

Appointment of Auditors (Sec 139) Part-3

(Continued from Geeta Saar 102)

4.2 Appointment of first auditor of a company, other than a government company

Sub-section (6) of section 139 of the Act states that, notwithstanding anything contained in sub-section (1), the first auditor of a company, other than a government company, shall be appointed by the board of directors within 30 days from the date of registration of the company and in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within 90 days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

As per this sub-section, the board has to appoint auditor within 30 days or if the Board fails to appoint, then on 31st day onwards the board's duty to inform the members about such failure of the board for appointment of first auditor triggers. The members, shall within 90 days from the date of information being sent to them, appoint auditor and such auditor shall hold office till the conclusion of the first annual general meeting. As stated above, the duty of the Board to inform members about their failure to appoint first auditor, triggers immediately on expiry of the 30 days period whereas the duty of the members of the company to appoint first auditor, triggers immediately on receipt of information of non – appointment by the Board.

The members of the company cannot be presumed to be aware of the fact that the first auditor has not been appointed by the Board and in absence of receipt of any information or notice of Extra-ordinary general meeting in this regard, it cannot be said that the shareholders are required to appoint first auditor before expiry of 120 days from the date of registration/ of the company. The duty or the power of members of the company to appoint first auditor triggers from the date of being informed about such non – appointment by the Board of Directors.

Further, the first auditor or auditors so appointed are to hold office until the conclusion of the first annual general meeting of the company. However, the auditor or auditors so appointed may be removed before the first annual general meeting. For details, see analysis under section 140.

4.3 Appointment of auditors in a Government Companies

4.3.1 Appointment of first auditor in case of a Government Company

As per sub-section (7) of section 139, notwithstanding anything contained in sub-section (1) or sub-section (5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State

Governments, the first auditor shall be appointed by the C&AG within 60 days from the date of registration of the company.

In case C&AG does not appoint such auditor within the said period, the board of the company shall appoint such auditor within the next 30 days. If the board fails to appoint such auditor within the next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting.

Such auditor shall hold office till the conclusion of the first annual general meeting.

Further, based on the analysis of sub-section (1) of section 139, all appointments made by the C&AG are required to be intimated by the company to the Registrar within 15 days vide Form ADT - 1.

4.3.2 Appointment of subsequent auditor(s) in case of a Government Company

Sub-section (5) of section 139 of the Act provides that notwithstanding anything contained in sub-section (1), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the C&AG shall appoint an auditor duly qualified to be appointed as an auditor of companies under this Act. Such appointment shall be made in respect of a financial year within a period of 180 days from the commencement of the financial year. Such auditor shall hold office till the conclusion of the annual general meeting.

As per close reading of this sub-section (5) of section 139, it is pertinent to note that the power to appoint auditor other than first auditor in case of Government companies shall rest with the C&AG exclusively.

Further, C&AG is also bound to follow the provisions of Chapter X to the extent applicable. Also, it is pertinent to note that the power of C&AG in this context, is limited to appointment of Auditor for a financial year only. The C&AG cannot appoint an auditor for more than one financial year at a time. Further, the C&AG is responsible to appoint auditor or audit firm within a period of 180 days from the commencement of the financial year.

Also, the auditor to be appointed by the C&AG shall fulfil the conditions pertaining to eligibility, qualification as stipulated in section 141 of the Companies Act, 2013.

4.4 Appointment of an auditor to fill casual vacancy

Casual vacancy is not defined under the Act. As per Black's Law Dictionary [9th Edition, Page 247], "Casual" means "not expected, foreseen, or planned". Further, the word "vacancy" [Black's Law Dictionary, 9th Edition] means "1. the state or fact of a lack of occupancy in an office, post, or piece of property. 2. The time during

which an office, post, or piece of property is not occupied; 3. An unoccupied office, post, or piece of property; an empty place Although the term sometimes refers to an office or post that is temporarily filled, the more usual reference is to an office or post that is unfilled even on a temporary basis. An officer's misconduct does not create a vacancy even if a suspension occurs; a vacancy, properly speaking, does not occur until the officer is officially removed."

Therefore, in this context, casual vacancy may arise out of death, disqualification, resignation or removal etc. of the auditor or non-ratification of appointment by the shareholders as per the first proviso to sub-section (1) of section 139.

Sub-section (8) of section 139 of the Act stipulates the following:

4.4.1 Filling of casual vacancy in case of a Government Company

In the case of a company whose accounts are subject to audit by an auditor appointed by the C&AG, such casual vacancy shall be filled by the C&AG within 30 days.

However, in case the C&AG does not fill the vacancy within the said period, the board shall fill the vacancy within next 30 days.

4.4.2 Filling of casual vacancy in case of a company other than a Government Company

In the case of a company other than a Government company, be filled by the board within 30 days.

However, 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 3 months of the recommendation of the Board. It is pertinent to note that, in case of casual vacancy arising out of resignation of existing auditor, Board can only recommend appointment of an individual or audit firm and the final authority to appoint such individual or audit firm as Auditor remains with the members of the company.

As discussed under analysis of sub-section (1) of section 139, the general object of a proviso is to except something from the main clause or to qualify or restrain its generality and prevent mis-interpretation. Use of the word "recommendation" in proviso to clause (ii) of sub-section (8) of section 139 makes it clear that in case of casual vacancy arising out of resignation of the existing auditor, the board shall recommend appointment of an individual or audit firm as auditor within 30 days of the date of casual vacancy and the shareholders shall appoint within 3 months from the date of such recommendation of the board and the said individual or audit firm shall hold the office till conclusion of the next annual general meeting.

4.5 Term of auditor and rotation after expiry of term As per sub-section (2) of section 139 read with Rule 5, following companies (excluding one person companies and small companies) shall not appoint an individual as auditor for more than one term of five consecutive years; and an audit firm as auditor for more than two terms of five consecutive years:

- i. listed company
- ii. all unlisted public companies having paid up share capital of rupees 10 crore or more;
- iii. all private limited companies having paid up share capital of rupees 20 crore or more;
- iv. All companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crores or more.

An individual auditor or an audit firm who has completed his or its term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term.

Further, an audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall not be appointed as auditor of the same company for a period of five years. This status is to be checked as on the date of appointment.

Divergent view are held on whether appointment of first auditor or as an auditor appointed in casual vacancy shall also be counted as one term, through the period of appointment terminate with the conclusion of first/next annual general meeting respectively.

While one argument is that the short tenure in office would also count as a term, the other argument is a 'term' implies the term of five years for appointment by shareholders. As reflected by section 139(2) of the Act the duration of appointment must be one or two terms of five years as a case may be. The mandate given to shareholders is to appoint auditor for one or two terms of five years.

Rule 6 deals with the manner of rotation of auditors by the companies on expiry of their term. It provides that the audit committee shall recommend to the board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of his term. In case a company is required to constitute an audit committee, the Board shall consider the recommendation of such committee. In other cases, the Board shall itself make the recommendation for appointment of the next auditor by the members in annual general meeting.

Sub-rule (3) provides that for the purpose of the rotation of auditors-the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be.

Further, the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

For the purposes of these rules the term “same network” includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Further, a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation. In case a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Illustration on the aforesaid section –individual auditor

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after 1 st April, 2014]	Maximum number of consecutive years after 1 st April, 2014 for which he may be appointed in the same company after transitional/grace period	Aggregate period which the auditor would complete in the same company in view of column I and II
I	II	III
5 years or more	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 years	4 years	5 years

Illustration explaining rotation in case of audit firm

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after 1 st April, 2014]	Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)	Aggregate period which the firm would complete in the same company in view of column I and II
I	II	III
10 years or more	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 years	9 years	10 years

In case where the company has appointed two or more joint auditors (whether individuals or firms or any other combination), the rotation may be followed in such a manner that all joint auditors do not complete their term in the same year.

4.6 Rotation of auditing partner and his team

As provided in sub-section (3) of section 139 of the Act, subject to the provisions of this Act, members of a company may resolve to provide that—

- (a) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
- (b) the audit shall be conducted by more than one auditor. The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors in pursuance of sub-section (2). No such rules are prescribed till date.

4.7 Tenure of statutory auditor

4.7.1. Tenure of auditor appointed at annual general meeting

Sub-section (1) of section 139 of the Act provides that the auditor appointed at the first annual general meeting shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting subject to ratification in every annual general meeting. Similarly the auditor appointed thereafter shall hold office till the conclusion of every sixth meeting.

4.7.2. Tenure of auditor appointed to fill causal vacancy

The auditor appointed by the board or by members of a company on recommendation of the board (in case of filling of vacancy caused by resignation) holds office till the conclusion of next annual general meeting.

4.7.3. Tenure of auditor appointed by C&AG

The auditors appointed by Comptroller & Auditor General within one hundred eighty days from the commencement of the financial year holds office till the conclusion of the annual general meeting. The first auditor of a company specified in sub-section (7) of section 139 is required to be appointed by C&AG within 60 days from the date of registration of the company who holds office till the conclusion of the annual general meeting.

4.8 Re-appointment of retiring auditors at the annual general meeting

As provided in sub-section (9) of section 139, a retiring auditor may be reappointed at an annual general meeting, if following three conditions are satisfied:

- (a) he is not disqualified for re-appointment;
- (b) he has not given the company a notice in writing of his unwillingness to be reappointed; and

- (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.

This sub-section is “subject to provisions of sub-section (1) and rules made thereunder”. Hence, for such appointment, provisions of sub-section (1) will be applicable.

The use of the words “may be” in sub-section (9) clearly indicates that it is not mandatory to reappoint the retiring auditor even if 3 things stipulated in subsection (9) are not attracted. The provisions of the Companies Act, 1956 had used the words “shall be” which in fact made it mandatory to appoint a retiring auditor except in case 4 things given in section 224 were satisfied.

However, it may be noted that sub-section (10) of section 139 stipulates that where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. This was not the case under sub-section (3) of section 224 of the Companies Act, 1956. Under the sub-section (3) of section 224 of the Companies Act, 1956 the power to appoint a person as auditor on account of such casual vacancy vested in the Central Government.

Hence, it is clear that the retiring (existing) auditor even if not re-appointed, may still be automatically appointed if the company fails to appoint an Auditor in place of the existing auditor. However, this is subject to the auditor being eligible and complying with other provisions of the Act.

5. Punishment and Compoundability

For contravention by the company of provisions of this section, sub-section (1) of section 147 will be applicable. For contravention of provisions of this section by the Auditors, sub-section (2) of section 147 will be applicable.

(Concluded)

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.