the provisions of section 198.]

Provided also that if the company spends an amount in excess of the requirements provided under this sub-section, such company may set off such excess amount against the requirement to spend under this sub-section for such number of succeeding financial years and in such manner, as may be prescribed;

(6) Any amount remaining unspent under sub-section (5), pursuant to any ongoing project, fulfilling such conditions as may be prescribed, undertaken by a company in pursuance of its CSR Policy, shall be transferred by the company within a period of 30 days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the **Unspent CSR Account**, and such amount shall be spent by the company in pursuance of its obligation towards the CSR Policy **within a period of three financial years from the date of such transfer**, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

(7) If a company contravenes the provisions of sub-section (5) or sub-section (6), the company shall be punishable with fine which shall not be less than Rs. 50,000/- but which may extend to Rs. 25,00,000 and every officer of such company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5,00,000, or with both.

(8) The CG may give such general or special directions to a company or class of companies as it considers necessary to ensure compliance of provisions of this section and such company or class of companies shall comply with such directions.

(9) Where the amount to be spent by a company under sub-section (5) does not exceed fifty lakh rupees, the requirement under sub-section (1) for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee provided under this section shall, in such cases, be discharged by the Board of Directors of such company.

Activities Specified in Schedule VII	**1.** Eradicating hunger. Poverty and Malnutrition, promoting Health Care including Preventive Health Care and Sanitation and making available safe Drinking Water, Slum Area Development, **[Note:** Contribution to **Swach Bharat Kosh** and **Clean Ganga Fund** are also included in CSR.] **2.** Promoting Education, including Special Education and Employment enhancing Vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects, **3.** Promoting Gender Equality, Empowering Women, setting up homes and hostels for women and orphans, setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups, **4.** Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of Natural Resources and maintaining quality of soil, air and water, 5. Protection of National Heritage, art and Culture including restoration of buildings and sites of Historical Importance and works of art, setting up Public libraries, development of traditional arts and handicrafts, **6.** Measures for the benefit of Armed Forces Veterans, War Widows and their dependents, **7.** Training to Promote Rural Sports, nationally recognised sports, paralympic sports and Olympic sports, **8.** Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio—economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women, **9.** Contributions or Funds provided to Technology Incubators located within Academic Institutions which are approved by the Central Government, **10.** Rural Development Projects. **11.** Slum area development **12.** Disaster management, including relief, rehabilitation and reconstruction activities

CSR Activities / Expenditure - Exclusions	**1.** Activities undertaken in pursuance of normal course of business of the Company. **2.** Activities undertaken outside India, **3.** Activities that benefit only Employees of Company and their families. **4.** Contribution of any amount, directly or indirectly, to any Political Party, u/s 182. **5.** Expenditure on an item not in conformity or not in line with activities specified in Schedule VII.
Manner of CSR Activities	Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least 3 Fin. Years.
CSR Spending	**1.** The Board of every such Company shall ensure that the Company spends, in every financial year, atleast 2% of the Average Net Profits of the Company made during the three immediately preceding financial years, in pursuance of its CSR Policy. Average net profit shall be calculated in accordance with the provisions of section 198 of the 2013 Act **2.** The Company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.
Amount Unspent	**2.** In case the unspent amount does not relate to any ongoing project, unspent amounts to be transferred to a Fund specified under Schedule VII within a period of six months of the expiry of the financial year. **3.** In case the unspent amount relates to any ongoing project subject to fulfilling of prescribed conditions, unspent amounts to be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the Unspent Corporate Social Responsibility Account. **4.** Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.
Exclusions of Companies	Every Company which ceases to be a Company covered u/s 135(1) for 3 consecutive financial years shall **not** be required to — (a) constitute a CSR Committee, and (b) comply with Sec. 135, till such time it meets the criteria specified in Sec. 135(1).

Penalty Provisions	**1.** The company - punishable with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 25 lakhs **2.** Every officer of such company who is in default - shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 lakhs, or with both.

Indian branches and project offices of foreign companies covered under CSR provisions: Indian branches and project offices of foreign companies are covered under CSR provisions. This will also require such foreign companies to set up a CSR committee, CSR policy etc. to comply with these requirements.

CSR Reporting:

The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR. In case of a Foreign company, the Balance sheet filed under sub-clause (b) of sub-section (I) of section 38 shall contain an annexure regarding report on CSR.

If the Company has been unable to spend the minimum required on its CSR initiatives, the reasons for not doing so are to be specified in the Board Report. Where a Company has a website, the CSR policy of the Company would need to be disclosed on such website.

Surplus from CSR activities not business profits of company:

The CSR policy shall specify that the surplus arising from CSR activities are not to be considered as business profits of the company. Such surplus may therefore need to be ploughed back into CSR activities. CSR policy and activities to be displayed on website Companies will be required to display **the CSR policy** and **projects undertaken** and **amount spent in the Board Report** and on the Company's website.

Three years of non-applicability required to exit CSR compliance requirements: Once covered under CSR provisions, companies will need to have 3 consecutive years, where the provisions do not apply to them, before they can stop complying with the requirements relating to CSR.

Q 2. There are certain corporate groups who run hospitals and educational institutions, will this be considered as CSR?

Ans. MCA has clarified vide Circular No. 21/2014 – that expenses incurred by companies for the fulfillment of any Act or Statue of regulations (such as Labour Laws, Land Acquisitions Act etc.) would not count as CSR expenditure under the Companies Act, 2013.

If the hospitals and educational institutions are part of the business activity of the company they would not be considered as CSR activity. However, if some charity is done by these hospitals or educational institutions, without any statutory obligation to do so, then it can be considered as CSR activity.

CHAPTER X: AUDIT AND AUDITORS

Chapter X – Audit & Auditors ranging from Sections 139 to 148 of the Companies Act, 2013 along with Companies (Audit and Auditors) Rules, 2014 have been notified and they came into force on the 1st day of April, 2014.

Audit of accounts is compulsory for all types of companies

All the companies registered under the Companies Act, whether public or private, having share capital or not are required to maintain proper books of accounts and also to get their Books of accounts audited as required u/s **139 of the Companies Act, 2013.**

PRESONS QUALIFIED TO BE APPOINTED AS AUDITORS OF COMPANY

As per Section 141 of the Companies Act, 2013, (section notified on 26.03.2014)

(1) A person shall be eligible for appointment as an auditor of a company only if he is a CA:

Provided that a firm ***whereof majority of partners*** *practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.*

(2) Where a firm including an LLP is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

Eligibility:

a) Individual: Only if is a CA holding certificate of Practice as per Section 2(17) of the Companies Act, 2013.

b) Audit Firm/LLP: Majority of partners who are CA are practicing in India, appointed in Firm name. Only the partners who are CAs are authorised to act as auditors and sign.

Disqualifications u/s 141(3) of the Companies Act, 2013

The following persons shall not be eligible for appointment as auditors of a company or shall vacate the office after appointment:—

Disqualifications similar to old act:

(a) a body corporate ***other than a LLP***

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

Disqualifications amended and its limits:

(**d)** a person who, or ***his relative or partner—***

(i) is **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:

Provided that the relative may hold security or interest in the company of face value not exceeding 1000 rupees or such sum as may be prescribed; **(Prescribed sum is Rs. 1 lakh)**

(ii) is **indebted to the company**, or its **subsidiary,** or its holding or **associate** company or a subsidiary of such holding company, in excess of such amount as may be prescribed; **(Prescribed sum is Rs. 5 lakh)**

(iii) has given a **guarantee or provided any security i**n connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;**(Prescribed sum is Rs. 1 lakh)**

NEWLY ADDED disqualifications provided in the ACT:

(e) a person or a firm who, whether ***directly or indirectly, has business relationship*** with the **company**, or its **subsidiary**, or **its holding or associate company** or subsidiary of such holding company or associate company of such nature as may be prescribed;

The **rules define** the "**business relationship**" as any transaction entered into for a commercial purpose**, *except –***

(i) Commercial transactions which are in the nature of professional services **permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants** Act, 1949 and the rules or the regulations made under those Acts;

(ii) Commercial transactions **which *are in the ordinary course of business of the company at arm's length price – like sale of products or services to the auditor*,** as customer, in the ordinary course of business, by companies ***engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.***

(f) a person whose ***relative is a director*** or is in the ***employment of the company*** as a ***director or key managerial personnel***;

(g) a **person** who is **in full time employment** elsewhere

or

a person or a **partner** of a firm holding **appointment** as its **auditor**, if **such persons** or **partner** is at the **date of such appointment** or reappointment holding appointment as auditor of ***more than 20 companies;***

While calculating the limits of 20 companies the following Companies shall be excluded

- OPC defined under section 2(62)
- Dormant companies under section 455
- Small companies under section 2(85) and
- Private companies having paid-up share capital less than Rs. 100 Cr

Additional requirement for claiming exemption under section 141(3)(g) for counting ceiling limit is available only if such company has not committed default in filing its financial statements under section 137 and annual returns under section 92 of the Act to the registrar as per notification dated 13 June 2017.

(h) 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;

(i) **any person** whose **subsidiary** or **associate** company or any **other form of entity**, is **engaged as on the date of appointment** in consulting and ***specialised services*** as provided ***in section 144.***

Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company shall not be eligible for appointment as an auditor of a company.

AUDITOR NOT TO RENDER CERTAIN SERVICES - PROHIBITED SERVICES (Section 144 of the Companies Act, 2013, Section notified on 26.03.2014)

In Old Act, there was no provision as to rendering of non-audit services to an audit client. It was determined by applying the Code of Ethics and the Guidance Note on Independence of Auditors issued by the ICAI. But the New Act contains specific provisions that prohibit auditors of a company to render non-audit services to an audit client directly or indirectly or its holding company or subsidiary company.

Auditor not to render following services to company, holding company or subsidiary company, directly or indirectly:

(a) accounting and book keeping services;

(b) internal audit;

(c) design and implementation of any financial information system;

(d) actuarial services;

(e) investment advisory services;

(f) investment banking services;

(g) rendering of outsourced financial services;

(h) management services; and

(i) any other kind of services as may be prescribed

Here, the Act has provided a transition period 1 year meaning an auditor who has already been performing any non-audit services shall comply with this section till 31.03.2015.

Directly or Indirectly Defined:

Auditor – Individual: His Relative, any other person connected/associated with such individual, entity in which such individual has significant influence or control or whose name/trademark/brand is used by such individual.

Auditor – Audit Firm: All partners, parent/subsidiary/Associate Entity or entity in which firm/partner has significant influence or whose name/trademark/brand is used by such firm/partners.

As per section 141(4) of the Companies Act, 2013 (section notified on 26.03.2014)

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (*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.

Further, a person is not eligible for appointment as auditor of any Company, if he is disqualified from acting as auditor of that Company's subsidiary or holding Company or of any other subsidiary of the same holding Company.

e.g. H Ltd. (Holding of X ltd.)
X Ltd. (Mr. A is disqualified)
Y Ltd. (subsidiary of X Ltd)

In such a case Mr. A cannot be appointed as auditor of any of these companies.

Q 15. State whether the following statement is correct or incorrect

Directors' relative can act as an auditor of the Company.

(May 2015, 2 marks)

Answer: Quote the above provisions of section 141(3)(f). *In view of that* Directors relative cannot act as an auditor of the Company.

Q 16. Examine the validity of the following with reference to the provisions:

Mr. Prakash, a CA in full time practice was appointed as the auditor of ABC Ltd., which is a subsidiary of DGH Ltd. and DGH Ltd. has another subsidiary called PKM Ltd. Mr. Prakash had taken a loan of Rs. 25,000 from PKM Ltd. and the loan is outstanding as on the date of his appointment as auditor of ABC Ltd.

(5 Marks) (June 2009)

Answer

As per Section 143(1)(**d) 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 such holding company, in excess of such amount as may be prescribed; **(Prescribed sum is Rs. 5 lakh)**

As per section 141(4), where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (*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.

In view of the above provisions of law, since ABC Ltd is a subsidiary of DGH Ltd; which is the holding Company of PKM Ltd. to whom Mr. Prakash is not indebted for a sum exceeding Rs. 5,00,000/- his appointment as the auditor of ABC Ltd. is in order.

Q 17. Examine, whether the above statement is correct or not:

AB & Co. is an Audit Firm having Partners Mr. A and Mr. B Mr. C, the relative of Mr. B is holding Securities having face value of Rs. 2,00,000 in XYZ Ltd. AB & Co. is qualified for being appointed as an Auditor of XYZ Ltd.

(November 2015) (2 Marks)

Answer: Incorrect, because Firm is disqualified u/s 141(3)(d).

Q 18. Examine the validity of the following appointment:

Yashodharman Granites Limited reappointed Suresh & Company, a firm of Chartered Accountants, as auditors of the Company at the Annual General Meeting held on 30th September, 2011. The wife of one of the partners of Suresh & Company acquired large number of equity shares in Yashodharman Granites Limited on 5th October, 2011. But Suresh & Company continue to function as statutory auditors of the Company. (4 Marks) (Nov. 2012)

Answer

According to Section 141(1), *a firm, whereof majority of partners, practising in India are qualified for appointment as Auditors may be appointed by its firm name to be auditor of a company.*

According to section 141(3)(d) of the CA, 2013, a person who, or his relative or partner is 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;

Provided that the relative may hold security or interest in the company of face value **not exceeding Rs. 1,000** or such sum as may be prescribed; **(Rs. 1 lakh).**

As per section 141(4), where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (*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.

Hence, according to the provisions of Companies Act, Suresh & Company cannot continue to function as statutory auditors of the Company after 5th October 2011 i.e., after investment made by wife of a partner in the equity shares of YGL.

Q 19. Mrs. Sita, wife of CA. 'Arjun' the statutory auditor of Stellar Builders Limited, acquired shares in the company for a face value of Rs. 75000/- on 15th March, 2018. CA. 'Arjun', issued his audit report on 25th April, 2018. Examine the validity of this transaction under the Companies Act, 2013. Would your answer be different if face value of the shares have been Rs 150000/- (market value Rs. 95000/-)

Answer: As per Section 141(3)(d)(i) of the Companies Act, 2013, a person who, or his relative or partner is 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, shall not be appointed as an auditor of the company.

However, Rule 10 of the Companies (Audit and Auditors) Rules, 2014, states that a relative of

an auditor may hold securities in the company of face value not exceeding rupees one lakh.

In the given case Mrs. Sita, wife of CA. Arjun acquired shares in Stellar Builders Limited, in which he was a statutory auditor on 15th March, 2018. Since, the securities held by Mrs. Sita is within the prescribed limit of Rs. 1 lakh, such a transaction is valid.

Yes, the answer will be different in case where the face value of acquired shares is Rs.1,50,000. Then in that case:

(i) Corrective action to maintain the limit specified (i.e., 1 lac) shall be taken by the auditor within 60 days of such acquisition, or

(ii) Auditor has to vacate his office.

SECTION 139 – Appointment of auditors:

Compliance before appointment by company/auditor:

Before the appointment, a company **shall obtain from the auditor**–

Written consent of the auditor to such appointment

And Certificate that

(a) auditor is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

(b) the proposed appointment is as per the terms provided under the Act;

(c) the proposed appointment is within the limits laid down by or under the authority of the Act;

(d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Compliance after Appointment by Company:

A Company shall inform the auditor of his appointment & is to file a notice of appointment with ROC within 15 days of the meeting in which auditor is appointed. **(Form No. ADT 1)**

Note: *Earlier auditor used to file Form 23B and inform ROC, now the company is to inform ROC*, so in a way they shifted the burden to inform on Company.

Mandatory Rotation of Auditors in case of Listed Companies & Certain classes of Companies:

All Listed companies and Companies prescribed by CG **shall not** appoint or re-appoint–

- an individual – for more than **one term** of **5** consecutive **years**
- an audit firm – for more than **two terms** of **5** consecutive **years**

Classes of Company prescribed by CG under the Rules:

(a) all ***unlisted public companies*** having paid up **capital** of rupees ***ten crore* or more**;

(b) all ***private limited companies*** having paid up **capital** of rupees ~~20~~ ***50 crore*** or more;

(c) **all companies** having paid up share capital of below threshold limit mentioned in (a) & (b) above, but having ***public borrowings*** from **financial institutions, banks or public deposits** of **rupees *fifty crores or more***.

Amended by Enforcement of the Companies (Audit and Auditors) Second Amendment Rules, 2017 Vide Notification G.S.R. 621(E) dated 22nd June 2017 in exercise of powers conferred by section 139.

Cooling Period:

An individual or audit firm as the case may be who/which has completed the abovementioned terms shall **not be eligible** for re-appointment as auditor in the same company **for 5 years from the completion** of such term

Transition Period:

Every company required to comply as above, existing on or before the commencement of this Act, shall comply with the above requirements **within 3 years from 01.04.2014.**

Provisions in Rules regarding rotation:

- The period for which the individual/firm has held office as auditor prior to the commencement of the Act ***shall be taken into account for calculating the period of 5 or 10 years, as the case may be.***
- The incoming auditor/audit **firm shall not be eligible** if such auditor/audit firm is associated with the outgoing auditor/audit firm under the **same network** of **audit firms.**

Here, "same network" includes the **firms** operating or functioning**, hitherto or in future, under the same brand name, trade name or common control.**

Illustration explaining rotation in case of audit firm:

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	**Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)**	**Aggregate period which the firm would complete in the same company in view of column I and II**
I	II	III
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years

Section 139: Appointment of auditors (section notified on 26.03.2014)

	Appointment of Auditor
S 139(1)	Subject to the provisions of this Chapter, every company shall, at the first AGM, **appoint an individual or a firm as an auditor** who shall hold office **from the conclusion of that meeting till the conclusion of its sixth AGM** and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed; **Provided that the company shall place the matter relating to such appointment for ratification by members at every AGM**; Provided further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor; Provided also that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141: Provided also that the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the RoC within **fifteen** days of the meeting in which the auditor is appointed. Here for the purposes of this Chapter, "appointment" includes reappointment.
139(2)	No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint— (a) an individual as auditor for more than one term of five consecutive years; and (b) an audit firm as auditor for more than two terms of five consecutive years: Provided that— (i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term; (ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term: Provided further that 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: Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section **within three years from the date of commencement of this Act:** Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.
139(3)	Subject to the provisions of this Act, members of a company may resolve to provide that— (a) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or (b) the audit shall be conducted by more than one auditor.

139(4)	The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors in pursuance of sub-section (2).
	Appointment of Auditors of a Government Company
S 139(5)	Notwithstanding anything contained in sub-section (1), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, **the CAG shall, in respect of a financial year, appoint an auditor** duly qualified to be appointed as an auditor of companies under this Act, **within a period of 180 days from the commencement of the financial year**, who shall hold office till the conclusion of the AGM.
	Appointment of First Auditors
S 139(6)	Notwithstanding anything contained in sub-section (1), **the first auditor of a company**, other than a Govt Company, **shall be appointed by the BoDs within 30 days from the date of incorporation a**nd in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within 90 days at an EGM appoint such auditor and such auditor shall hold office till the conclusion of the first AGM.
	Appointment of First auditors in case of a Government company
S 139(7)	Notwithstanding anything contained in sub-section (1) or sub-section (5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the CG, or by any SG, or Governments, or partly by the CG and partly by one or more State Governments, **the first auditor shall be appointed by the CAG of India within 60 days from the date of incorporation** and in case the CAG does not appoint such auditor within the said period, the Board (BoDs) shall appoint such auditor within the next 30 days; and in the case of failure of BoDs to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within the 60 days at an EGM, who shall hold office till the conclusion of the first AGM.
	Casual Vacancy
S 139(8)	Any casual vacancy in the office of an auditor shall— (i) in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the CAG, be filled by the BoDs within **thirty days**, but if such casual vacancy is as a result of the **resignation** of an auditor, such appointment shall also be approved by the company **at a general meeting convened within 3 months** of the recommendation of the Board and he shall hold the office till the conclusion of the next AGM; (ii) in the case of a company whose accounts are subject to audit by an auditor appointed by the CAG, **be filled by the CAG within 30 days**: Provided that in case the CAG does not fill the vacancy within the said period, the BoDs shall fill the vacancy within next 30 days.
	Re-appointment of Retiring Auditor

S 139(9)	Subject to the provisions of sub-section (1) and the rules made thereunder, a retiring auditor may be re-appointed at an annual general meeting, if— (a) he is not disqualified for re-appointment; (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
S 139(10)	Where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
	Recommendations of Audit Committee
S 139(11)	Where a company is required to constitute an Audit Committee u/s 177, all appointments, including the filling of a casual vacancy of an auditor shall be made after taking into account the recommendations of such committee.

Q 20. ***State whether the following statement is correct or incorrect.***

Managing Director of A Ltd himself appointed the First Auditor of the Company.

(November 2015, 2 marks)

Answer: Incorrect, it should be appointed by Board of Directors.

Q 21. ***The First Auditors of a Government Company was appointed by the Board of Directors.***

(May 2016, 2 marks)

Answer: First Auditors of Govt. Co. should be appointed by C&AG, within 60 days from the date of registration of the Company. In case the CAG does not do so, BOD can appoint, within next 30 days.

Q 22. ***One of the members of ADB Ltd. has proposed the name of Mr. Fame for appointment as a Director of the Company in the AGM and given a notice under the CA, 2013. Mr. Fame is one of the partners of the Fame & Fame, Chartered Accountants, who are the retiring auditors of the company. But the audit of the company is being looked after by another partner of the firm. Examine whether Fame & Fame can be reappointed as auditors, if Mr. Fame is appointed as Director.***

(May 2006)

Answer: As per Section 2(30), a director is an officer of the company. Accordingly, Mr. Fame is appointed as a director of the company 'Fame and Fame' cannot be reappointed as company's auditors. The audit firm becomes disqualified u/s 143(3) even if any of its partners is also an officer of the company. It is immaterial that the audit of the company is being looked after by another partner of the firm and not by Mr. Fame. Therefore, if Mr. Fame is appointed as a director of the company, 'Fame and Fame' cannot be reappointed as company's auditors.

Q 23. ***State whether the following statement is correct or incorrect.***

Manner of rotation of Auditor will not be applicable to Company A, which is having Paid Up Share Capital of Rs. 15 Crores and having Public Borrowing from Nationalized Bank of Rs. 50 Crores because it is a Private Limited Company.

(Nov. 2015, 2 marks)

Answer: Incorrect, because as per the rule made u/s 139(2) of the Companies Act, 2013, the Company has public borrowings from Nationalised bank of Rs. 50 crore.

Appointment of Auditor of a Government Company

As per Section 2(*45*) "Government company" means any company in which not less than fifty one *percent* of the paid-up share capital is held by the CG, or by any State Government or Governments, or partly by the CG and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company;

Ans.: The appointment is to be made by the C & AG and not by the Central Government.

Q 24. The first auditors of Haryana Power Generation Corporation Limited (HPGCL), a Government Company, were appointed by the BOD. Comment.

Ans.: In case of a Government Company, the appointment of auditors is governed by the provisions of Section 139(7). Hence in the case of HPGCL, being a government Company, the first auditors shall be appointed by the CAG of India. Thus, the appointment of first auditors made by the BODs of HPGCL is **null and void.**

Q 25. Mewar Instrumentations Limited is a subsidiary of a Government Company. The CAG appointed Sobman & Company, Chartered Accountants to conduct a supplementary audit of Mewar Instrumentations Limited. Discuss, under the provisions of the Companies Act, whether the CAG's power to authorise such audit for the said subsidiary Company is in order? (5 Marks) (May 2010)

Answer: In accordance with the provisions of the Companies Act, 2013, as contained in section 2(45), the term 'Government Company' includes a Company which is a subsidiary of a Government Company. In view of the above provision, Mewar Instrumentations Limited comes within the purview of Government Company because it is a subsidiary of a Government Company.
Therefore, the power of the CAG to authorise Sobman & Company, Chartered Accountants to conduct supplementary audit of Mewar Instrumentations Limited is perfectly within the provisions as contained in section 143(5).

Q 26. Supplementary audit u/s 143(6) of the Companies Act, 2013. (4 Marks) (Nov. 2012)

Answer: Section 143(6) delegates the power to C&AG to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf. The person to be so authorized may well be the auditors appointed under sub-section (2) of that section.

Further C&AG may also direct by general or special order for any required information or additional information on such matter in such form by such person or persons, to be furnished to any authorised person or persons.

The Supplementary audit u/s 143(6) requires the auditor to give additional reports on those areas specified by the C & AG and the same has to be submitted within a time frame after submission of the statutory audit report to the company.

REMUNERATION OF AUDITORS (Section 142)

As per Section 142(1) of the Companies Act, 2013, (section notified on 26.03.2014), the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein, **provided that the Board may fix remuneration of the first auditor appointed by it.**

Section 142(*2*): The remuneration shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

As per **the old Act**, ***any sums paid by the company in respect of the auditors' expenses*** shall be deemed to be included in the expression "remuneration". But as per **the new act**, the remuneration in addition to the ***fee payable to an auditor***, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him ***but does not include any remuneration paid to him for any other service rendered by him at the request of the company.***

This means, the **Board** is free to decide the remuneration for other services provided by auditor provided they don't come within Section 144.

Section 140: Removal, Resignation of auditor and giving of special notice

- The auditor appointed u/s 139 may be **removed from his office before the expiry of his term** only by way **previous approval of CG** and a **special resolution** of the company to be passed in a general meeting **within 60 days of receipt of approval of CG.** However, before such step, the auditor shall be given a reasonable opportunity of being heard. The **application to CG** has to be made **within 30 days** of **passing the board resolution**. **(Form No. ADT- 2 along with fees).**

Here, a long-term relationship is built for 5 years, since removal before 5 years would be considered as removal before the expiry of his term. And for removal before the expiry of an auditor's term requires strict formalities to be followed.

- **Compliance by auditor after resignation:** The **auditor who has resigned** from the company shall file **within a period of 30 days** from the date of resignation, a **statement in the prescribed form** with the company and the ROC, indicating the reasons and other facts as may be relevant. **(Form No. ADT-3)**

- **Special Notice:** Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except in case of mandatory rotation in case of listed companies.

REMOVAL OF AUDITORS

Section 140: Removal of the Auditor, Section notified on 26.03.2014	
	Removal of Auditor(s) before expiry of his term
S 140(1)	The auditor appointed u/s 139 may be removed from his office before the expiry of his term only by a SR of the company, after obtaining the previous approval of the CG in that behalf in the prescribed manner:

	Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard (RoH).
	Auditor to give reasons for his resignation
140(2) FORM ADT-3	The auditor who has **resigned from the company** shall file within a period of 30 days from the date of resignation, a statement in the prescribed form with the company and the Registrar, and in case of companies referred to in section 139(5), the auditor shall also file such statement with the C & AG, indicating the reasons and other facts as may be relevant with regard to his resignation.
140(3)	**If the auditor does not comply with the provisions of sub-section (2), he or it shall be liable to a penalty of Rs. 50,000/- or an amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with a further penalty of Rs. 500 for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.**
140(4)	(*i*) Special notice shall be required for a resolution at an AGM appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, **except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided u/s 139(2).** (*ii*) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor. (*iii*) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,— (*a*) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and (*b*) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company, and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting: Provided that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar: Provided further that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.
	Auditor acted in a fraudulent manner
S 140(5)	Without prejudice to any action under the provisions of this Act or any other law for the time being in force, **the Tribunal either *suo moto* or on an application made to it by the Central Government or by any person concerned**, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted

	in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors: Provided that if the application is made by the CG and the Tribunal is satisfied that any change of the auditor is required, it shall within 15 days of receipt of such application, make an order that he shall not function as an auditor and the CG may appoint another auditor in his place: Provided further that an auditor, whether individual or firm, against whom **final order** has been passed by the Tribunal shall not be eligible to be appointed as an auditor of any company **for a period of 5 years** from the date of passing of the order and the auditor shall also be liable for action u/s 447.

Q 27. A is the Auditor of B and Co. Ltd. BoD decided to remove A on certain grounds. Please indicate what procedure is to be followed to remove A? Advise the Board.

(5 M) (Nov.10)

Ans: As per section 140(4) of the Companies Act, 2013, a special notice of a resolution to be moved at an AGM for appointing an auditor other than the retiring auditor or removing of an existing auditor is given to the Company in the manner as prescribed under the Act.

The retiring auditor has a right to attend the meeting where his removal is to be discussed. He can also speak out at such meeting. The newly appointed Auditor should communicate with retiring Auditor and Obtain a copy of relevant minutes of the General Meeting (GM), duty certified by the Chairman of the meeting.

Q 28. Parkash Carriers Limited appointed Mr. Raman as its auditor in the AGM held on 30th September, 2009. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2009 for personal reasons. The BoDs seeks your advice for filling up the vacancy by appointment of Mr. Albert as auditor. Advice.

Q 29. Also suggest the procedure to be adopted in case Mr. Albert is proposed to be removed from his office before the expiry of his term. (5 Marks) (Nov 2009)

Answer: As per section 139(8), in the case of a company other than Government Company, be filled by the BoDs within 30 days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next AGM;

Thus, in the present case, the Company may convene an EGM to appoint Mr. Albert as its auditor consequent upon the resignation by Mr. Raman.

Further as per section 140 of the CA, 2013

The auditor appointed u/s 139 may be removed from his office before the expiry of his term **only by a SR**, **after obtaining the previous approval of the CG**.

Thus, Mr. Albert may be removed from office before the expiry of his term only by the Company in General Meeting after obtaining previous approval of the CG.

Powers of Auditors

1. Every auditor of a Company shall have a right of access at all times to the books and accounts and vouchers of the Company, whether kept at the head office of the Company or elsewhere.

2. He shall be entitled to require from the officers of the Company such information and explanations as he thinks necessary for the performance of his duties as auditor.

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

(*a*) shall be entitled to visit the branch office, and

(*b*) shall have a right of access at all times to the books and accounts and vouchers of the Company maintained at the branch office.

4. He has the right to attend any general meeting of the Company and be heard on matters that concerns him as an auditor.

Duties of Auditors

The auditor shall make a report to the members of the Company on the accounts examined by him, and on every balance sheet and profit and loss account and on every other document declared by this Act to be part of or annexed to the balance sheet or profit and loss account, which are laid before the Company in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by this Act in the manner so required and give a true and fair view

Whether in his opinion and to the best of his information and according to the explanations given to him, the accounts, give a true and fair view in the case of the balance sheet, of the state of the Company's affairs as at the end of its financial year and in the case of the profit and loss account, of the profit or loss for its financial year.

Concept of "True and Fair": The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.

What constitutes "true and fair" has not been defined in the legislation. It is a matter of the auditor's judgement in the particular circumstances of the case. In specific terms to ensure truth and fairness, an auditor has to see:

(i) that the assets are neither undervalued nor overvalued;

(ii) no material asset is omitted;

(iii) the charge on assets, if any, is disclosed;

(iv) material liabilities should not be omitted, and liabilities are neither undervalued nor overvalued;

(v) accounting policies have been followed consistently;

(vi) all unusual, exceptional, non-recurring items have been disclosed separately;

(vii) accounts have been drawn as per requirement of Schedule III; and

(viii) the accounts have been drawn in compliance to the relevant accounting standards. In case of deviation from accounting standards, disclosure should be made of the reasons for such deviation and financial effects, if any arising due to such deviation.

Powers and duties of auditors and auditing standards	
143(*1*)	Every auditor of a company shall have a **right of access at all times to the books of account and vouchers of the company**, whether kept at the RO or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties and amongst other matters inquire into the following matters, namely:— (*a*) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are 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 interests of the company; (*c*) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company; (*d*) whether loans and advances made by the company have been shown as deposits; (*e*) whether personal expenses have been charged to revenue account; (*f*) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading: Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries. **Right of access by the auditor of a holding company to the accounts and records of the associate company, whose accounts are required to be consolidated. As per the recent amendment, this right has been extended to associates also.**
143(*2*)	The auditor shall make a report to the members of the company and on every financial statements which are required under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.
143(*3*)	**The auditor's report shall also state—** (*a*) whether he has sought and **obtained all the information and explanations** which to the best of his knowledge and belief were necessary for the purpose of

	his audit and if not, the details thereof and the effect of such information on the financial statements; (*b*) whether, in his opinion, **proper books of account as required by law** have been kept by the company so far as appears from his examination of those books and proper returns adequate for 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 u/ss *8* by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report; (*d*) whether the company's **balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns**; **(e)** whether, in his opinion, the financial statements comply with the **accounting standards**; **(*f*) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;** **(*g*) whether any director is disqualified from being appointed as a director u/s 164(*2*);** **(*h*) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;** (*i*) whether the company has **adequate internal financial controls with reference to financial statements in place and the operating effectiveness** of such controls; **Section 143(3)(i), shall not apply to a private company: - (i) which is a one-person company or a small company; or (ii) which has turnover less than rupees fifty crores as per latest audited financial statement or which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than rupees twenty-five crore."** (*j*) such other matters as may be prescribed.
143(*4*)	Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefore.
	Provisions relating to supplementary audit of Government Companies
143(*5*)	In the case of a Government company, the CAG shall appoint the auditor u/s 139(5) or 139(7) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the CAG which, among other

	things, include the directions, if any, issued by the CAG, the action taken thereon and **its impact** on the accounts and financial statement of the company.
143(*6*)	The CAG shall within 60 days from the date of receipt of the audit report u/s 143(5) have a right to, — (*a*) conduct a supplementary audit of the financial statement **by such person** (s) as he may authorise in this behalf; and (*b*) comment upon or supplement such audit report: Provided that any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under section 136(*1*) and also be placed before the AGM at the same time and in same manner as the audit report.
143(*7*)	The CAG may, in case of any company covered u/s 139(5) or 139(7), if he considers necessary, by an order, **cause test audit to be conducted of the accounts of such company** and the provisions of section 19A of the CAG's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.
	Audit of Branch Offices
143(*8*)	Where a company has a branch office, the accounts of that office shall be audited either by the Statutory auditor or by any other person qualified for appointment as an auditor of the company, or 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 and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed. Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.
143(*9*)	**Every auditor shall comply with the auditing standards**
143(*10*)	The CG may prescribe the **standards of auditing**, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA): Provided until any auditing standards are notified, standard or standards of auditing specified by the ICAI shall be deemed to be the auditing standards.
143(*11*)	The CG may, in consultation with the NFRA, by general or special order, direct, in respect of such class or description of companies, as may be specified in the

	order, that the auditor's report **shall also include a statement on such matters as may be specified therein.**
143(*12*)	In case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days. Vide Notification dated 14.12.15, the MCA further amended the *Companies (Audit and Auditors) Rules, 2014* through the enforcement of the *Companies (Audit and Auditors) Amendment Rules, 2015* from the date of its publication in the OG. Through this amendment Rules, for Rule 13, the following rule shall be substituted- **13. Reporting of Frauds by Auditor and Other Matters:** (1) If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually **an amount of rupees one crore or above**, is being or has been committed against the company **by its officers or employees**, the auditor shall report the matter to the CG. **Procedure for Reporting to CG** (2) The auditor shall report the matter to the Central Government as under: - • the auditor shall report the matter to the Board/ AC, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within 45 days; • on receipt of such reply or observations, the auditor shall forward his report and the reply along with his comments on such reply to the CG within 15 days from the date of receipt of such reply; • in case the auditor fails to get any reply or observations within 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; • the report shall be sent to the Secretary, MCA in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same; • 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 • The report shall be in the form of a statement as specified in Form ADT-4. (3) In case of a fraud involving lesser than Rs. 1 crore, the auditor shall report the matter to Audit Committee or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following: - (a) Nature of Fraud with description; (b) Approximate amount involved; and (c) Parties involved. (4) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report: - (a) Nature of Fraud with description;

	(b) Approximate Amount involved; (c) Parties involved, if remedial action not taken; and (d) Remedial actions taken. (5) The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties u/s 148 and section 204 respectively.
143(*13*)	No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (*12*) if it is done in good faith.
143(*14*)	The provisions of this section shall *mutatis mutandis* apply to— (*a*) the **cost accountant** conducting cost audit u/s 148; or (*b*) the **company secretary** in practice conducting secretarial audit u/s 204.
143(*15*)	**If any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall,— (a) in case of a listed company, be liable to a penalty of five lakh rupees; and (b) in case of any other company, be liable to a penalty of one lakh rupees.**

Q 30. State whether the following statement is correct or incorrect.

The Auditor has to report to Central Government within 90 days of his knowledge of an offence involving fraud. (November 2015, 2 marks)

Answer: Incorrect, the prescribed time is 60 days.

Signature of Audit Report etc.

As per Section 145, only the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (*2*) of section 141, and
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 **read before the company in general meeting** and **shall be open to inspection by any member of the company.**

Auditors to Attend General Meeting
As per Section 146 of the CA, 2013, Auditor shall, unless otherwise exempted by the company, attend any general meeting:
(i) By himself or
(ii) Through his authorized representative who is qualified to be an auditor.

Audit of Cost Accounts

Audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilization of material or labour or other items of costs maintained by the Company is called Cost Audit.

Cost Audit comprises of the following: -

✓ Verification of cost accounting records such as the cost accounts, cost reports, cost statements, cost data and costing techniques.

✓ Examination of these records to ensure that they adhere to the Cost Accounting Principles, Plans, Procedures and Objective.

APPOINTMENT OF COST AUDITORS:

The audit under sub-section (2) of Section 148 of the Companies Act, 2013 (Act) shall be *conducted by a Cost Accountant* who shall be *appointed by the Board* on such remuneration as may be determined by the members (*that means Shareholders to fix remuneration*) in a following manner:

a. The companies required to get its cost records audited, shall within 180 days of the commencement of every financial year, appoint a cost auditor.

"Cost Accountant" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act;

b. Every company referred above shall inform the cost auditor concerned of his appointment as such and file a notice of such appointment with the CG 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.

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

d. **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 Central Government in Form CRA -2 within 30 days of such appointment of Cost Auditor.

e. Provided that no person appointed u/s 139 as an auditor (*that means Statutory Auditors*) of the company shall be appointed for conducting the audit of cost records:

f. Provided further that the auditor conducting the *cost audit* shall *comply with the* ***Cost Auditing Standards.***

Explanation— For the purposes of this sub-section, the expression "**Cost Auditing Standards**" mean such standards as are issued by the Institute of Cost and Works Accountants of India with the approval of the Central Government.

g. An audit conducted under this section shall be **in addition to the audit conducted u/s 143**.

h. The qualifications, disqualifications, rights, duties and obligations applicable to statutory auditors shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company:

COST RECORDS:

The *Central Government is empowered to direct, by order*, in respect of such class of *companies engaged in the production of such goods or providing such services as may be prescribed*, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed *(given below in the tabular format)* shall also be included in the books of account kept by that class of companies:

Provided that the CG shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

a. Every company falling under Companies (cost records and audit) Rules, 2014 (*as given below in the tabular format*) , including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.

However, in case of item no. 12 and 24 to 32 under category B i.e., non-regulated items *(as given below in the tabular format)* it shall apply in respect of each of its financial year commencing on or after the 1st day of April, 2015.

b. The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources and these records shall also provide necessary data which is required to be furnished under these rules.

Exception to the Cost Records requirements:

The requirement for cost records under these rules SHALL NOT BE APPLICABLE to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria u/s 7(9) of the Micro, Small & Medium Enterprises Development Act, 2006.

Exception to the Cost Audit requirements:

The requirement for cost audit under these rules SHALL NOT BE APPLICABLE to a company covered under the Rules if revenue from exports, in foreign exchange, exceeds 75% of its total revenue OR if it is operating from a Special Economic Zone.

COST AUDIT:

In a case the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered u/s 148(1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

Provided that the report on the audit of cost records shall be submitted by the cost accountant to the Board of Directors of the company.

a. The cost auditor shall forward his report to the Board of Directors within a period of 180 days from the closure of the financial year to which the report relates and the Board shall consider and examine such report particularly any reservation or qualification contained therein.

b. Every company covered under these rules shall, within a period of 30 days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in

form CRA-4.

Punishment for Contravention under the provisions –

If any default is made in complying with the provisions of this section, —

(a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;

(b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

Explanation I.—It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

(1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000 and every officer of the company who is in default shall be punishable ~~**with imprisonment for a term which may extend to one year or**~~ with fine which shall not be less than Rs. 10,000/- but which may extend to one lakh rupees, ~~**or with both.**~~

(2) If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000 ***or four times the remuneration of the auditor, whichever is less.***

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall ***not be less than Rs. 50,000/-*** but which may extend to Rs. 25,00,000 ***or eight times the remuneration of the auditor, which every is less.***

(3) Where an auditor has been convicted under sub-section (2), he shall be liable to: -

(i) refund the remuneration received by him to the company;

(ii) and pay for damages to the company statutory bodies or authorities or to ***members or the creditors of the Company*** for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(4) The CG shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages the such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

(5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil criminal as provided in this Act or in any other law for the time being in force, for such act shall be the partner or partners concerned of the audit firm and of the firm jointly and severally.

Provided that in case of criminal liability of an audit firm, in respect of liability other ***than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.***

THE COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

APPLICABILITY OF COST RECORDS AND COST AUDIT:

Sectors	**Cost Records**	**Cost Audit**
Companies engaged in the production of following goods or providing following services – A. **Regulated Sectors** 1. **Telecommunication services** made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the TRAI 2. Generation, transmission, distribution and supply of **electricity** regulated by the relevant regulatory body or authority under the Electricity Act, 2003 3. **Petroleum products** regulated by the Petroleum and Natural Gas Regulatory Board 4. **Fertilizers** 5. **Drugs and Pharmaceuticals**; 6. **Sugar and industrial alcohol**	Companies having an overall turnover from all its products and services of Rs. 35 Crore or more during the immediately preceding financial year.	Companies having an overall turnover from all its products and services of Rs. 50 Crore or more during the immediately preceding financial year AND The aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained is Rs. 25 Cr or more.
B. **Non-regulated Sectors** 1. machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item *(Explanation – For the purposes of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause, shall be deemed to be covered under these rules.)* 2. turbo jets and turbo propellers; 3. arms and ammunitions 4. propellant powders; prepared explosives (other than propellant powders), safety fuses, detonating fuses, percussion or detonating caps, igniters, electric detonators 5. radar apparatus, radio navigational aid apparatus and radio remote control apparatus 6. Tanks and other armored fighting vehicles, motorized, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent. or more by the Government or Government Agencies 7. Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered by a Port in relation to a	Companies having an overall turnover from all its products and services of Rs. 35 Crore or more during the immediately preceding financial year.	Companies having an overall turnover from all its products and services of Rs. 100 Crore or more during the immediately preceding financial year AND The aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained is Rs. 35 Cr or more.

vessel or goods regulated by the Tariff Authority for Major Ports 8. Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority 9. Steel 10. Roads and other infrastructure projects 11. Rubber and allied products being regulated by the Rubber Board 12. Coffee and tea 13. Railway or tramway locomotives, railway or tramway fixtures and fittings, mechanical traffic signaling equipment's of all kind 14. Cement 15. Ores and Mineral products 16. Mineral fuels (other than Petroleum), mineral oils etc. 17. Base metals 18. Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals 19. Jute and Jute Products 20. Edible Oil 21. Construction Industry 22. Companies engaged in health services viz. functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories 23. Companies engaged in education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business 24. Milk Powder 25. Insecticides 26. Plastics and Polymers 27. Tyres and Tubes 28. Paper 29. Textiles 30. Glass 31. Other machinery 32. Electricals and electronic machinery 33. Production, import and supply or trading of following medical devices namely Cardiac stents, Drug Eluting Stents, Catheters, Intra Ocular Lenses, Bone Cements, Heart Valves, Orthopedic Implants, Internal Prosthetic Replacements, Scalp Vein Set, Deep Brain Stimulator, Ventricular peripheral Shud, Spinal Implants, Automatic Impalpable Cardiac Deflobillator, Pacemaker (temporary		

and permanent), patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device, Cardiac Re-synchronize Therapy, Urethra Spinicture Devices, Sling male or female, Prostate occlusion device; and Urethral Stents. (Provided that requirement for cost records for item 33 shall not apply to foreign companies having only liaison offices)		

Advantages of Cost audit

(1) To Management

(i) Reliability of data for price fixing, control and decision making.

(ii) Waste control and consequently cost reduction.

(iii) Through the system of budgetary control and standard costing, cost control is established.

(iv) Proper valuation of closing stock, work in progress.

(2) To Society: Cost Audit is often introduced for the purpose of price fixation. Customers are saved from exploitation through proper costing of products and services. Since price increase by some industries is not allowed without proper justification as to increase in cost of production, inflation through price hikes can be controlled and consumers can maintain their standard of living.

(3) To Shareholders: Cost Audit ensures that proper records are kept as to purchases and utilization of materials and expenses incurred on wages etc. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. The shareholders are assured about the calculation of the profitability and thus return on their investments.

(4) To Government: Some of the specific advantages are:

(i) It helps in the fixation of selling prices of essential commodities and thereby avoiding undue profiteering.

(ii) In the case of cost-plus contracts of Government, it helps to fix the price at reasonable level.

(iii) It enables the Government to focus the attention on inefficient units.

(iv) It enables the Government to lay down policies in favour of protecting certain industries.

(v) It facilitates the settlement of disputes brought to the Government.

(vi) It creates healthy competition in the industry.

(vii) Cost audit and consequent management action can create a healthy competition among the various units in an Industry. This imposes an automatic check on inflation.

Q 31. The BOD of a Company have filed a complaint with the ICAI against their statutory auditors for their failing to attend the AGM in which audited accounts were considered. Comment.

Ans.:
As per Section 146 of the CA, 2013, Auditor shall, unless otherwise exempted by the company, attend any general meeting:
By himself or through his authorized representative who is qualified to be an auditor.

Section 231 of the CA, 1956 used to confer right on the auditor to attend the General Meeting. The said section provided that all notices and other communications relating to any general meeting of a Company which any member of the Company is entitled to have are also to be forwarded to the auditor.

However, as per the Companies Act, 2013, the Auditor shall, unless otherwise exempted by the company, attend any general meeting:

- **By himself or**
- **Through his authorized representative who is qualified to be an auditor.**

Q 32. XYZ & Company Limited by passing a resolution by the entire body of shareholders want to limit the powers of the statutory auditors.

Ans.:

a. The Companies Act specifies the rights of a Company auditor which include right of access to the books of accounts, right to receive notices, right to seek information and explanations, right to visit branches, etc. These rights have been granted to the auditor to carry out his duties and responsibilities prescribed under the Act.

b. The rights of the auditor cannot be restricted in any manner.

c. Any resolution passed by the entire body of shareholders limiting the powers of the auditor or any such provisions in the Articles of Association is void.

d. In the case of **Newton V. Birmingham Small Arms Co.**, the same was upheld.

Chapter XXIII – Government Companies

Annual reports on Government Companies	
Section 394	(*1*) Where the CG is a member of a Government Company, the CG shall cause an annual report on the working and affairs of that Company to be— (*a*) **prepared within three months of its AGM** before which the comments given by the CAG and the audit report is placed under the proviso to sub-section (*6*) of section 143; and (*b*) as soon as may be after such preparation, laid before both Houses of Parliament together with a copy of the audit report and comments upon or supplement to the audit report, made by the CAG. (*2*) Where in addition to the CG, any SG is also a member of a Government Company, that SG shall cause a copy of the annual report prepared under sub-section (*1*) to be laid before the House or both Houses of the State Legislature together with a copy of the audit report and the comments upon or supplement to the audit report referred to in sub-section (*1*).
Section 395: Annual reports where one or more State Governments are members of Companies	
Section 395	(*1*) Where the CG is not a member of a Government Company, every SG which is a member of that Company, or where only one SG is a member of the Company, that SG shall cause an annual report on the working and affairs of the Company to be— (*a*) prepared within the time specified in sub-section (*1*) of section 394; and (*b*) as soon as may be after such preparation, laid before the House or both Houses of the State Legislature together with a copy of the audit report and comments upon or supplement to the audit report referred to in sub-section (*1*) of that section. (*2*) The provisions of this section and section 394 shall, so far as may be, apply to a Government Company in liquidation as they apply to any other Government Company.

Corporate Governance

Corporate Governance is a continuous process of applying the best management practices, ensuring the law is followed the way intended, and adhering to ethical standards by a firm for effective management, meeting stakeholder responsibilities, and complying with corporate social responsibilities.

It contains policies and rules to maintain a strong relationship between the owners of the company (shareholders), the Board of Directors, management, and various stakeholders like employees, customers, Government, suppliers, and the general public. It applies to all kinds of organizations-profit or not-for-profit.

Principles of Corporate Governance

The principles of Corporate Governance are:

Accountability

Accountability means to be answerable and be obligated to take responsibility for one's actions. By doing so, two things can be ensured-

That the management is accountable to the Board of Directors.

That the Board of Directors is accountable to the shareholders of the company.

This principle gives confidence to shareholders in the business of the company that in case of any unfavourable situation, the persons responsible will be held in charge.

Fairness

Fairness gives shareholders an opportunity to voice their grievances and address any issues relating to the violation of shareholder's rights. This principle deals with the protection of shareholders' rights, treating all shareholders equally without any personal favouritism, and granting redressal for any violations of rights.

Transparency

Providing clear information about a company's policies and practices and the decisions that affect the rights of the shareholders represents transparency. This helps to build trust and a sense of togetherness between the top management and the stakeholders. It ensures accurate and full disclosure timely on material matters like financial condition, performance, ownership.

Independence

Independence means the ability to make decisions freely without being unduly influenced. Decisions should be made freely without having any personal interest in the company. It ensures the reduction in conflict of interest. Corporate governance suggests the appointment of independent directors and advisors so that decisions are taken responsibly without influence.

Social Responsibility

Apart from the 4 main principles, there is an additional principle of corporate governance. Company social responsibility obligates the company to be aware of social issues and take action to address them. In this way, the company creates a positive image in the industry. The first step towards Corporate Social Responsibility is to practice good Corporate Governance.

Corporate Governance in India

- The Ministry of Corporate Affairs (MCA) and Securities and Exchange Board of India (SEBI) is responsible for corporate governance initiatives in India. The corporate sector of India faced major changes in the 1990s after liberalization.
- In the 1900s, SEBI regulated corporate governance in India through various laws like the Security Contracts (Regulation) Act, 1956; Securities and Exchange Board of India Act, 1992; and the Depositories Act of 1996.
- In February 2000, SEBI established the first formal regulatory framework for corporate governance in India owing to the recommendations of the Kumar Mangalam Birla Committee. It was undertaken to improve the standards of corporate governance in India. This came to be known as clause 49 of the Listing Agreement.
- A major corporate governance initiative was undertaken in 2002 when the Naresh Chandra Committee on Corporate Audit and Governance furthered their recommendations addressing multiple governance issues.
- MCA and the Government of India have set up multiple organisations and charters like the Confederation of Indian Industry (CII), National Foundation for Corporate Governance (NFCG), Institute of Chartered Accountants of India (ICAI).

Frequently Asked Questions on Corporate Governance

Why is corporate governance important?

Corporate governance is important to improve the integrity and performance of a company. It gives it a sustainable approach to the affairs of the organisation. This provides an upper ground to the company and increases its competitive advantage.

What are the elements of Corporate Governance?

The elements of corporate governance are:

- Transparent disclosure
- Well-defined rights of shareholders
- Internal control environment
- Structured Board practices
- Board commitment

What are the four ‘P’s (Philosophies) of corporate governance?

The four Ps are People, Purpose, Process, and Performance.