

## Removal and Resignation of Auditor (Sec 140) Part-1

### 1. Legislative background

The notes on clauses to the Companies Bill, 2011 read as follows:

“This clause corresponds to Clause 225 of the Companies Act, the Clause seeks to provide for the provisions for removal of auditor before the expiry of his terms. It provides that the auditor concerned shall be given a reasonable opportunity of being heard. The Clause provides for the provisions for resignation by auditor. It further provides that special notice shall be required for appointing a person as auditor other than a retiring auditor. The tribunal is empowered to change the auditor of a Company in case of in any fraudulent activities by auditor. An Auditor, Company Secretary in practice, or Cost Accountant in practice shall immediately report to the Central Government, if they have reason to believe in pursuance of their duties that an offence involving fraud is being committed against the company.”

### 2. Removal of auditors appointed under section 139

Section 140 of the Act permits removal of auditor before completion of his term and contains procedure for the same. As per sub-section (1) of section 140, 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. A close reading of subsection (1) of section 140 makes it clear that the expression “auditor appointed under section 139” would mean that the auditor(s) appointed by the shareholders or board of directors or Comptroller and Auditor-General of India can be removed before the expiry of his term subject to compliance with requirements of sub-section (1) of section 140.

### 3. Requirement of special notice

It is evident that the sub-section (1) of section 140 of the Act exclusively deals with removal of auditor(s) before completion of his term fixed by the board, shareholders or Comptroller and Auditor-General of India, as the case may be and therefore, there is no specific requirement of special notice by shareholders as stipulated under sub-section (4) of section 140 of the Act for removal of auditor before expiry of his term.

However, the shareholder can also move resolution for removal of auditor by virtue of right available under section 111 read with section 100 of the Act. In case of such requisition, the provisions of sub-section (1) of section 140 need to be complied with.

## 4. Procedure for removal of Auditor

The plain reading of section 140 of the Act clearly stipulates that the auditor can be removed by passing special resolution after obtaining prior approval of the Central Government (powers delegated to Regional Director vide notification S.O. 1352(E) dated 21.05.2014). With respect to shareholders approval, it is important to note that the requirement under the erstwhile section 224A of the Companies Act, 1956 was only for an ordinary resolution whereas section 140 of the Act requires a company to pass special resolution of members.

Further, it may be noted that the power to make an application to the Central Government under sub-section (1) of section 140 is vested in the board of directors of the company in terms of provisions of section 179 of the Act which deals with powers of the board.

As per Rule 7(1), the application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014. As provided in per Rule 7(2), the application shall be made to the Central Government (powers delegated to Regional Director vide notification S.O. 1352(E) dated 21.05.2014) within 30 days of the resolution passed by the Board. Further, as per Rule 7(3), the company shall hold the general meeting within 60 days from the date of receipt of approval of the Central Government (Regional Director) for passing the special resolution.

Further, as per e-form ADT 2 and help-kit provided by the Ministry of Corporate affairs on its website, the company is required to pass special resolution prior to making an application to the Regional Director for removal of auditor.

In view of the above it can be concluded that the company would be required to hold general meeting and pass special resolution for removal of auditor subject to approval of the Central Government i.e. before making an application to Central Government in e-form ADT-2.

## 5. Reasonable opportunity of being heard to be given to the auditor

Proviso to sub-section (1) of section 140 provides that before taking any action under the said sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Action means 'the fact or process of doing something, typically to achieve an aim'. Therefore, the requirement stipulated in the proviso to sub-section (1) of section 140 is that the auditor shall be given a reasonable opportunity of being heard before any action is taken by the shareholders or central government for his removal. Reasonable opportunity of being heard given under proviso to sub-section (1) of section 140 of the Act is different from reasonable opportunity of being heard given under clause (iii) of sub-section (4) of section 140 of the Act (the latter is

given to a retiring auditor in whose place another auditor is proposed to be appointed).

The word “reasonable” as given in different dictionaries means as follows:

As per Webster’s Third New International Dictionary, the term “reasonable” means:

“Being in agreement with right thinking or right judgment, not conflicting with reason, not absurd, not ridiculous, a conviction, a theory, being or remaining within the bounds of reason, not extreme, not excessive, a request, a hope of succeeding, spent a amount of time in relaxation, is of a size, moderate as, not demanding too much, a boss, not expensive, that allows a fair profit, having the faculty of reason, rational, possessing good sound judgment, well balanced, sensible, can rely on the judgment of a man.”

As per Black’s Law Dictionar [9th Edition, Page 1379], the term “reasonable” means

“1, Fair, proper, or moderate under the circumstances. <reasonable pay>. 2. According to reason <your argument is reasonable but not convincing>. 3. (Of a person) having the faculty of reason <a reasonable person would have looked both ways before crossing the street>.”

As per The New Shorter Oxford English Dictionary, the term “reasonable” means

“Endowed with the faculty of reason, rational, Now rare, in accordance with reason, not irrational or absurd, proportionate, having sound judgment, ready to listen to reason, sensible, also not asking for too much, within the limits of reason, not greatly less or more than might be thought likely or appropriate, moderate, in price, of a fair, average, or considerable amount, size, etc., requiring the use of reason.”

As per the dictionary meaning the word “reasonable” is having a very broad amplitude and that may vary facts to facts, however, an objective, fair and just conclusion supported by acceptable reasons is its foundation. The “reasonable opportunity to state its or his objections”, thus, means the opportunity to state objections to arrive at just and fair conclusion.

The term was interpreted by the Rajasthan High Court in Smt. Geeta Patel vs. State of Rajasthan & Ors. [DB Civil Special Appeal No.840/2012 dated 07.04.2014, reportable] by citing earlier Supreme Court precedents in the said matter. It held that:

“The term “reasonable opportunity” itself has been explained and interpreted by Hon’ble the Supreme Court with reference to clause (2) of Article 311 of the Constitution of India. Under clause (2) of Article 311 reasonable opportunity of being heard is required to be given to a civil servant who may be dismissed or removed from service or reduced in rank as a consequent to an inquiry in relation

charges of misconduct. In *Khem Chand v. Union of India & Ors.* (AIR 1958 SC 300), Hon'ble the Supreme Court summarised the ingredients of "reasonable opportunity" under Article 311(2) of the Constitution as under:

- (a) " An opportunity to deny his guilt and establish his innocence, which he can only do if he is told what the charges levelled against him are and the allegations on which such charges are based;
- (b) an opportunity to defend himself by cross- examining the witnesses produced against him and by examining himself or any other witnesses in support of his defence; and finally
- (c) an opportunity to make his representation as to why the proposed punishment should not be inflicted on him, which he can only do if the competent authority, after the enquiry is over and after applying his mind to the gravity or otherwise of the charges proved against the government servant tentatively proposes to inflict one of the three punishments and communicates the same to the government servant."

Para (c) referred above has lost its importance after 42nd constitutional amendment, however, in view of the law laid down in the case of *Union of India & Ors. v. Mohd. Ramzan Khan* (AIR 1991 SC 471), a report of the inquiry officer is an adverse material to the person effected and, therefore, copy of it is required to be given to the person concerned before penalising him with dismissal, removal or reduction in rank. The other extension of the concept of reasonable opportunity is that an opportunity of personal hearing is required to be given to the person effected before subjecting to a penalty. The order of penalty should be speaking and reasoned one is another important facet of this concept.

Having considered the terms "reasonable" and "reasonable opportunity" as above, it can be said that under the administrative law the doctrine of reasonable opportunity is an objective mode to adjudicate a disputed issue and that demands a fair, proper, moderate and satisfactory opportunity to the person effected to place his version of facts before the authority competent to decide the issue or to take penal action and further that the competent authority should consider such version of the effected person without any bias, prejudice or on extraneous factor, and while doing so, as far as possible an opportunity of personal hearing should also be given. The objective consideration includes the duty of supporting findings by reasons".

It is not clear as to who shall give the reasonable opportunity of being heard. Whether the shareholders should give the opportunity of being heard to the auditor or the central government or both. There are two school of thoughts on this issue. As per company law jurisprudence, it seems that the shareholders have to give reasonable opportunity of being heard and not the central government.

In the matter of *Basant Ram & Sons & Anrs .vs. Union of India & Ors [2002 110 CompCas 38 Delhi]*, it was held that

“There is considerable merit in this submission as there is no statutory bar on a prior meeting being held, wherein the shareholders or the members approve the resolution for making of the application to seek the previous consent of the Central Government. The appointment of the statutory auditors under section 224 of the erstwhile Act is by the shareholders in the Annual General Meeting, till the next general meeting is held. The Board of Directors are not authorised to remove the statutory auditors prior to its expiry of term except under the procedure provided under Section 224(7) of the Act. In the instant case, pursuant to the resolution passed to submit the application for seeking approval of the Central Government for removal of the auditors, the application was submitted on 17.12.1998. The hearing was given by respondent No. 2 on 31.3.1999 and 12.4.1999. The impugned order granting the permission is again made subject to further approval of the members of respondent No. 3 company in terms of section, 224(7) of the Act. The impugned order giving sanction for removal becomes operative only after the approval by the shareholders”.

To conclude, harmonious reading of the requirements of the e-form ADT-2 and sub-section (1) of section 140 read with Rule 7 would lead to a view that the shareholders may pass special resolution subject to approval of the Central government for such removal prior to filing e-form ADT – 2 and removal shall take effect from the date of receipt of approval of the central government. The company shall also comply with any specific observations, order of the central government in context of such removal of auditor.

*(To be continued...)*

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