

**Opinion of the Council of
The Institute of Cost Accountants of India**

on

**Statutory Audit and eligibility for appointment as Internal
Auditors in Public Companies under section 138 of the
Companies Act, 2013**



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**The Institute of Cost Accountants of India
(Statutory body under an Act of Parliament)**

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INSTITUTE OF COST ACCOUNTANTS OF INDIA

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Statutory Audit and eligibility for appointment as Internal Auditors in
Public Companies under section 138 of the Companies Act, 2013**

PREAMBLE

All public or private companies that are covered under section 138 of the Companies Act, 2013 read with Rule 13 of the Companies (Accounts) Rules, 2014 are required to appoint an Internal Auditor, who shall either be a Chartered Accountant or a Cost Accountant or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

Many instances have been brought to the notice of the Council of the Institute of Cost Accountants of India that number of public or private companies prescribe following mandatory conditions under eligibility for appointment as Internal Auditors under section 138 of the Companies Act, 2013 -

- (i) The individual should be a Chartered Accountant or the firm should comprise of Chartered Accountants;
- (ii) The individual or the firm should have requisite experience in statutory audit; and
- (iii) The individual or the firm must be empanelled with the office of Comptroller & Auditor General (C&AG) of India.

While reckoning the experience as statutory auditor, the cost audit conducted under section 148 of the Companies Act, 2013 is not considered as statutory audit.

These issues have been examined and the opinion of the Council of the Institute on all the issues is given in this document. All stakeholders are advised to follow and rely upon this opinion issued by the Council of the Institute of Cost Accountants of India.

OPINION

The individual should be a Chartered Accountant or the firm should comprise of Chartered Accountants

As per provisions contained under section 138¹ of the Companies Act 2013 read with Rule 13² of the Companies (Accounts) Rules, 2014, all companies that meet with the prescribed criteria are required to appoint an Internal Auditor. Under this section, qualification as Chartered Accountant or Cost Accountant or such other professional as may be decided by the Board has been prescribed to conduct internal audit of the functions and activities of the company.

The provisions under law have very clearly specified that both Chartered Accountants and Cost Accountants are equally eligible to conduct internal audit of any public or private company. Explanation given under Rule 13 further

¹ Section 138 (1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

(2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

² Rule 13. (1) The following class of companies shall be required to appoint an internal auditor, which may be either an individual or a partnership firm or a body corporate, namely:-

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

Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

Explanation – For the purpose of this rule –

- (i) the internal auditor may or may not be an employee of the company;
- (ii) the term "Chartered Accountant" or "Cost Accountant" shall mean a "Chartered Accountant" or a "Cost Accountant", as the case may be, whether engaged in practice or not.

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

clarifies that the term "Chartered Accountant" or "Cost Accountant" shall mean a "Chartered Accountant" or a "Cost Accountant", as the case may be, whether engaged in practice or not. Hence, it would be totally unlawful if any such pre-condition of only a Chartered Accountant is made mandatory eligibility for undertaking internal audit assignment in any public or private company. This clearly violates the rights enshrined upon the Cost Accountants under the Companies Act, 2013.

The individual or the firm should have requisite experience in statutory audit

It may be seen that different statutory audits conducted under various Laws/Statutes are performed by different professionals. But the most popular term used for statutory audit is the annual financial audit conducted under the Companies Act, 2013 in which auditor reports to the member of the company i.e. shareholders. In other words, statutory audit is another name popularly used for financial audit. It is factually not correct as by mere common understanding, it does not include other statutory audits conducted under other laws (statutes) viz. audit under Income Tax Act, GST Act, VAT Act, etc. and not even the other statutory audits conducted under the Companies Act, 2013 viz. cost audit or secretarial audit. This limited meaning of the term 'statutory audit' is not defined in law but is merely accepted as a practice. But wherever, there is reference drawn to the eligibility of an individual or a firm based on its experience in statutory audit, it would be totally unlawful if the individual's or the firm's experience in other audits conducted under other laws/statutes is not reckoned.

Further, it has been seen that for appointment of Internal Auditors under section 138 of the Companies Act 2013, certain Government Companies prescribe that the individual or the firm should have experience of statutory audit. And while reckoning the experience as statutory auditor, the cost audit conducted under section 148 of the Companies Act, 2013 is not considered as statutory audit. Since the cost audit is also a statutory audit conducted under the Companies Act 2013, such a practice of not accepting cost audit as a statutory audit is summarily against the law and needs to be stopped.

The individual or the firm must be empanelled with the office of Comptroller & Auditor General (C&AG) of India

In India, appointment of statutory financial auditors of Government Companies/Corporations is done by the Comptroller & Auditor General

(C&AG) of India under section 139 of the Companies Act, 2013. For this purpose, the office of C&AG maintains a panel of eminent firms of Chartered Accountants as per the eligibility, qualifications and disqualifications as prescribed under section 141 of the Companies Act. However, the appointment of cost auditor in Government Companies made under section 148 of the Companies Act is not regulated by the C&AG and hence, they do not maintain any similar panel of firms of Cost Accountants who are in public practice.

As prescribed under section 138 of the Companies Act 2013 read with Rule 13 of the Companies (Accounts) Rules, 2014, all companies that meet with the criteria prescribed therein are required to appoint an Internal Auditor. Under this section, qualification as Chartered Accountant or Cost Accountant has been prescribed to conduct internal audit of the functions and activities of the company. It has been clarified by the office of C&AG that no such empanelment of either Chartered Accountants or Cost Accountants is done by them as per the qualification prescribed under section 138 of the Companies Act, 2013.

For appointment as Internal Auditors under section 138 of the Companies Act 2013, instances have been brought to the notice of the Council that many public companies prescribe empanelment with the office of Comptroller & Auditor General (C&AG) of India as a mandatory condition. Since, as per provisions of the Companies Act 2013, both Chartered Accountants and Cost Accountants are equally eligible to conduct internal audit; it is unlawful if any such precondition of C&AG empanelment is made mandatory eligibility for undertaking internal audit assignment in any government [or non-government] company. This violates the rights enshrined upon the Cost Accountants under the Companies Act, 2013.

Note appended with this Opinion explains the meaning of Statutory, Audit, Purpose of Audit, Statutory Audit, Types of Statutory Audit and Audit by Whom.

Appendix

**Note explaining the meaning of Statutory, Audit, Purpose of Audit,
Statutory Audit, Types of Statutory Audit and Audit by Whom**

STATUTORY

The word 'Statutory' means any matter relating to, or set by, or conforming to, or created, decided, controlled, regulated, enforced, prescribed, authorized, recognized, restricted, or required by law(s) or statute(s). Examples are, statutory restrictions on driving, legal age limit for marriage, job or retirement, statutory tax rates, etc. Normally, non-compliance of any legal or statutory matter is a punishable offence as prescribed under the relevant law/statute.

The term 'law' includes the Acts, Rules, Regulations, Notifications, Orders, etc. issued by any statutory authority under any law enacted by the concerned Legislature i.e. Parliament of India or State Assembly of any State or UT.

Though the terms 'statutory' & 'legal' are often used as synonyms, but there is slight difference in their applications. If something is legal, it is allowed by the law; if it is statutory, it is regulated by law. Conversely, if something is not legal, the law says you can't do it; but if something is not statutory, then you can perhaps do it as there are no laws regulating it.

AUDIT

An 'audit' is systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization to ascertain how far the account statements as well as non-financial disclosures present a true and fair view thereof. It also attempts to ensure that the books of accounts and requisite records are properly maintained as required by law. The auditor examines the records produced before him, obtains evidence, evaluates the same and formulates an opinion on the basis of his professional skepticism & judgement which is communicated through his audit report. Auditor provides third party assurance to various stakeholders that the account statements give true & fair view and are free from material misstatements. The primary stakeholders are management, shareholders, investors, government(s), tax authorities, and lenders. Others include customers, debtors, creditors, & employees. Audits are also performed to provide an assessment of the internal control systems. Owing to many constraints, an audit seeks to provide only

reasonable assurance that the statements are free from material error(s). Audit may be conducted for an organization, business, government entity, or individual.

PURPOSE OF AUDIT

Audit is performed for various purposes. A statutory audit is meant to fulfill the requirements prescribed under the law or statute. However, a voluntary audit is meant to serve the specific purpose of the authority within the organization who prescribed such audit.

Under the provisions of Companies Act, 2013, the Board of Directors have been entrusted with full responsibility to manage affairs of the company. They act as trustees for the stakeholders. Thus, the law has enshrined full responsibility upon the Board of Directors to ensure maintenance of accounting records, preparation of annual accounts, laying down effective accounting policies & internal controls, compliance with the accounting standards, etc. so as to ensure true & fair view of the state of affairs of the company. Similarly, the management is fully responsible to maintain lawfully required cost accounting records & prepare requisite cost statements. Further, as per Directors' Responsibility Statement, ensuring compliance with various Laws in the country is sole responsibility of the Board and company management. However, the law has still provided for audit of financial statements, cost statements and secretarial compliances by an independent professional to certify the truth & fairness of the company's statements & other disclosures so as to provide comfort to all stakeholders and to report by exception on all requirements under the prescribed law/statute.

The audit has a clear public interest objective as it is conducted for the benefit of all i.e. management, shareholders, investors, government(s), tax authorities, lenders, customers, debtors, creditors, employees and the public at large. They all rely on the assurance provided by the auditors on the soundness of reporting and its impact on the economic well-being of the organisation, community and the country. The audit also provides an assurance on the business ethics followed, and its governance structure. It helps in early detection of a fraud or possible happening of a fraud/misappropriation, and also provides reasonable assurance on future viability of the business. In short, the objectives & purpose of audit and the auditors' responsibilities goes much beyond mere checking of account vouchers & records.

STATUTORY AUDIT

The term 'statutory audit' denotes that the audit is required by statute. A statute is a law or regulation enacted by the legislative branch of the government. Laws/Statutes can be enacted at multiple levels including Central Government, State Government, Regulators, or Local Bodies. In business, a statute also refers to any rule set by the organization's leadership team or Board of Directors.

Statutory auditor is a title used in various countries to refer to a person or entity with an auditing role, whose appointment is mandated by the terms of a statute. In India, the term 'statutory auditor' refers to an external auditor whose appointment is mandated by law.

A statutory audit is a legally required review of the accuracy of statements and records of a government or an entity. The purpose of a statutory audit is the same as the purpose of any other audit - to determine whether an organization provides fair and accurate presentation of its statements, disclosures, and records.

Being subject to a statutory audit is not an inherent sign of wrongdoing. Instead, it is often a formality designed to help prevent certain unlawful activities such as misappropriation of funds, wrongful disclosure of financial & non-financial data, etc. by ensuring regular examination of various records by a competent third party. The same applies to all types of audits.

Generally, all entities have to undergo statutory audit(s). These include all central & state organisations, municipalities, public & private companies, banks, brokerage and investment firms, credit rating agencies, insurance companies, partnership firms, LLPs, proprietorship firms, HUFs, cooperatives, societies, trusts, etc.

TYPES OF STATUTORY AUDIT

There are many such statutory audits prescribed by the law or statute in India. For example,

- Financial audit prescribed u/s 139 of the Companies Act, 2013
- Cost Audit prescribed u/s 148 of the Companies Act, 2013
- Secretarial Audit prescribed u/s 208 of the Companies Act, 2013
- Internal audit prescribed u/s 138(1) of the Companies Act, 2013

- Tax Audit prescribed u/s 44AB of the Income Tax Act, 1961
- GST Audit prescribed u/s 35(5) of the GST Act, 2017
- Audit prescribed under the Customs Act, Central Excise Act, State VAT Acts, etc.
- Concurrent Audit, branch audit, stock audit, etc. prescribed under the Banking Act
- Billing & Metering Audit prescribed by Telecom Regulatory Authority of India (TRAI)
- Internal Audit/Concurrent Audit under the National Health Mission (NHM)
- Internal Audit/Concurrent Audit under the Model Concession Agreement on infrastructure for PPP projects in Highways
- Financial audit of banks, insurance companies, cooperative societies, partnership firms, LLPs, proprietorships, HUFs, societies, trusts, etc.
- Performance audit of cooperative societies under the Cooperative Societies Act
- Forensic audit prescribed under various statutes
- Audit of Stock Brokers and Credit Rating Agencies as prescribed by the Securities & Exchange Board of India (SEBI)
- Internal & Concurrent audit for Depository Operations under the National Securities Depository Limited (NSDL)

Note: The list is not exhaustive.

AUDIT BY WHOM

In case of Governments or public authorities, audit is conducted by the Government's auditor. In India, the Comptroller & Auditor General is assigned this responsibility under the Constitution.

However, an audit of an organization or business entity or an individual is generally carried by the independent professionals appointed as auditors. The independent auditors are not its employees except in the case of internal audit.

All audits, whether statutory or voluntary, are not conducted by the Chartered Accountants. These are conducted by different professionals like,

- Financial audit under the Companies Act, 2013 or Banking Regulation Act, 1949 or Insurance Act, 1938 etc. is conducted by the Chartered Accountants;
- Financial audit under the Cooperative Societies Act is conducted by the Cost Accountants (in few States);

- Tax audit under the Income Tax Act, 1961 is conducted by the Chartered Accountants;
- Cost audit under the Companies Act, 2013 is conducted by the Cost Accountants;
- Secretarial audit under the Companies Act, 2013 is conducted by the Company Secretaries;
- Internal audit under the Companies Act, 2013 is conducted by both Chartered Accountants and Cost Accountants; it may even be conducted by employees of the organization who need not be either Chartered Accountants or Cost Accountants;
- Audit under the GST Act, Customs Act, Central Excise Act, State VAT Acts, etc. is conducted by both Chartered Accountants and Cost Accountants;
- Stock audit under the Banking Regulation Act, 1949 is conducted by both Chartered Accountants and Cost Accountants;
- Similarly, various other audits like billing & metering audit, performance audit, forensic audit, concurrent audit, etc. are also performed by both Chartered Accountants and Cost Accountants.

Thus, it may be seen that barring Financial Audit, Cost Audit and Secretarial Audit conducted under the Companies Act 2013 by a Chartered Accountant, a Cost Accountant and a Company Secretary respectively, all other statutory audits done under the provisions of various other laws/statutes are conducted by both Chartered Accountants and Cost Accountants. Hence, they all are classified as statutory auditors.
