

Appointment, Removal and Resignation of Auditor

Section 139 and 140 of the Companies Act, 2013

The Companies Act, 2013 has been evolving for nearly a decade now from a bill introduced in the year 2008. There are few provisions which still require clarification from the regulator's end. This article is to comprehend the provisions relating to appointment, removal and resignation of auditors by and from the companies.

Section 140(1) of the Companies Act states that the auditor appointed under Section 139 may be removed by a special resolution after obtaining Central Government approval. Section 140(4) requires special notice for a resolution at an AGM appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except in case of retirement due to Section 139(2) of the Act. To understand the provisions more clearly let's find out applicable resolutions in the following cases:

Case 1:

The extract of Sections 140(1) of Companies Act, 2013 states as follows:

Section 140 Appointment of Auditors

(1) The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner:

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Company 'A' wants to remove its Auditor 'X'. In the given scenario, Company 'A' has to apply in Form ADT-2 with the Central Government (presently delegated to the Regional Director vide Notification No. S.O. 1352(E). dated 21st May 2014). On receipt of approval, the Company has to hold a general meeting within 60 days to pass a special resolution for removal of auditor. The resolution can be passed either at an AGM or EGM.

Case 2:

The extract of Sections 139(2) of Companies Act, 2013 states as follows:

139 Appointment of Auditors

(2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

- (a) an individual as auditor for more than one term of five consecutive years; and
- (b) an audit firm as auditor for more than two terms of five consecutive years

Company 'A', a listed Company wants to appoint an auditor 'Y' in place of 'X' existing auditor who is bound to retire in terms of Section 139(2) after being appointed in the year 2014 and has served 5 years. The Company need not pass any resolution for not re-appointing auditor 'X' but shall pass an ordinary resolution at the AGM for appointment of 'Y' in place of 'X'.

Case 3:

The extract of Sections 140(1) and 140(4) of Companies Act, 2013 states as follows:

Section 140 Appointment of Auditors

(1) The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner:

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

(4) (i) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139.

(ii) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(iii) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,—

(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company, and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting:

Provided that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar:

Provided further that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

Company 'A' wants to remove its auditor 'X' and appoint 'B' in his place. For removal of 'X' the company has to pass a special resolution after obtaining the central government approval in accordance with Section 140(1) as in Case 1. For appointing auditor 'B', the company if it receives a special notice as per Section 140(4), the Company shall send copy of the same to the existing auditor 'X' to receive his representation; send the representation received along with copy of the notice of AGM wherein the appointment can be made by passing an ordinary resolution.

Case 4

The extract of Sections 139(9) and 140(4) of Companies Act, 2013 states as follows:

Section 139 Appointment of Auditors

(9) Subject to the provisions of sub-section (1) and the rules made thereunder, a retiring auditor may be re-appointed at an annual general meeting, if—

(c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

Section 140 Appointment of Auditors

(4) (i) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139.

(ii) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(iii) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,—

(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company, and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting:

Provided that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar:

Provided further that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

Company 'A' has received a special notice from a member to remove the auditor 'Firm X' after being served as the Company's auditor for 5 years and appoint another audit firm Y. The company may pass a special resolution in line with Sections 139(9) and 140(4) to remove audit firm X and an ordinary resolution for appointment of audit firm Y.

Case 5

The extract of Section 139(8) of Companies Act, 2013 states as follows:

Section 139 Appointment of Auditors

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(8) Any casual vacancy in the office of an auditor shall—

(i) in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;

Auditor X has resigned from a Company A which has resulted in a casual vacancy and the Company intends to appoint Y as its auditor. The provisions of Section 139(8) guides that auditor Y may be appointed by the board of directors within 30 days and the same shall be approved by the shareholders at a general meeting convened within a period of 3 months of board appointment and Y shall hold the office till the conclusion of the next annual general meeting.

Case 6

The extract of Section 140(5) of Companies Act, 2013 states as follows:

Section 140 Removal, Resignation of Auditor and Giving of Special Notice

(5) Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either suo moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors:

Provided that if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place:

Provided further that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

Explanation I.—It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

X, an auditor in Company 'A' is proposed to be removed by the Central Government due to his collusion with the senior management of the company for suppression of income during his audit period. The Central Government has made an application with the Tribunal for the same as per Section 140(5) of the Act and the same is ordered by the Tribunal. The Central Government hasn't appointed any other auditor in place of X. The Company 'A' intends to appoint another auditor 'Y' in place of 'X'. The appointment of auditor Y can be made only by the Central Government as the appointment of auditor in the given situation is its right.

Summary of table indicating the appointment and removal of auditor under Section 139 & 140

I	X – Remove	S.R. + C.G.
II	X – should not be reappointed - Term expired Cooling off period → No resolution	Appt. of Y → Ordinary resolution
III	Z – Remove → S.R. + C.G. 140 (1)	A – Appoint → Special Notice + O.R. Sec. 140 (4)
IV	X – Retiring auditor – shall not be re-appointed → Special Notice + S.R.	Y – Appoint → S.R. / O.R. Sec. 139 (9)
V	Casual vacancy has arose	Appoint an auditor – Board & S.H. – O.R.
VI	Y – appoint in the place of X	S.R. O.R.

Case 7:

The extracts of Sections 140(1), 140(5) and 245(1) of Companies Act, 2013 states as follows:

Section 140 Removal, Resignation of Auditor and Giving of Special Notice

(1) The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner:

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

(5) Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either suo moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors:

Provided that if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place:

Provided further that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

Explanation I.—It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

Section 245 Class Action

(1) Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of

the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:—

- (g) to claim damages or compensation or demand any other suitable action from or against—
 - (ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or
- (h) to seek any other remedy as the Tribunal may deem fit.

The depositors of Company 'A' voiced their concern by a letter to the Chairman of the Company that auditor 'X' needs to be removed due to collusion with the management for falsification of accounts and misstatement in the auditor's report. Few of the depositors are also members of the Company. Whether all the depositors can apply for removal of auditors in their capacity or members-cum-depositors can only apply? The depositors as well as members are eligible to bring class action suit against the auditors under Section 245(1)(g) in the NCLT to claim damages or compensation or demand any other suitable action. However, they cannot plead removal of the auditor under this section as the auditors have been appointed by the members at the AGM. The removal of auditor can be made by the members by applying to the Central Government and passing a special resolution at the general meeting under Section 140(1). It may also be noted that the NCLT has wide powers to remove the auditor suo-moto even if the class action suit is filed by the depositors, by invoking Section 140(5) or 245(1)(h).

Case 8:

The extract of Section 132 (4) of Companies Act, 2013 states as follows:

Section 132 Constitution of National Financial Reporting Authority

(4) Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall—

- (c) where professional or other misconduct is proved, have the power to make order for—
 - (B) debarring the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountant of India referred to in clause (e) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 for a minimum period of six months or for such higher period not exceeding ten years as may be decided by the National Financial Reporting Authority.

Explanation.—For the purposes of this sub-section, the expression “professional or other misconduct” shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949.

The Ministry of Corporate Affairs has brought to the notice of professional body regulating auditors and the NFRA, that an auditor X has allowed a person of his office not being a member of the Institute in practice, to sign on his behalf the financial statements of Company A. The NFRA may take up investigation and determine if the professional or other misconduct has been proven, debar the auditor from practice for such period in accordance with section 132 of Companies Act, 2013, which is a deemed removal.