

**WEBINAR on the
Opinion of the Council of 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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What is Internal Audit?

- Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.
- It assists the organization to accomplish its objectives by bringing a systematic, & disciplined approach to evaluate and improve the effectiveness of
 - *risk management,*
 - *control, and*
 - *governance processes.*
- IA provides an assurance relating to
 - *Effectiveness of operations,*
 - *Reliability of financial management and reporting, and*
 - *Compliance with laws and regulations.*

Legal Provisions on Internal Audit

- Section 138 of the Companies Act 2013 read with Rule 13 of the Companies (Accounts) Rules, 2014 - following class of companies shall be required to appoint an internal auditor
 - *every listed company;*
 - *every unlisted public company having –*
 - paid up share capital of Rs.50 crore or more during the preceding financial year; or
 - outstanding deposits of Rs.25 crore or more at any point of time during the preceding financial year; and
 - *every unlisted public company or private company having –*
 - turnover of Rs.200 crore or more during the preceding financial year; or
 - outstanding loans or borrowings from banks or public financial institutions exceeding Rs.100 crore or more at any point of time during the preceding financial year:

Legal Provisions on Internal Auditor

- 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.
- Explanation below Rule 13 of the Companies (Accounts) Rules, 2014 - For the purpose of this rule –
 - ***the internal auditor may or may not be an employee of the company;***
 - 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.***
- 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.

Appointment of Internal Auditor in Public Companies

- Many Central Government Companies, State Government Companies, and their Subsidiary & Joint Venture Companies follow tender process for appointment of Internal Auditors.
- They prescribe following mandatory conditions of eligibility–
 - *The individual should be a Chartered Accountant or the firm should comprise of Chartered Accountants;*
 - *The individual or the firm should have requisite experience in statutory audit; and*
 - *The individual or the firm must be empanelled with the office of Comptroller & Auditor General (C&AG) of India.*
- **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.**

Opinion of the Council

- The Council of the Institute of Cost Accountants of India has considered all the relevant issues and published its Opinion on the following matters:
 - *What is meant by “Statutory Audit”*
 - *Who are lawfully eligible for appointment as Internal Auditors in Public Companies under section 138 of the Companies Act, 2013*
 - *Whether there is necessity for any individual or the firm to be empanelled with the office of Comptroller & Auditor General (C&AG) of India*

Certain Terms Explained

- For better understanding of the issues, following terms have been explained
 - *Statutory*
 - *Audit*
 - *Purpose of Audit*
 - *Statutory Audit*
 - *Types of Statutory Audit*
 - *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,
 - *Fundamental rights*
 - *Grant of Citizenship*
 - *Driving restrictions*
 - *Legal age limit for marriage, job or retirement*
 - *Statutory tax rates*
 - *CRR, SLR, Repo Rate, Reverse Repo Rate, etc.*
- There is no law to decide whom you want to marry, how many children you should have, which colour clothes you wear, what you should eat or drink [but there is law restricting drink & drive]

STATUTORY

- The term 'law' includes the
 - Principal Acts enacted by the concerned Legislature i.e. Parliament of India or State Assembly of any State or UT.
 - Subordinate legislations viz. Rules, Regulations, Notifications, Orders, etc. issued by any statutory authority under the powers conferred under the Principal Act
 - **Companies Act, 2013 passed by Parliament of India**
 - **Companies (Cost Records and Audit) Rules, 2014 notified by the Ministry of Corporate Affairs**
- The terms 'statutory' & 'legal' are often used as synonyms
- Non-compliance of any legal or statutory matter is a punishable offence under the relevant law/statute.

AUDIT

- An 'audit' is systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization to provide “**Assurance**” to all “**Stakeholders**” on the
 - *True & fair view of account statements*
 - *Non-financial disclosures*
 - *Maintenance of books of accounts and records*
 - *Material misstatements*
 - *Internal control systems*
 - *Business ethics followed*
 - *Governance structure*
- A statutory audit is meant to fulfill the requirements prescribed under the law or statute.
- A voluntary audit is meant to serve the specific purpose of the authority within the organization who prescribed such audit.

AUDIT

- The audit has public interest objective as it is conducted for the benefit of all stakeholders.
- The primary stakeholders are management, shareholders, investors, government(s), tax authorities, and lenders.
- Other stakeholders include customers, debtors, creditors, & employees.
- 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.
- The auditor also helps in early detection of fraud or possible happening of fraud/misappropriation.

Purpose of Audit

- As per Companies Act 2013, Board & Management are responsible for
 - *maintenance of books of account & related records,*
 - *laying down effective accounting policies & internal controls,*
 - *preparation of annual financial statements,*
 - *compliance with the accounting standards,*
 - *maintenance of cost accounting records & preparation of cost statements, and*
 - *ensuring compliance with various laws in the country.*
- Still, law has provided for financial audit, cost audit & secretarial audit by independent professionals – **why??**
- The auditor provides independent assurance to all stakeholders about the truth & fairness of the entity's statements & other disclosures and to report by exception on all other requirements as prescribed under the law.

Statutory Audit

- The term 'statutory audit' denotes that the audit is required by statute i.e. by 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.

Statutory Audit

- 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

- ***Audits under the Companies Act, 2013***
 - Financial audit prescribed u/s 139
 - Cost Audit prescribed u/s 148
 - Secretarial Audit prescribed u/s 208
 - Internal audit prescribed u/s 138(1)
- ***Audits under the Direct & Indirect Tax Laws***
 - 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 under Customs Act, Central Excise Act, & State VAT Acts

Types of Statutory Audit

- ***Audits under other Statutes***

- Concurrent Audit, Branch audit, & Stock audit under the Banking Regulation Act
- Billing & Metering Audit prescribed by TRAI
- Audit of Stock Brokers and Credit Rating Agencies prescribed by SEBI
- Internal Audit/Concurrent Audit under the National Health Mission
- Performance audit of cooperative societies under the Cooperative Societies Act
- Internal & Concurrent audit for Depository Operations under the National Securities Depository Limited (NSDL)
- Financial audit of banks, insurance companies, cooperative societies, partnership firms, LLPs, proprietorships, HUFs, societies, trusts, etc.
- Forensic audit prescribed under various statutes

Audit by Whom

- In case of Governments or public authorities, audit is conducted by the Comptroller & Auditor General (C&AG).
- An audit of a public or private organization or business entity is carried by the independent professionals appointed as auditors.
- The independent auditors are not employees except may be in the case of internal audit.
- All audits, whether statutory or voluntary, are not conducted by the Chartered Accountants.
- Large number of statutory audits are conducted by Cost Accountants.
- Other special audits are conducted by specialist professionals

TYPE OF STATUTORY AUDIT	AUDIT BY WHOM	
Financial audit under the Companies Act, 2013 or Banking Regulation Act or Insurance Act	CA	
Financial audit under the Cooperative Societies Act (in few States)	CA	CMA
Tax audit under the Income Tax Act, 1961	CA	
Cost audit under the Companies Act, 2013		CMA
Internal audit under the Companies Act, 2013	CA	CMA
Audit under the GST Act, Customs Act, Central Excise Act, State VAT Acts, etc.	CA	CMA
Stock audit under the Banking Regulation Act	CA	CMA
Billing & Metering audit, Performance audit, Forensic audit, Concurrent audit, etc.	CA	CMA

TYPE OF OTHER AUDITS	AUDIT BY WHOM
Secretarial Audit	Company Secretary
Energy Audit	Power Engineer
Structural Audit	Architect or Structural Engineer
Pollution or Environmental Audit	Environment Specialist
Quality Audit	Quality Engineers
Project Audit	Project Managers
Operations Audit	Operations Manager
Health Audit	Doctors or Medical Experts
Regulatory Audit	Regulatory Authorities
Management Audit	Management Accountants
Academic Audit	Academic/Education Experts
Soft or IS Audit	Software Engineers
Technical Audit	Technical Experts

Many public companies prescribe three conditions of eligibility for appointment as Internal Auditors.

Condition No. 1

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

On condition no. 1

- As per section 138 of the Companies Act 2013, an Internal Auditor may be a
 - Chartered Accountant or
 - Cost Accountant or
 - such other professional as may be decided by the Board.
- 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.

On condition no. 1

- Identical definitions under the Companies Act, 2013
 - Section 2(17) "**chartered accountant**" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act.
 - Section 2(28) "**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 (23 of 1959) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act.

On condition no. 1

- Rule 13 of the Companies (Accounts) Rules, 2014 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 company.*
- *This clearly violates the rights enshrined upon the Cost Accountants under the Companies Act, 2013.*

Condition No. 2

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

On condition no. 2

- Statutory audits are conducted under various Laws/Statutes
 - Financial audit, Cost Audit, & Secretarial Audit conducted under the Companies Act, 2013
 - Audit under Income Tax Act, GST Act, Customs Act, Central Excise Act, & State VAT Acts
 - Concurrent Audit, Branch audit, & Stock audit under the Banking Regulation Act
 - Billing & Metering Audit under TRAI Regulations
 - Performance audit under the Cooperative Societies Act

On condition no. 2

- Statutory audits conducted under various Laws/Statutes are performed by different professionals viz. Chartered Accountants, Cost Accountants & Company Secretaries
- But the most popular term used for statutory audit is the financial audit conducted under the Companies Act, 2013.
- This limited meaning of the term 'statutory audit' is not defined in law but is merely accepted as a practice.

On condition no. 2

- It would be totally unlawful if the individual's or the firm's experience in other audits conducted under other laws/ or statutes is not reckoned.
- And while reckoning the experience as statutory auditor, the cost audit conducted under section 148 of CA, 2013 is not considered as statutory audit.
- Such a practice of not accepting cost audit as a statutory audit is summarily against the law and needs to be stopped.

Condition No. 3

***The individual or the firm
must be empanelled with
the office of Comptroller &
Auditor General of India***

Appointment of statutory auditors in government companies/corporations

Financial auditor

- Appointed made by the C&AG u/s 139 of CA, 2013
- C&AG maintains a panel of eminent firms of Chartered Accountants as per the eligibility, qualifications and disqualifications as prescribed u/s 141 of CA 2013
- Report given to Shareholders

Cost auditor

- Appointed made by the Board u/s 148 of CA, 2013
- C&AG **does not** maintain any panel of eminent firms of Cost Accountants as per the eligibility, qualifications and disqualifications as prescribed u/s 141 & 148 of CA 2013
- Report given to Board

On condition no. 3

- As per section 138 of the Companies Act 2013, an Internal Auditor may be a
 - Chartered Accountant or
 - Cost Accountant or
 - such other professional as may be decided by the Board
- As per law, both Chartered Accountants and Cost Accountants are equally eligible to conduct internal audit of any public or private 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.*

On condition no. 3

- All companies to note:
 - Both Chartered Accountants and Cost Accountants are equally eligible for appointment as Internal Auditors under section 138 of the Companies Act 2013
 - C&AG **does not** maintain any panel of either Chartered Accountants or Cost Accountants for appointment as Internal Auditors in Government Companies/ Corporations as per the qualification prescribed under section 138 of Companies Act, 2013.
- *Therefore, it is unlawful if any such pre-condition of C&AG empanelment is made mandatory eligibility for appointing internal auditor in any public company.*
- *This violates the rights enshrined upon the Cost Accountants under the Companies Act, 2013.*

GIST OF OPINION

- **No company which is mandatorily covered for Internal Audit under Section 138 (1) of the Companies Act, 2013 and Rules made thereunder**
 - **can issue a tender document by laying down such conditions that makes the**
 - **Cost Accountants or Cost Accountant Firms**
 - **ineligible for appointment as Internal Auditors of the Company.**

THANKS