

The Company Audit – II

Books of account, etc., to be kept by company :

- a) all sales and purchases of goods and services by the company;
- b) the assets and liabilities of the company;
- c) all sums of money received and expended by a company
 - Every company shall prepare and keep at its registered office
 - The company may also keep all or any of the books of accounts at any other place in India as the Board of directors may decide.

Electronic form of Books of accounts:

- The Companies (Accounts) Rules, 2014 provides that the company may keep its books of account or other relevant papers in electronic mode.
- Shall remain accessible in India so as to be usable for subsequent reference
- There shall be a proper system for **storage, retrieval**
- The **back-up** of the books of account and other books and papers of the company maintained in electronic mode

Period of Maintenance:

The books of account of every company together with the vouchers relevant to any entry in such books of accounts shall be kept in order by the company for a minimum period of **8 financial years** immediately preceding a financial year.

Financial Statements:

- (a) a **balance sheet** as at the end of the financial year;
- (b) a **profit and loss account**, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

- (c) **cash flow statement** for the financial year;
- (d) a statement of changes in equity, if applicable

Where a company has one or more subsidiaries, it shall, in addition to its own 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.

Board's Report - Directors' Responsibility Statement

The directors' responsibility statement shall state that—

- in the preparation of the annual accounts, the applicable accounting standards had been followed
- the directors had taken proper and sufficient care for the maintenance of adequate accounting records
- the directors had prepared the annual accounts on a going concern basis
- the directors had taken proper and sufficient care for safeguarding the assets of the company

Special Requirements of Company Audit:

Memorandum of Association:

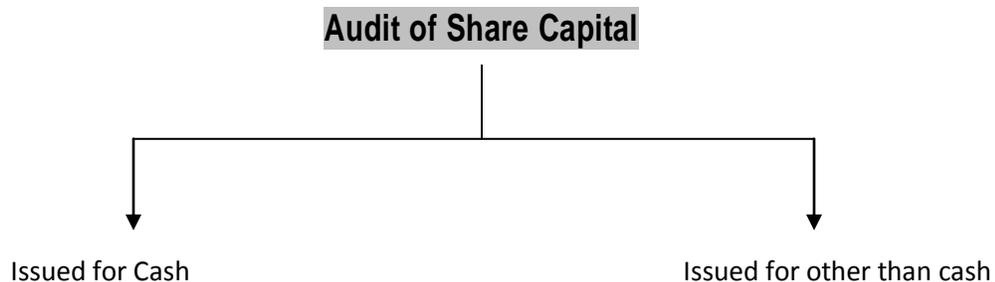
- It is a document that contains particulars of business activities that the company can undertake and its powers.
- If a company enters into a transaction which is ultra vires, the shareholders, though entitled to claim the profit arising on such a transaction, may restrain the management from charging the loss
- If the auditor fails to detect and report the transactions which are ultra vires the company, he would be guilty of negligence.

Articles of Association

- These are rules and regulations for the **internal management** of the company
- The auditor, who fails to take note of the provisions in the Articles in the verification of statements of accounts, would be guilty of **professional negligence**.
- While delivering judgment in the case, **Leeds Estate Building and Investment Co. v. Shepherd, Starling J.** said, "It is the duty of the auditor to see that the balance sheet is a true and correct representation of the company's affairs. It was no excuse that the auditor had not seen the articles when he knew of their existence."

Prospectus:

- It is a formal document which a public company must issue before it makes the allotment of shares.
- In case the company fails to carry out any of these undertakings or if any statement made by it ultimately is proven to be false, the shareholder has the option to claim **refund** of the amount paid by him.
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Verification of Shares Issued for Cash:

- Check entries in the Application and the Allotment Book as regards deposits of money, received with the applications, with those in the Cash Book
- Vouch amounts refunded to the unsuccessful applicants with copies of Letters of Regret
- Check whether the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on such application have been received by the company.
- See the returns of allotment have been filed with the Registrar of Companies.

Verification of Shares Issued for other than Cash:

Sometimes, in view of the nature of the transaction, it may be difficult to know whether an allotment is for cash or for a consideration, other than cash, for instance, allotment of shares in adjustment of a debt owed by the company. In such a case, if the allotment is made in adjustment of a bonafide debt payable in money at once, the allotment should be considered as against cash.

Shares Issued at a Premium:

The Auditor must verify if the securities premium account is applied by the company, only for the below mentioned purposes:

- towards the issue of fully paid bonus **shares**;
- in writing off the **preliminary expenses** of the company;
- in writing off the expenses of, or the **commission** paid or discount allowed on, any issue of shares or debentures of the company;
- in providing for the **premium** payable on the redemption of any redeemable **preference shares** or of any debentures of the company; or
- for **buy-back** of shares

Shares Issued at a Discount:

A company shall not issue shares at a discount, except in the case of an issue of sweat equity shares.

Any share issued by a company at a discounted price shall be void. Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Issue of Sweat Equity Shares:

The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

- the issue is authorised by a **special resolution** passed by the company;
- the resolution specifies the number of shares, the current market price, consideration, if any
- not less than **one year** has, at the date of such issue, elapsed since the date on which the company had commenced business.
- If the company was listed on a stock exchange, if guidelines of the SEBI were followed for issuing the Sweat equity shares.

Audit of buy-back of shares:

The Auditor shall verify whether:

- the buy-back is authorised by its articles
- a proper resolution has been passed in general meeting of the company authorising the buy-back.
- Every buy-back shall be completed within **twelve months** from the date of passing the resolution

- the buy-back is equal or less than **twenty-five per cent** of the total paid-up capital and free reserves of the company
- Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within **seven days** of the last date of completion of buy-back
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Audit of Issue of Preference Shares:

- issue of such shares has been authorized by passing a special resolution in the general meeting of the company
- the price at which such shares are proposed to be issued
- the terms of redemption, including the tenure of redemption
- the manner and modes of redemption
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Redemption of Preference Shares :

The Auditor should ensure that-

- no such shares shall be redeemed unless they are fully paid
- no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption
- where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account

Verification of Forfeiture of Shares :

The auditor should-

- ascertain that the Articles authorise the Board of Directors to forfeit shares
- verify the amount of call or instalment of calls which was outstanding in respect of each of the share forfeited
- ascertain that the Board of Directors has the authority under the Articles to re-issue forfeited shares
- Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of Section 53 of the Companies Act, 2013 is essential as issuance of shares at discount other than sweat equity share are void.

Shares Transfer Audit:

- Check where an instrument of transfer of securities held in physical form is in Form No.SH.4 duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation
- Examine if the company has duly maintained the records of the transfer forms.

Verification of Issue of Bonus Shares:

The Auditor shall verify:

- it is authorised by its articles
- it has, on the recommendation of the Board, been authorised in the general meeting of the company
- it has not defaulted in payment of interest or principal in respect of fixed deposits, if any
- the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up

- it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus
- The auditor should ensure that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets (Only Free reserves can be used)

Audit of Debentures:

As in the case of shares, in the case of debentures also, it is necessary for the auditor to verify whether allotment was made having regard to the terms and conditions contained in the prospectus or the Statement in lieu of Prospectus.

Further, the auditor should ensure that the issue of debentures with an option to convert such debentures into shares, wholly or partly at the time of redemption, are approved by a special resolution passed at a general meeting.

Debenture Redemption Reserve Account : Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

The Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend.

The company shall create Debenture Redemption Reserve equivalent to notified rate i.e at least 25 percent of the amount raised through the debenture issue before debenture redemption commences.

The total amount of premium payable on redemption may be debited to an account denominated as “Loss on Issue of Debentures” and credited to “Premium payable on Redemption of Debentures Account or subsequently, the debit balance in the first mentioned account should be carried forward till it is written off, while the latter account would be closed on payment of the premium, on redemption of debentures.

Audit of Dividends:

- Inspect the shareholders' Minute Book to verify the amount of dividend declared and confirm that the amount recommended by the directors.
- If a separate bank account was opened for payment of dividends, check the transfer of the total amount of dividends payable from the Dividends Accounts.
- According to section 123, as it is compulsory for a company to transfer the total amount of dividend which remains unpaid or unclaimed, within thirty days of the declaration of the dividend to a special bank account entitled "Unpaid Dividend Account of Company Limited/Company (Pvt.) Limited". Such an account is to be opened only in a scheduled bank. The transfer must be made within 7 days from the date of expiry of thirty days.
- In case any money transferred to the unpaid dividend amount of a company remain unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred to Investor Education and Protection Fund

Interim Dividends:

- A company may distribute part of its profits during the two annual general meetings. That means, a company may declare dividends before the close of the accounting year and finalisation of accounts.
- The Board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.