BUSINESS LAW

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AUDITOR'S REPORT

"A report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject-matter of the report."—-Lancaster

An auditor is appointed by the shareholders of a company to audit its accounts and as such, he makes a report to them about the affairs of the company. Sometimes, the auditor is appointed by the Directors as the first auditor of a company and in case of casual vacancy but still then, he submits his report to the shareholders.

Under section 227(2)' of the Companies Act, the auditor is required to make a report to the members of the company on the accounts examined byhim and on every Balance Sheet and Profit and Loss Account and on every other document declared by the Act to be annexed to the Balance sheet or Profit and Loss Account which are laid before the company in General Meeting during his tenure of office. Such a report is known as the Auditor's Report.

It is, however, the duty of the Directors to prepare the accounts for presentation to the auditor. The manner in which these accounts are to be approved by the Directors is laid down in section 215 of the Companies Act.

Importance of Auditor's Report to Shareholders

As stated earlier, an auditor is the agent of the shareholders who have virtually no knowledge of the material facts about the affairs of the company. The chief value of the Auditor's Report lies in its check on the accuracy of the figures presented, though, of course, it does not add anything to the information disclosed. The auditor is required to conduct a sufficient examination of the books and other records including the Balance Sheet and Profit and Loss Account. On the basis of this security, he makes a report to the members of the company and thus, acquaints them with true and fair state of the company's affairs. Hence the auditor is appointed for their benefit of shareholders and not for the benefit of the Directors.

An auditor is not expected to guarantee the of everydetail of the company's books. He cannot bring all the errors and fraud to light and act against those who are found guilty of somefraudulent manipulation. He is a watchdog and not a blood-hound. His duty is simply to make a report to the members that the Company's financial position is truly exhibited by the Balance Sheet and Profit and Loss Account.

Contents of the Audit Report

According to section 227 (3) of the Companies Act, the Auditor's Report shall state:

(I) "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, in the case of the Balance Sheet, of the state of the company'saffairs as at the end of its financial year andin the case of the Profit and Loss Account, the profit or loss for its financial years."

Explanation- This reveals a set of two duties to be performed by the auditor. On the one hand, he has to certify that 'the accounts give the information required by the Companies Act, in the manner so required, and on the other hand, he has to declare that the accounts give a true and fair view of the company's affairs and its profit or loss for its financial year.

The Auditor's Report shall also state:

(2) "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."

Explanation- The Act has empowered the auditor to inspect all the books, accounts and vouchers of the company at all times whether they are kept at the Head Office of the company or elsewhere and the auditor shall be entitled to require from the officers of the company such information and explanations as he may think necessary for the performance of his duties as an auditor.

(3) "Whether in his opinion, proper books of accounts as required by law have been kept by the company so far as it appears from examination of those books and proper returns adequate for the purpose

Secondly, he should confirm and report that proper returns are being submitted by the branches and these returns are adequate for the purpose of his audit. This provision is applicable for those branches which have not been visited by him.

(4) “Whether the report on the accounts of any Branch Office audited by branch auditors is received.

Under section 228 by a person other than the company’s auditor has been forwarded to him as required by Clause of sub-section (3) of that section and he has dealt with the same in preparing the Auditor’s Report.” Explanation. Further, the auditor should confirm that the accounts of any Branch Office have been audited under section 228 by a person other than the company’s auditor and the report of such an auditor has been forwarded to him.

He has to state clearly that he has taken full note of the said report in preparing his own report.

(5) “Whether the company’s Balance Sheet and Profit and LossAccount dealt with by the report are in agreement with the books of accounts and returns.”

Explanation- Lastly, he has to confirm in his report whether the Balance Sheet and Profit and Loss Account of the company are in full agreement with its books, accounts and returns.

This needs no comment in every business, the final accounts are prepared in accordance with the books of accounts, returns, etc. The auditor of every company is required specifically to mention this fact in his report that it has been actually done.

Practically, it is rather very difficult for an auditor to report against the Directors of the company. But after all, it is his responsibility to submit his correct report to the shareholders whose interests he has to safeguard.

Basic Elements of Auditor's Report

The auditor's report should incorporate the following elements in it:

Title

Addressee

Identification of the financial statements audited

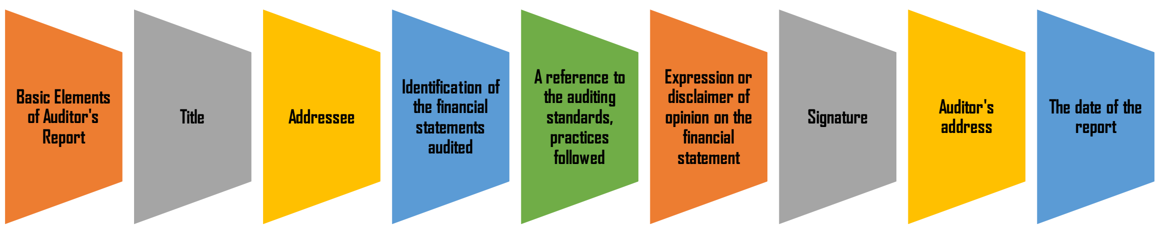
A reference to the auditing standards, practices followed

Expression or disclaimer of opinion on the financial statement

Signature

Auditor's address

The date of the report



The specific contents of the report will be according to the requirements of the Act if the report is mandatory in the act. In companies Act, section 227 casts the duty on auditor to make report to shareholders. In addition to this report, the auditor makes out a long form audit report to the management. It contains detailed observation of auditors on various matters connected with financial areas of the company. It points out weaknesses, lapses and errors/frauds observed in the system. It suggests corrective measures. A good report must alteast meet the following qualifications:

It should be based on factual information

It should be convincing

It should be forceful

It should be unbiased

It should point out mistakes

It should be a constructive criticism and not be in reprimanding tone it should offer constructive and timely suggestions to the management

It should be brief. If it is lengthy, the object of the report is defeated even if it is well written.

Singing of Auditor's Report:

Only the person appointed as the auditor of the company, or a partner in the firm of auditors (if all the partners of the firm are entitled to practice in India) may sign the auditor's report, or may sign or authenticate any other document of the company required to be signed or authenticated by the auditor (Section 229). In case it has been signed by a partner of the firm of auditors, he should inform the Registrar within a reasonable time that he has signed the report. This intimation should be sent preferably within seven days after the date on which the audit report was signed. If any auditor's report is made, or any document of the company is signed or authenticated, otherwise than in conformity with the requirements of Section 227 and 229, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document, shall , if the default is wilful, be punishable with fine which may extend to not thousand rupees (Section 233).

Report of the auditor (including the auditor's separate, special or supplementary report, if any) shall be attached to every balance sheet placed before every annual general meeting (Section 216), while the report is to be annexed to every annual returns.

Types of Opinion

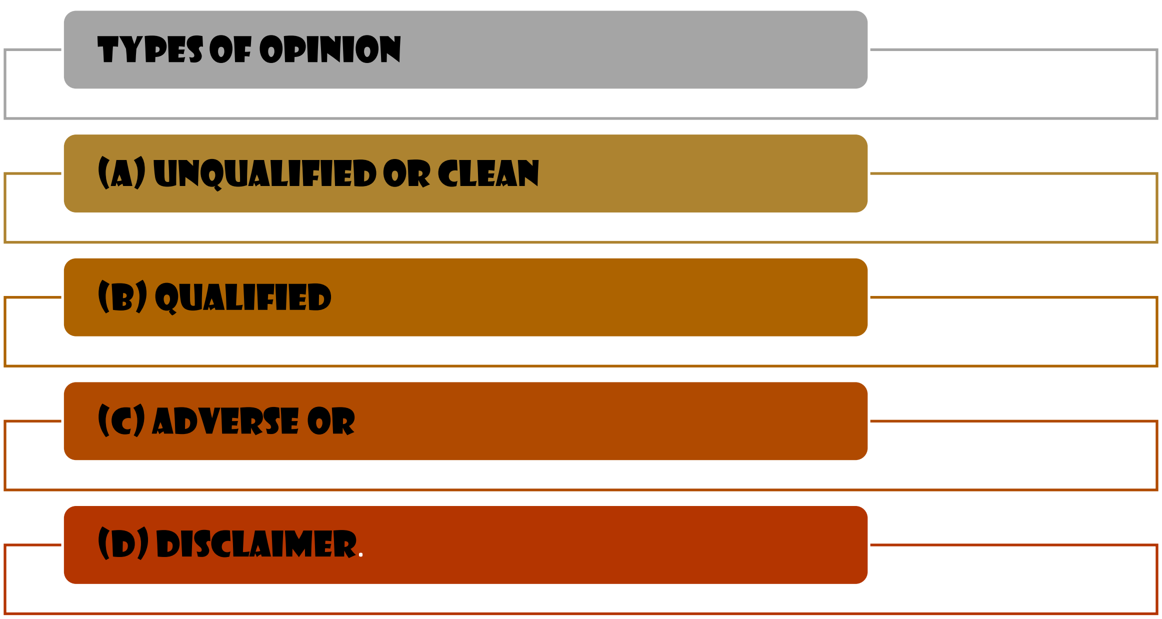
The auditor expresses his opinion about the financial information reported in annual statements of accounts. His opinion may be

(a) Unqualified or clean

(b) Qualified

(c) Adverse or

(d) Disclaimer.



Unqualified opinion

The auditor issues an unqualified opinion if he is satisfied in all material respects with the matters he reports to shareholders. Specifically, if he is satisfied in all material respect with regard to

(a) Preparation of accounts adhering to accepted accounting policies and application of accounting policies in a consistent manner;

(b) The final accounts being in agreement with the books of account;

(c) The final accounts being true and fair summary of the financial transactions of the company;

(d) The disclosure of information in final accounts as per the requirements contained in the Act and;

(e) The transactions of the company, in so far they get reflected in financial statements being not violative of the provisions of the companies Act, memorandum of association or articles of association. An unqualified opinion is also called clean or positive opinion.

Qualified Opinion:

The auditor issues qualified opinion when

He is not satisfied in material respects with matters concerning the areas of his report. (i.e. truth and fairness of financial information, proper disclosure of information, compliance to provisions of statute etc.),

His non-satisfaction is due to circumstances such as limitations imposed on his scope of audit work, disagreement with management or uncertainty over financial information.

The effect of his disagreement, uncertainty or limitation is not so material as to compel the auditor to give an adverse opinion or to state a disclaimer.

The auditor must be very clear as to when he should qualify his report and how he should qualify the report. The directors sometimes, try to persuade the auditor to desist from giving qualified report as it is a slur on the work of the directors for the year under review. Moreover, a qualified report leads to bad consequences e.g., fall in value of shares in the market, non-renewal of appointment of directors, appointment of investigation etc. Unconcerned to these, the auditor must set out his qualifications to the report if it is necessary according to his professional judgement of circumstances.

Adverse Opinion:

The auditor issues an adverse opinion when

He is not satisfied in material respects with matters concerning the areas of his report (e.g., truth and fairness of financial information, proper disclosure of financial information, compliance to provisions of stature etc.)

His dissatisfaction is due to disagreement with management, in what they have done (both omission and commission) respecting preparation and presentation of financial information.

His dissatisfaction is of such a magnitude as to force the auditor to frame up a negative opinion that the financial statements, taken as a whole, don’t give true and fair view of the results of operations of the company or financial position of the company.

It has been said that the auditor should desist from issuing qualified opinion when he must issue adverse opinion. It, then equally implies, that the auditor should desist from resorting to issue of adverse opinion when qualified opinion is sufficient. For example, when the matters over which the auditor is not satisfied are material in themselves, but not so serious as to make the whole of financial statements as untrue or unfair, the auditor should not give out adverse opinion, but give only qualified opinion.

Disclaimer:

The auditor issues an opinion of disclaimer when

He is unable to express his opinion in respect of matters concerning areas of his report

The inability to express opinion is due to limitations placed on the scope of his audit work or uncertainty affecting financial statements the resolution of which is dependent on future events.