

10

CHAPTER

THE COMPANY AUDIT

Chapter X of the Companies Act, 2013: AUDITORS

Companies Act, 2013 is a RULE based Act. One should follow the rules as given in the sections and rules of the Companies Act.

CA students should have very good knowledge on these provisions as these are going to be followed in practice. Broadly, in this chapter you will understand “who can be appointed as an auditor under the Act, *i.e.*, qualifications and disqualifications, the manner of appointment and removal of an auditor and rights and duties of an auditor”.

Section of Companies Act, 2013 to be discussed in this chapter	
139	Appointment of Auditors
140	Removal, Resignation of auditor and giving of Special Notice
141	Eligibility, Qualifications and Disqualifications of Auditors
142	Remuneration of Auditors
143	Powers and Duties of Auditors and Auditing Standards
144	Auditor not to render certain services
145	Auditors to sign Audit Reports, etc.
146	Auditors to attend General Meeting
147	Punishment for contravention
148	Central Government to specify audit of items of Cost in respect of certain Companies

Read the provisions very carefully

Qualifications and Disqualifications of Auditor [Section 141]

The Section 141 has **four sub-sections**

141(1) & (2) – discuss about Qualifications;

141(3) & (4) – discuss about Disqualifications.

QUALIFICATIONS of an auditor [Section 141(1) & (2)]

Section 141

- (1) A person shall be eligible for appointment as an auditor of a company **only if he is a chartered accountant** within the meaning of the Chartered Accountants Act, 1949. [CA means a Chartered Accountant *who holds valid Certificate of PRACTICE - Section 2(17)*]

A firm whereof **majority of partners** practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

In case of a partnership firm – Company appoints the “Firm” not the partner in individual capacity.

- (2) Where a firm including a **limited liability partnership (LLP)** is appointed as an auditor of a company, **only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.** [Section 141(2)]



Concept capsule 1

Yogita, a member of the ICAI, does not hold a Certificate of practice. Is her appointment as an auditor valid?

Suggested answer

Not qualified for appointment as auditor u/s 141(1) as she doesn't hold Certificate of practice.



Concept capsule 2

Raj is the Sole Proprietor of Raj & Co., CA's. Can he be appointed by his Firm Name?

Suggested answer

No - When Individual CA is appointed as Auditor, appointment should be in his Personal Name.

DISQUALIFICATIONS of auditors

[Section 141(3) and Rule 10 of Companies (Audit and Auditors) Rules, 2014]:

The following persons **shall not be eligible for appointment** as an auditor of a company, namely:

- (a) “a **body corporate other than a limited liability partnership (LLP)** registered under the Limited Liability Partnership Act, 2008”;

Explanation

It means – If chartered accountants form a company (Whether public/private - like RK Private Ltd./RK Limited) – This Company of CAs cannot be qualified for appointment as auditor of another company.

What is body corporate?

Body corporate u/s 2(11) includes a company as per the Companies Act, 2013 and a foreign company which is incorporated outside India.

Logic behind why a body corporate is not eligible to be an auditor?

As you know a Limited company has “limited liability” & Separate legal entity – The members of the company are responsible only to the extent of unpaid capital (if any). In case of any issue – We cannot make members personally responsible.

In case of LLP, at least one partner will have unlimited liability; hence it is allowed to be auditor.

- (b) an **officer or employee** of the company;

Explanation

As per Section 2(59), ‘**Officer**’ includes

- ◆ Any director;
- ◆ Manager;
- ◆ Key managerial personnel (KMP); or
- ◆ Any person in accordance with whose directions or instructions the BOD or any one or more of the directors is or are accustomed to act.

As per Section 2(51), '**Key Managerial Personnel**', in relation to a company, means:

- ◆ the chief executive officer (CEO) **or** the managing director **or** the manager;
- ◆ the company secretary;
- ◆ the whole-time director;
- ◆ the chief financial officer (CFO); and
- ◆ such other officer as may be prescribed. Like *Chief Operating Officer (COO)*, etc.

Reason

An officer or employee – cannot be independent – If those are appointed as auditors of the company, they cannot express independent opinion on the financial statements.

(c) a person who is a **partner**, or who is in the employment (**employee**), of an **officer** or **employee** of the company;

Explanation

In this case, two relations are possible *i.e.*,

- | | | |
|----------------|---|------------------------|
| (i) partner | } | of officer or employee |
| (ii) employee; | | |

Reason

These people have indirect relationship; hence they are not independent and cannot be appointed as auditor.

Read the above points before answering the following questions.



Concept capsule 3

Answer the following questions

- i. Mr. X is an independent director of ABC Ltd. and he is a partner of a CA firm of XY & Co. Can he be appointed as auditor of ABC Ltd.?
- ii. Mr. Y is the other partner of the firm, can he be appointed as auditor of ABC Ltd.?
- iii. Can firm be appointed as auditor of ABC Ltd.?
- iv. Mr. K is a practicing Chartered Accountant and he is a non-executive director (part time director) of XYZ Ltd. Can Mr. K be appointed as auditor of ABC Ltd.?

Suggested answer

Based on Section 141(3)(b) & (c) –

- i. Mr. X is an officer (director is an officer) of the company; hence he is not eligible for appointment under clause (b).
- ii. Mr. Y is a partner of officer Mr. X; hence he is not eligible for appointment under clause (c);
- iii. When partners are disqualified – Firm is disqualified – Hence firm cannot be appointed as auditor;
- iv. Mr. K is NOT an officer of THE Company (ABC Ltd.) – He is eligible for appointment as auditor.

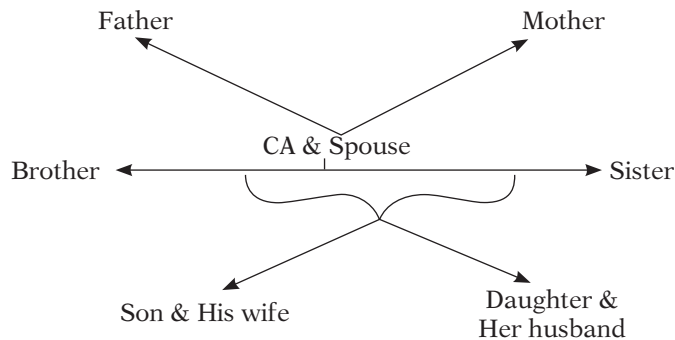
Clause (d) has three sub-clauses – read carefully

(d) a person **who, or his relative or partner**

- (i) **is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company;**
- (ii) **is indebted** to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, **in excess of ₹ 5 Lacs; OR**
- (iii) **has given a guarantee or provided any security** in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, **in excess of ₹ 1 Lac;**

Who is relative as per the Companies Act, 2013?

As per section 2(77) & Rules



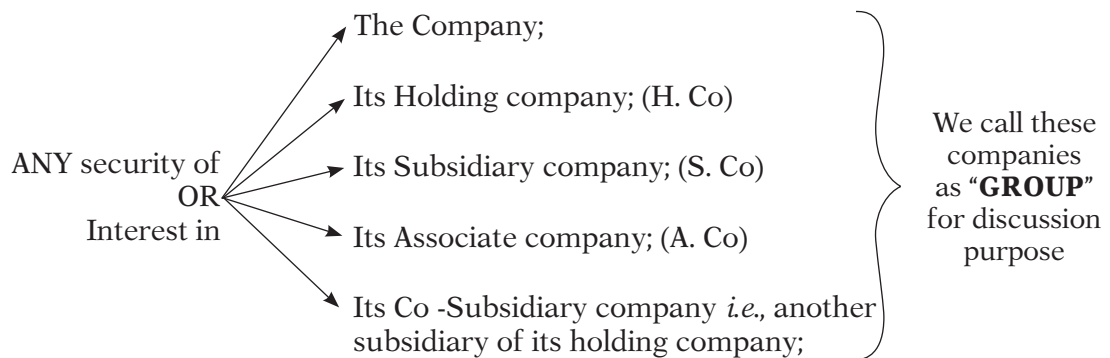
“Relative” includes

- ◆ Members of Hindu Undivided family;
- ◆ Step father, Step mother, Step brother, Step sister & Step son (except Step daughter).

This sub-section should be read with the rules (Follow instructions for better understanding).

First read the above sub-section (3) clause (i);

It says **Auditor (himself)** or **his Relative** or **Partner** should **NOT** hold



There is an exception to the above point- As per Rule 10 of the Company (Audit and Auditors) Rules, 2014,

- ◆ The relative may hold security or interest in the company of **FACE VALUE ≤ ₹ 1,00,000**; (*Remember this exception is applicable only to relative but NOT to the auditor & Partner and also, this exception is not applicable if a relative holds security in any other group company such as H Co./S Co./A Co. Fellow S Co.*)
- ◆ If the relative acquires any security or interest greater than ₹ 1,00,000 face value – Corrective action can be taken by the auditor within 60 days of such acquisition or interest.

What do you mean by Security as per the Securities Contracts (Regulation) Act, 1956?

The word “Securities” include - All Shares, scrips, bonds, debentures, stock, derivatives etc.

**Concept capsule 4**

Mr. A, a practicing Chartered Accountant, is holding securities of XYZ Ltd. having face value of ₹ 900. Whether Mr. A is qualified for appointment as an Auditor of XYZ Ltd.?

Suggested answer

The exception (Rule 10) of holding securities of the company (only – not in the other companies like H. Co., S. Co., A. Co., Co-Subsidiary) to the relatives of the auditor but not to the auditor and partners of the firm. As Mr. A is holding securities in the company – he is disqualified for appointment of auditor of XYZ Ltd.



Concept capsule 5

Mr. P is a practicing Chartered Accountant and Mr. Q, the relative of Mr. P, is holding securities of ABC Ltd. having face value of ₹ 90,000. Whether Mr. P is Qualified from being appointed as an Auditor of ABC Ltd.?
(CA Inter - May 2018)

Suggested answer

As per the rule 10 of the Company (Audit and Auditors) Rules, 2014, the relative may hold security or interest in the company of **FACE VALUE ≤ ₹ 1,00,000;**

In the given case the total holding is less than ₹ 1,00,000, hence Mr. P is qualified to be appointed as auditor of ABC Ltd.



Concept capsule 6

BC & Co. is an Audit Firm having partners Mr. B and Mr. C, and Mr. A the relative of Mr. C, is holding securities of MWF Ltd. having face value of ₹ 1,01,000. Whether BC & Co. is qualified from being appointed as an Auditor of MWF Ltd.?

Suggested answer

As per the rule 10 of the Company (Audit and Auditors) Rules, 2014, the relative may hold security or interest in the company of **FACE VALUE ≤ ₹ 1,00,000;**

If the relative acquires any security or interest greater than ₹ 1,00,000 face value – Corrective action can be taken by the auditor within 60 days of such acquisition or interest.

This correction is applicable when the relatives acquire **after appointment.**

In the given case, as on the date of appointment itself, the relative holds securities, hence BC & Co. firm is not eligible for appointment.



Concept capsule 7

Is this rule of holding not more than ₹ 1,00,000 nominal value of shares applicable to

- (a) Relatives of ONLY Signing partner of the firm;
- (b) Relatives of ALL partners of the firm;

Suggested answer

The Act has not distinguished between signing partner and other partners. Hence, it applies to ALL relatives of ALL partners.



Concept capsule 8

A, B & C are partners of firm ABC & Co.; All are CA holding COP. Mr. A holds 100 equity shares of having Face value ₹ 1,000 in XYZ Ltd.

1. Can appointment be made in the name of Firm in XYZ Ltd.?
2. Can appointment be made in personal name of Mr. B/ Mr. C?
3. Mr. B is partner in BDF & Co. Can BDF & Co. be appointed?

Suggested answer

1. No. If partner is disqualified, Firm is also disqualified.
2. As per Sec. 141(3)(d) - If a partner is disqualified, other partners are also disqualified because the words used are, "A person who or his relative or his partner".
3. BDF & CO may be appointed as none of its partners hold shares in XYZ Ltd.



Concept capsule 9

A, B & C are partner of ABC & Co. All are CA holding COP. Mr. A relative holds 100 equity shares of having Face value ₹ 1,01,000 in XYZ Ltd.

1. Can appointment be made in the name of firm in XYZ Ltd.?
2. Can appointment be made in personal name of Mr. B/Mr. C?
3. Mr. B is partner in BDF & Co. Can BDF & Co. be appointed?

Suggested answer

1. No. As A's relative holds shares of face value more than ₹ 1,00,000, Mr. A is disqualified. So, Firm ABC & Co. is also disqualified.
2. Yes. Mr. B/Mr. C or his partner or his relative does not hold any shares. So, he is qualified.
3. Yes. Mr. B is qualified, So BDF & Co. all the partners are qualified for appointment. So, appointment in name of BDF & Co. is valid.

I hope you understood, clause (i); Let us get into clause (ii)

(ii) is **indebted** to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, **in excess of ₹ 5 Lacs; OR**

(iii) has **given a guarantee or provided any security** in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, **in excess of ₹ 1 Lac.**



Concept capsule 10

Mr. A, a practicing chartered accountant, purchased goods on credit for more than ₹ 6 lakh. As per the entity's regular credit policy – it gives two months credit. Whether he is eligible for appointment of auditor?

Suggested answer

As per the section 141(3)(d)(ii) – auditor or his relative or partner should not be indebted to the group in excess of ₹ 5 lakh;

In the given case, Mr. A is indebted (liable) to the company in excess of ₹ 5 lakh; (whether it is regular credit policy or not); and hence, he is not eligible for appointment.



Concept capsule 11

Can Mr. A 's wife purchases the goods for credit for the same amount?

Suggested answer

The section 141(3)(d)(ii) is applicable for the auditor and his relative also; Hence Mr. A is not eligible for appointment of auditor.



Concept capsule 12

Mr. A wants to collect **advance** fees of ₹ 5,50,000. Is this allowed for appointment of auditor?

Suggested answer

If Mr. A receives advance fees which is more than ₹ 5 lakhs, the above disqualification attracts and hence he is not eligible to be appointed as auditor. That is, if he receives advance of ₹ 5 lakhs or less, it would be okay and he can be appointed.

Explanation

Just imagine the journal entry – Auditor a/c is debited; Cash a/c is credited;

Say if he provided services first – company records – Expense a/c is debited and credit auditor.

**Concept capsule 13**

Continuation to the above capsule, will he be eligible for appointment if he bills progressive basis – i.e., say he completed 40% of work – billing for 40% of fees?

Suggested answer

Progressive billing is allowed. In this case, auditor is not indebted to the company as he is receiving what is owed to him i.e., the accrued fees. He is eligible for appointment of auditor.

**Concept capsule 14**

Mr. X wants to be auditor of SBI Ltd. Can he

- ◆ Hold savings bank a/c in SBI Bank?
- ◆ Hold Credit card of the same bank?

Suggested answer**Savings bank a/c:**

Auditor can hold a bank account. In this case, he is not indebted to the banker, (think – bank only liable to auditor);

Credit Card:

Auditor can hold the credit card subject to maximum limit of ₹ 5,00,000 at any point of time.

**Concept capsule 15**

Can we appoint a person as auditor who is indebted up to ₹ 5,00,000 & gave a guarantee of ₹ 1,00,000?

Suggested answer

Yes. We can appoint such person as auditor of the company. *Read the section carefully. (By Law, indebtedness up to ₹ 5 lakhs and guarantee up to ₹ 1 lakh are allowed.)*

I hope you understood the clause. Let us get into clause (e) of sub-section (3) of section 141- It says

- (e) a person (auditor) or a firm who, whether directly or indirectly (*through agent/relation*), has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company;

It says – Auditor or Firm should not have business relationship with the group either directly or indirectly.

What is business relationship? (As per rules)

'Business relationship' shall be understood as any transaction entered into for a commercial purpose, **except** (*means the following are not treated as business relationship*)

- (i) commercial transactions which are in the nature of **professional services permitted** to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;

- (ii) commercial transactions **which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.**

Just think,

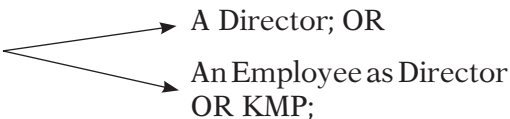
Mr. A is a chartered accountant in practice – His wife (relative) is a director in ABC Ltd. and she has ₹ 50,000 face value equity shares in the company.

Can Mr. A be appointed as auditor for ABC Ltd.? – First read all above points and answer.

Answer

Answer is YES – as per so far clauses discussed. BUT your answer will be “NO” after reading the below clause.

- (f) A person

Whose relative is 

(In simple words - a person whose relative is a director or key managerial person of the company is disqualified)

- (g) This clause has two points

Point (i) - A person who is in **full time employment elsewhere;**

Explanation – When a member is in full time employment – he **cannot be in practice** as per CA Act, 1949. If a person is not in practice – he is not eligible to be appointed as an auditor of a company.

OR

Point (ii) - A person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment **holding appointment as auditor of more than 20 companies;**

It means company cannot appoint a person as auditor if he is already auditor for 20 companies. It further means – one member cannot be auditor for more than 20 companies simultaneously.

I would like to discuss this point in detail at **later part of this chapter**. So just go ahead.

- (h) A person who has been convicted by a court of an offence **involving fraud** and a period of ten years has not elapsed from the date of such conviction.



Concept capsule 16

Mr. X, a CA in practice, killed a person in road accident & was convicted. He was imprisoned for 4 years. After 4 years of sentenced period, can he be appointed as auditor of a company?

Suggested answer

Yes. The above clause is not applicable as the offence does not involve fraud.



Concept capsule 17

Mr. X a CA in practice, involved in a fraudulent activity and convicted. He was imprisoned for 4 years. After 4 years of sentenced period, can he be appointed as auditor of a company?

Suggested answer

No. If the person convicted in an offence involving fraud, he cannot be appointed as auditor for a company for 10 years from the date of conviction even if his sentenced period is complete.

- (i) A person who directly or indirectly rendered any service referred to in section 144 to the company, its holding or its subsidiary.

(Section 144 deals with prohibited services by auditor – we will discuss this at later part of this chapter).

Your sub-section (3) of section 141 is completed.

I have a question for you

When should we check all the above qualifications and disqualifications i.e., 141(1), (2) & (3) – I mean Is it at the time of appointment? OR

During the tenure of office? OR

Both?

Answer

Both. It is because of section 141(4). See below sub-section now

Section 141(4) - Says

If a person appointed as an auditor of a company incurs any of the disqualifications specified in Section 141(3), he shall be **deemed to have vacated his office**. Such vacation shall be **deemed to be a casual vacancy** in the office of the auditor.

It means – he must not attract disqualifications u/s 141(3) throughout the tenure of his office. At any time, if he does attract ANY disqualification, it is deemed that NO auditor exists in office. Auditor shall vacate the office immediately and no one need to serve any notice to auditor.

Go through the entire section once again before attempting the below capsules.

Whether a Non-Executive Director (Part time director OR independent director) be appointed as Auditor?

No. The reason is every director is covered under the term “Officer”.

Whether a Person who is Relative of Director or Employee of the Company be appointed as Auditor?

If relative is a director – NO as per Section 141(3)(f);

If Relative is an employee **other than** KMP – Yes; (As per Sec.141(3)(c), partner of an employee and employee of an employee are prohibited to be appointed as Auditor. Whereas, as per Sec.141(3)(f), relative of an employee is prohibited to be appointed as Auditor only when such employee is Director/KMP)

Can an Auditor be said to be Indebted if he recovers travelling and other expenses in Advance?

Yes. It is treated as “indebted” and disqualified if the amount is greater than ₹ 5,00,000.



Concept capsule 18

Anurag, a practicing CA, is attending to the tax matters of XYZ Ltd., and for that purpose, he has to **regularly attend** to the Company from 10.00 A.M. to 2.00 P.M. on all working days. He is paid ₹ 25,000 p.m. for the same. XYZ Ltd. intends to appoint Anurag as its Auditor at the General Meeting. Advice whether Anurag can accept the appointment.

Suggested answer

Mr. Anurag CAN accept the Appointment if attending Tax Matters is Contract for Services –

- ◆ An Auditor may render services to the Company in matters relating to Taxation, Finance or other related area as long as his contract is a ‘contract for services’ (retainer ship) and not a ‘contract of service’ (employment).
- ◆ There is no prohibition for charging fee on monthly basis towards other services rendered.
- ◆ In the given case, Anurag attends office regularly from 10.00 A.M. to 2.00 P.M. on all working days. It should be seen that he is not bound by the office timings but is attending to tax matters regularly during office working hours according to his own convenience.



Concept capsule 19

'B' owes ₹ 5,00,001 to 'C' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting out travelling expenses?

Suggested answer

Disqualified as per Section 141(3)(d)(ii) - Indebted for amount exceeding ₹ 5 Lakh.

Irrespective of reason for advance, auditor is indebted to the entity for an amount exceeding ₹ 5 lakh. In this case, either he should tell the company to meet the travelling expenses or should claim reimbursement of the same afterwards. The auditor is entitled to recover fees on a progressive basis only.



Concept capsule 20

Mr. A was appointed as an auditor of X Ltd. to audit the accounts for the five years from 01.04.18 to 31/03/23 in the AGM held on 16.8.2018. Mr. A is indebted to the company for a sum of ₹ 6 Lakh as on 1.4.2018, the opening date of the accounting year which had been the subject to his audit. Upon learning that he might be appointed as the auditor, he repaid the amount on 14.8.2018. Is his appointment valid?

Suggested answer

Valid - The relevant date for reckoning disqualification is the date of appointment. Where the person has paid his debt before appointment date, there is no disqualifications.



Concept capsule 21

(CA Inter-Nov. 2022, Similar)

X, a CA in practice is a Statutory Auditor of MNO Ltd. He purchased a car from the Company under the Hire Purchase Scheme run by the Company on the same terms and conditions as applicable to all other customers, the cash down price of the car is ₹ 8 Lakh. The initial payment of 25% was made on signing the Hire Purchase Agreement and the balance is payable in 24 monthly instalments. Is X disqualified to act as Auditor?

Suggested answer

Disqualified as per Section 141(3)(d)(ii) - Indebted for amount exceeding ₹ 5 Lakh. No exception has been provided under Act to retain the independence of Auditor. Even in case of a transaction like above which is applicable to all customers in general, Auditor won't be able to go by this and the limit of ₹ 5 lakhs is binding.



Concept capsule 22

KBC & Co. a firm of Chartered Accountants has three partners, K, B & C;

Mr. K is also in whole time employment elsewhere. The firm is offered the audit of ABC Ltd. and is already holding audit of 40 companies.

Suggested answer

Cannot accept as per Section 141(3)(g)

K is in whole-time employment elsewhere, therefore, he will be **excluded** in determining the number of company audits that the firm can hold. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is 40, and in the given case, KBC & Co. is already holding 40 audits; and therefore, KBC & Co. can't accept the audit of ABC Ltd.



Concept capsule 23

Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2019-20. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.

Suggested answer**Disqualified as per Section 141(3)(d)(i) and 141(4)**

Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partners Mr. Hanuman is holding equity shares of its subsidiary. As the firm had already been appointed as Auditor, it shall vacate office as such with immediate effect as per Sec. 141(4).

**Concept capsule 24**

Mr. Aditya, a practising chartered accountant is appointed as a 'Tax Consultant' of ABC Ltd., in which his father Mr. Singhvi is the Managing Director. Whether it is permissible?

Suggested answer

Qualified - Mr. Aditya is a 'Tax Consultant' and not a 'Statutory Auditor'.

**Concept capsule 25**

Mr. Fat, auditor of Thin Ltd., has his office and residence in the building owned by Thin Ltd. Mr. Fat has been given 10% concession in rent by the company as compared to other tenants.

Suggested answer

Qualified as per Companies Act, 2013

As per SA 200, 'Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing'. An audit engagement is in the public interest and, therefore, it is required by the Code of Ethics, that the auditor shall be independent of the entity subject to the audit. In general, we may presume that giving 10% concession in rent does not affect independence of the auditor in expressing his opinion on the audit of Thin Ltd.; hence he may accept the audit.

**Concept capsule 26**

Mr. Amar, a Chartered Accountant, bought a car financed at ₹ 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to act as such even after taking the loan.

Suggested answer

Disqualified as per Section 141(3)(d)(ii) - Indebted to the holding company for an amount exceeding ₹ 5 Lakh.

**Concept capsule 27**

Mr. A, a chartered accountant has been appointed as auditor of Laxman Ltd. in the AGM held in September, 2018, and he accepted the assignment. Subsequently in January, 2019 he joined B, another chartered accountant, who is the Finance Manager of Laxman Ltd., as partner. **(CA Inter – RTP May 2019)**

Suggested answer:

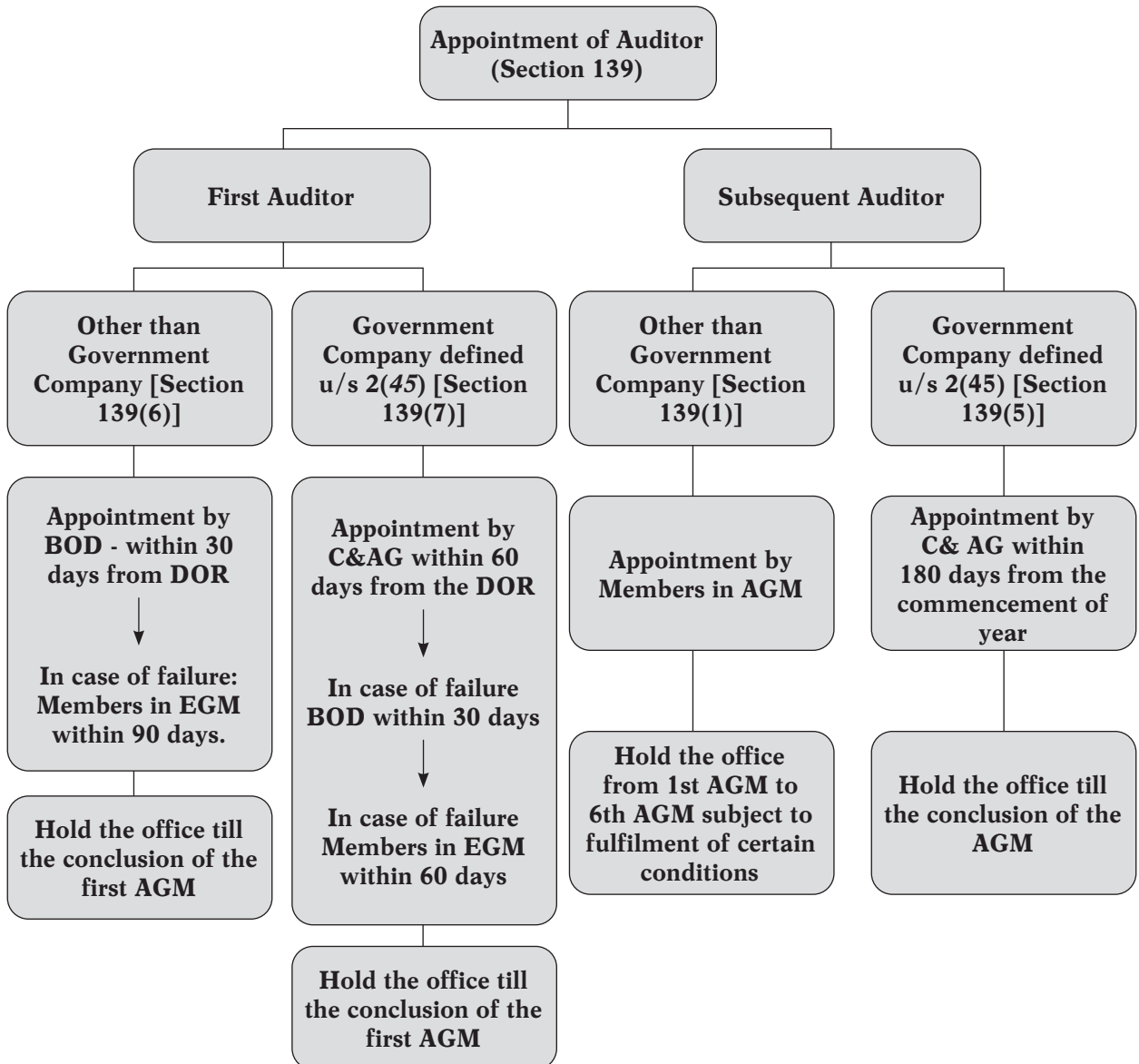
As per Section 141(3)(c) - any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company and sub-section (4) provides that it is deemed that auditor has vacated office as an auditor if he is disqualified under sub-section (3) **during the tenure** of office.

Conclusion: In the present case, A, an auditor of M/s Laxman Ltd., joined as partner with B, who is Finance Manager of M/s Laxman Limited, has attracted Sec. 141(3)(c) and, therefore, he shall be **deemed to have vacated office** of the auditor of M/s Laxman Limited.

I hope you understood the section.

APPOINTMENT OF AUDITORS [Section 139]

This section discusses appointment of first auditor, subsequent auditor, rotation of auditors and casual vacancy. Different sub-sections are applicable for Government Company and other than Government Company. Let us start with the discussion of first auditor.



Appointment of the First Auditor [Sec. 139(6)]

- ◆ The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors (only by BOD) within 30 days from the date of registration (*i.e.*, Date of Incorporation) of the company.
- ◆ In the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall appoint within 90 days at an extraordinary general meeting (EGM).
- ◆ The first auditor shall hold office from the date of appointment to till the conclusion of the first AGM.



Concept capsule 28

Managing Director of PQR Ltd. would like to appoint a Chartered Accountant, as first auditor of the company. Comment. What would be your answer if the appointment is made by audit committee?

Suggested answer

As per Section 139(6) the first auditor or auditors of a company shall be appointed by the Board of Directors and not by the Managing Director. Hence, the appointment made by MD of PQR Ltd. is invalid.

If appointed by audit committee, even then such appointment is **invalid**.



Concept capsule 29

Will that be fine, if the first auditor’s name is mentioned in Memorandum of Association (MOA) & Articles of Association (AOA) instead of appointment by BOD?

Suggested answer

No. Mentioning the name in MOA & AOA will not be equivalent to appointment by BOD.



Concept capsule 30

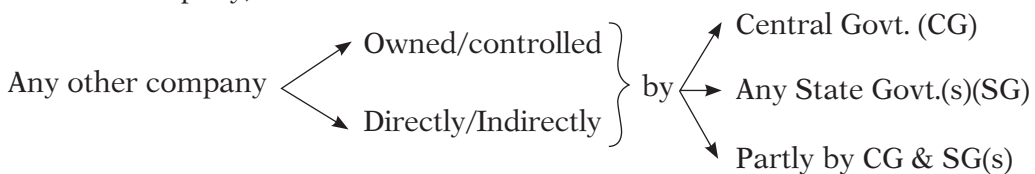
White Star Ltd. was incorporated on 01.08.2019 and Mr. T who is related to the chairman of the company appointed as auditor by the BOD in their meeting on 04.09.2019.

Suggested answer

Not valid appointment. As per the above section, power to appoint lies with the board of directors only for 30 days from date of registration. After 30 days power to appointment will be shifted from BOD to the members. In the given case, they appointed after 30 days hence it is invalid. As the appointment is invalid, we need not look at the point of relative.

Appointment of the First Auditor of Government Company [Sec. 139(7)]

For a government company; or



- ◆ First auditor shall be appointed by the **CAG within 60 days from the date of registration** of the company.
- ◆ In case the **CAG does not appoint** such auditor within the said period, the Board of Directors of the company **shall appoint** such auditor **within 30 days**.
- ◆ In the case of **failure of the Board to appoint** such auditor, it **shall inform the members** of the company within the next 30 days and **who shall appoint** such auditor **within the 60 days at an EGM**.
- ◆ The auditor so appointed shall hold office **from** the date of appointment **till** the conclusion of the 1st AGM.



Concept capsule 31

The first auditors of Health and Wealth Ltd., a government company, was appointed by the BOD.

Suggested answer

Not Valid - As per Section 139(7), the first auditor of a Govt Co. should be appointed by CAG.

APPOINTMENT OF SUBSEQUENT AUDITOR/REAPPOINTMENT OF AUDITOR

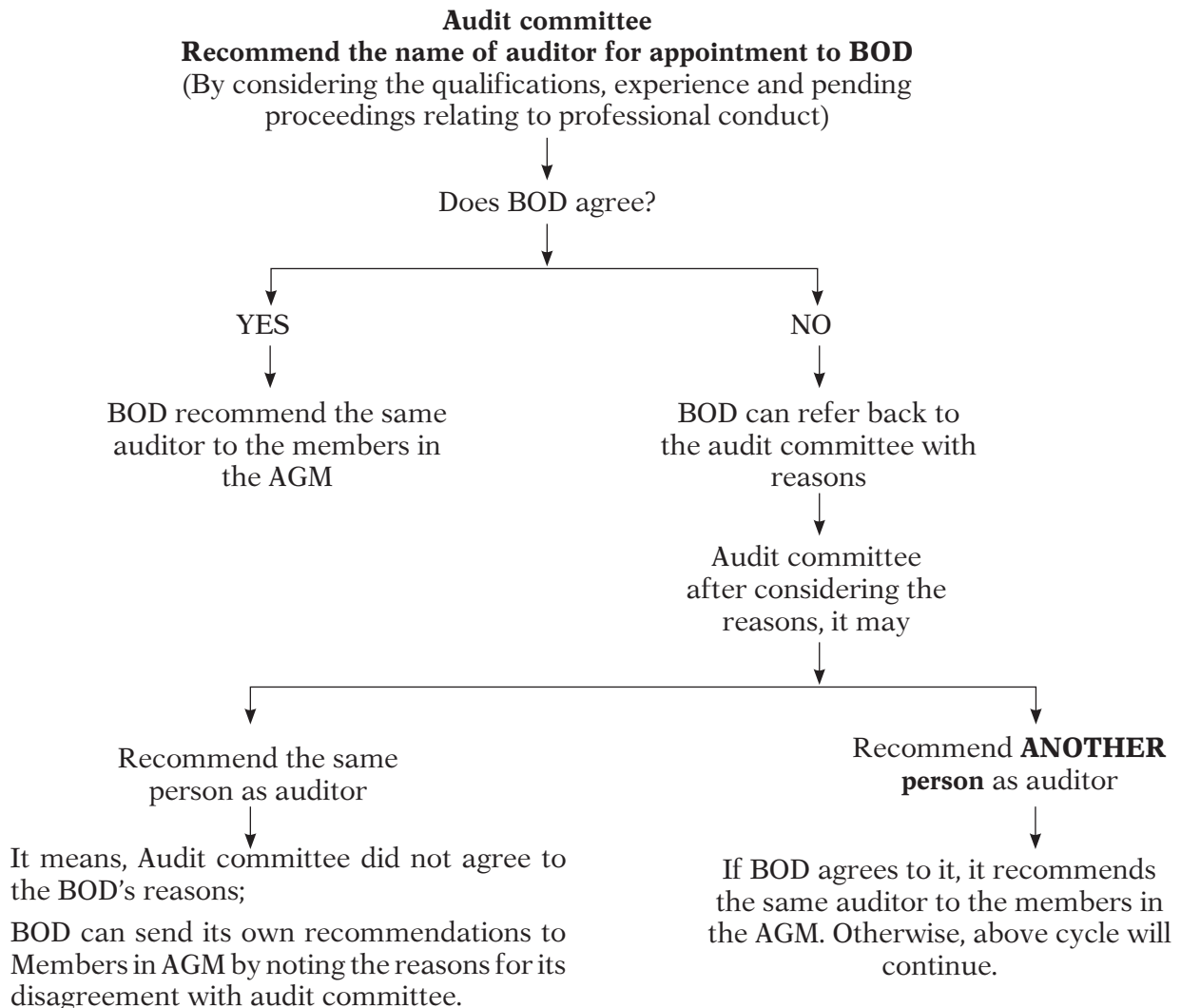
[Section 139(1) & Rules 3 and 4 of Companies (Audit and Auditors) Rules, 2014]

- (1) **Every company shall**, at the First AGM, appoint an individual or a firm (includes LLP) as an auditor of the company.
 - ◆ Every company means ALL the companies incorporated under the Act which includes one-person company, Sec. 8 company, etc.;
 - ◆ Ordinary resolution is sufficient to appoint an auditor.
- (2) The auditor shall hold office from the **conclusion of 1st AGM till the conclusion of its 6th AGM** (*i.e.*, for 5 years); Appointment takes place only for 5 years, it means – No company can appoint auditor for less than 5 years. The AGM, in which he is appointed is counted as 1st AGM.

MANNER AND PROCEDURE FOR APPOINTMENT

[Rule 3 of Companies (Audit and Auditor's) Rules, 2014]

The competent authority to appoint auditor is Audit committee of the company (if the company has); If it does not have audit committee, Board of directors are competent authority.



- ◆ The entity should obtain **written consent** and a **certificate** before the appointment is made at **AGM**. Auditor should **certify** that
 - (a) Individual/firm is **eligible for appointment** and **is not disqualified** for appointment under
 - a. the Companies Act, 2013(*i.e.*, compliance of Sec. 141);
 - b. the Chartered Accountants Act, 1949; and
 - c. the Rules or Regulations made there under;
 - (b) the proposed appointment is **as per the term** provided under the Act;
 - (c) the proposed appointment is **within the limits** laid down by or under the authority of the Act;
 - (d) the **provided list of proceedings** relating to professional matters of conduct against the auditor **or** audit firm **or any partner** of the audit firm pending with respect to **is true and correct**.

After this

Company appoints the auditor at AGM by passing ordinary resolution and thereafter, the company should

1. Give the information of appointment to the auditor *i.e.*, it should write a letter to the auditor by attaching “extract of resolution in the minutes of AGM”; and
2. **File Form ADT-1** of such appointment with the **Registrar within 15 days of the meeting** in which the auditor is appointed. Form ADT -1 will be filed by the company only once in 5 years.

We must note that:

Where a company is required to constitute an Audit Committee u/s 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

Additional information

Which company should constitute audit committee? [Sec.177]

The following companies should constitute

1. ALL Listed companies; and
2. The following classes of companies
 - i. All public companies with a paid-up capital \geq ₹ 10 crore;
 - ii. All public companies having turnover \geq ₹ 100 crore;
 - iii. All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits $>$ ₹ 50 crore.

Explanation- The paid-up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on **the date of last audited Financial Statements** shall be taken into account for the purposes of this rule.

Asked in RTP

Explain the manner and procedure of selection and appointment of auditor as per Rule 3 of Companies (Audit and Auditors) Rules, 2014. **(CA Inter - RTP May 2019)**



Concept capsule 32

No AGM was held for the year ended 31st March, 2019, in XYZ Ltd., Mr. Dasaratha is the auditor for the previous 5 years, whether he is continuing to hold office for current year or not.

Suggested answer

Continue as Auditor - As per Section 139(1), the auditor shall hold office from the conclusion of 1st AGM till the conclusion of its 6th AGM (*i.e.*, for 5 years). In case the AGM is not held within the period prescribed, the auditor will continue in office **till the AGM is actually held and concluded.**

TERM & ROTATION OF AUDITOR**Sec. 139(2) & Rule 5 of Companies (Audit and Auditors) Rules, 2014**

Rotation of auditors is a new topic introduced in the Companies Act, 2013. As per the section, a company should rotate auditors after specified time. It means, the same auditor cannot continue forever. Let us get into the details of the section. **(CA IPCC - May 2015 & 2017)**

TERM

Rotation is applicable only to

- (1) Listed companies;
- (2) Other prescribed class of companies (except One person & small companies)
 - (a) all **unlisted public companies** having paid up share capital \geq ₹ 10 crore;
 - (b) all **private limited companies** having paid up share capital \geq ₹ 50 crore; or
 - (c) **all companies** having public borrowings from financial institutions, banks or public deposits \geq ₹ 50 crores.

The above companies **shall not 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.**

**Concept capsule 33**

R Ltd. is a private limited Company, having paid up share capital of ₹ 18 crore but having public borrowing from nationalized banks and financial institutions of ₹ 72 crore, the company wants to appoint the same audit firm for third term. Is it allowed as per the Act? **(CA Inter – RTP May 2018)**

Suggested answer

The company is falling with the list of prescribed companies as per section 139(2) as its borrowings from banks \geq ₹ 50 Cr. As rotation is applicable to the company – the company can appoint or re-appoint an audit firm for not more than two terms of five consecutive years. Hence, the intention of the company is not correct.

Cooling off Period

An auditor who completed the term as discussed above *i.e.*, Individual (one term of 5 years)/Firm (two terms of 5 years each) is **NOT** eligible for re-appointment as auditor for 5 years.

Example: XYZ Ltd. which is a listed company appoints **Mr. R** (*Individual*) as an auditor in its AGM dated 29th September, 2014. Mr. R will hold office of Auditor from the conclusion of this meeting up to conclusion of sixth AGM *i.e.*, AGM to be held in the year 2019. Now as per Section 139(2), Mr. R shall not be re-appointed as Auditor in XYZ Ltd. for further term of five years *i.e.*, he cannot be appointed as Auditor up to year 2024.

Example: XYZ Ltd. which is a listed company appoints M/s R & Associates as an **audit firm** in its AGM dated 29th September, 2014. M/s R & Associates will hold office from the conclusion of this meeting up to conclusion of sixth AGM to be held in the year 2019. Now as per Section 139(2), M/s R & Associates can be appointed or re-appointed as auditor for one more term of five years *i.e.*, up to year 2024. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years *i.e.*, up to year 2029.