

Course: M.Com Part II

Paper IX

Topic: Rights and Duties of Company Auditor

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Rights and Duties of Company Auditor

1. Right of Access to Books of Accounts:

Every auditor of a Company has a right of access at all times to the books of accounts and vouchers of the company whether kept at the head office of the company or elsewhere.

Thus, the auditor may consult all the books, vouchers and documents whenever he so likes. This is his statutory right. He may pay a surprise visit without informing the Directors in advance but in practice, the auditors inform the Directors before they pay their visits.

2. Right to obtain Information and Explanations:

He has a right to obtain from the Directors and officers of the company any information and explanation as he thinks necessary for the performance of his duties as an auditor.

This is another important power in the hands of the auditor. He will, however, decide as to which information or explanations he thinks necessary to obtain. If the Directors or officers of the company refuse to supply some information on the ground that in their opinion it is not necessary to furnish it, he has a right to mention the fact in his report.

3. Right to Correct any Wrong Statement:

The auditor is required to 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. The Directors have a duty to prepare them and present them to the auditor.

The auditor cannot require but advise the Directors to amend their system of maintaining accounts if it is faulty. If his suggestions are not carried out, he has a right to refer the matter to the members. If the method of accounting is inadequate, he must state the fact in his report that proper books of accounts have not been kept by the company.

4. Right to visit Branches:

According to section 228, if a company has a branch office, the accounts of the office shall be audited by the company's auditor appointed under section 224 or by a person qualified for appointment as auditor of the company under section 226.

Where the Branch Accounts are not audited by a duly qualified auditor, the auditor has a right of access at all time to the books, accounts and vouchers of the company and thus, may visit the branch, if he deems it necessary.

5. Right to Signature on Audit Report: Under section 229, only the person appointed as auditor of the company, or where a firm is so appointed, only a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

6. Right to receive Notice and other Communications relating to General Meeting and attend them:

Under section 231 an auditor of a company has a right to receive notices and other communications relating to General Meeting in the same way as a member of the company. He is also entitled to attend any General Meeting which he attends or any part of the business which concerns him as an auditor.

According to the power of the auditor, he may make any statement or explanation with regard to the accounts as he may desire. He need not, however, answer any questions.

Ordinarily, it is not necessary for the auditor to attend every General Meeting, but it will be good for him to attend meetings in the following circumstances:

- (a) When his report contains important qualifications directly affecting the management, so that his remarks may not be misunderstood or misinterpreted.
- (b) When he has received a notice from the company that someone else is going to be proposed for appointment as auditor of the company at the Annual General Meeting.

(c) When he has been specially asked by the management to be present.

7. Right of being indemnified:

Under section 633, an auditor (being an officer of a company), has a right to be indemnified out of the assets of the company against any liability incurred by him defending himself against any civil and criminal proceedings by the company if it is proved that the auditor has acted honestly or the judgement delivered is in his favour.

8. Right to have Legal and Technical Advice:

He has a right to seek the opinion of the experts and, thus, take legal and technical advice. This is necessary to give his opinion in his report. (Re. London and General Bank Case, 1895).

He has a right to receive his remuneration provided he has completed the work which he undertook to do.

Duties of an Auditor:

I. According to the Companies Act:

1. To Enquire:

The duties of an auditor have been extended by the insertion of sub-section (1A) of section 227 under the Companies (Amendment) Act 1965 which is reproduced below:

With prejudice to the provision of sub-section (1), the auditor shall enquire:

(a) Whether loans and advances made by a company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members.

(b) Whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company.

(c) Where the company is not an investment company within the meaning of section 372 or a banking company, whether so much of the assets of the company, as consists of shares, debentures and other securities have been sold at a price less than 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) Whether it is stated in the books and papers 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 account books and the Balance sheet is correct, regular and not misleading.

2. Under section 227 (2, 3, 4 and 5), the duties of the auditor which relate to his report are given hereunder:

The Report:

The auditor shall report to the shareholders on the accounts examined by him. The report so submitted shall contain the following:

(a) Whether, in his opinion, the Profit and Loss Account referred to in his report exhibits a true and fair view of the profit or loss.

(b) Whether, in his opinion, the Balance Sheet referred to in his report is properly drawn up so as to exhibit a true and fair view of the state of affairs of the business according to the best of the information and explanations given to him as shown by the books of accounts.

(c) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit.

(d) Whether, in his opinion, proper books of accounts as required by law have been kept by the company so far as appears from his examination of those books, and proper returns adequate for the purpose of his audit have been received from branches not visited by him.

(e) Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him as required by (c) of subsection (3) of that Section and how he had dealt with the same in preparing the auditor's report.

(f) Whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of accounts and returns.

Where any of the matters referred to above is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

Under section 227 (4A), the Central Government may, by general or special order, direct that, in the case of such class or description of companies as may be specified in the order, the Auditor's Report shall also include a statement on such matters as may be specified therein.

The Central Government before making any such order may consult the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949, in regard to the class or description of companies, if the Government thinks it necessary.

In exercise of the powers conferred by sub-section (4A) of section 227 of the Companies Act, 1956, the Central Government has issued the Manufacturing and other Companies (Auditor's Report) Order, 1975 which applies to every company which is engaged in one or more of the following activities:

- (1) Manufacturing, mining or processing,
- (2) Supplying and rendering services,
- (3) Trading, and
- (4) The business of financing investment, Chit Fund, Nidhi or mutual benefit societies.

The order will not apply to banks. The order requires that the Auditor's Report on the accounts of every company examined by him to whom this order applies, for any financial year ending on a day on or after January 1, 1976, should contain matters specified in paragraphs 4 and 5 of the order.

The Company Law Board has now issued a fresh order viz. the Manufacturing and other companies (Auditor's Report) order, 1988 which has superseded the previous order of 1975.

Other Statutory Duties:

3. Under section 229, it is the duty of an auditor to sign the report prepared by him. Only a partner in the firm practicing in India may sign the Auditor's Report or authenticate any other document.

4. Under section 56(1), the Prospectus issued by an existing company shall contain a report from the auditor of the company regarding:

- (i) Profits and losses;

(ii) Assets and liabilities of the company and its subsidiaries; and

(iii) Rates of dividends paid by the company for each of the five it is auditor's duty to submit his report.

5. According to section 165 (4), the auditors of the company shall, in so far as the statutory report relates to the shares allotted by the company, the cash received in respect of shares and the receipts and payments of the company, certify it as correct after the same has been certified as correct by not less than two Directors of the company, one of whom shall be a Managing Director.

(Every company shall within a period of not less than one month and not more than six months from the date from which the company is entitled to commence business, hold a General Meeting of the members which shall be called the statutory Meeting.)

6. When a company goes into its voluntary winding up and a declaration of solvency is made by its Directors under section 488 (I), such a declaration is to be accompanied by the report of the auditors of the company under section 488(2). It is the duty of the auditors to make such a report.

7. Under section 240, it is the duty of an auditor "to preserve and to produce to an inspector or any person authorized by him in this behalf with the previous approval of the Central Government, all books and papers of, or relating to the other body corporate which are in their custody or poser and otherwise to give to the Inspector all assistance in connection with the investigation which they are reasonably able to give".

Under section 240(6), the auditor is treated as an agent of the company for the purpose of this section.

II. Under the Legal Decisions

(1) Re: London & General Bank (1895):

"The auditor's business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question: How is he to ascertain such position? The answer is: By examining the books of the company

He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than a farce the auditor, however, is not bound to do more than exercise reasonable care and skill in making the enquiries and investigations. He is not an insurer; he does not guarantee

that the books do correctly show the true position of the company's affairs..... He must be honest..... “

2. Re: Allen, Craig & Co. (London) Ltd. (1934):

“It is not duty of an auditor to see that his report has been sent or placed in the hands of the shareholders. After having signed his report and the Balance Sheet and having sent it to the Secretary of the company, his duty is over.”

3. Spaceman vs. Evans (1868) (already quoted earlier):

“An auditor is appointed to keep a check on the Directors and therefore he has to send his report to the members even though he might have been appointed by the Directors; He is the agent of the shareholders to examine the accounts maintained and supervised by the Directors and to report to them whether the Directors have properly maintained the accounts.”

4. Cuff vs. London and Country Land & Building Company Ltd. (1912):

“The Court would not interfere with the Director's decisions not to allow the auditor access to the books and vouchers of the company on the ground of negligence, but the usual practice would be to direct the calling of a General Meeting to ascertain the view of the shareholders.”

5. Re: Kingston Cotton Mills Ltd. (1896):

“The auditor is not an insurer and all that he is required to do is to exercise reasonable care and skill. This reasonable care depends on the particular circumstances of each case....”

6. Scarborough Harbour Commissioners vs. Thomas Whitewood & Others (1934):

“It is not the duty of an auditor to give advice to the Director or other persons as to how the business should be run.”

Other Duties based on Case Laws

1. An auditor should correspond in writing with the previous auditor:

He should see that for his appointment, the Articles of Association have been complied with or not.”

2. It is the duty of an auditor that he should not adopt foul means over the shareholders to get himself appointed as an auditor and maintain his office at two places to defraud others.

3. The auditor should inform the shareholders about the violation of the provisions of the Sections of the Companies Act.

- 4.** It is the duty of an auditor not to practice as an auditor unless he is a member of the Institute and holds a Certificate of Practice granted by the Council of the Institute.
- 6.** While auditing the accounts of a company, it becomes the duty of an auditor to scrutinize debentures in detail and examine properly the rules in the Debenture Trust Deed.
- 7.** An auditor, who fails to verify cash in hand and to draw the attention of the shareholders to the unsatisfactory condition of the bank which he audits and fails to bring to bear on his work that skill and diligence in the performance of his duties which were required of him, is guilty of professional misconduct punishable under section 20(2) and 21(3) of the Chartered Accountants Act, 1949.
- 8.** It is the duty of an auditor that he should verify investments himself while certifying such investments.
- 9.** An auditor should check properly the stock and the accounts.
- 10.** That it is the duty of a company's auditor in general to satisfy himself that the securities of the company in fact exist and are in the safe custody, cannot be gainsaid.