Concept of Retiring Auditors under Act, 2013

- Whether still holds good or mere remnants of erstwhile provision?

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Introduction

This year being the 5th year of implementation of the Companies Act, 2013 (CA 2013), one common agenda pertaining to appointment/ reappointment of statutory auditors is going to be placed before the shareholders in the ensuing annual general meetings of most of the companies. Since the scheme of the law on appointment of auditors changed substantially with the advent of the CA 2013, this article is an attempt to analyse whether the concept of retiring auditors at all exists and whether a special notice will be required for appointing an auditor other than the existing one.

How is the new law different from the erstwhile law?

Under the erstwhile law (Section 224), appointment of auditors was required to be made from the conclusion of the AGM till the conclusion of the next AGM. At the ensuing AGM the auditor retired and was available for reappointment. There was a genuine expectation that the auditor will be re-appointed unless a special notice is received for appointing another person in place of the existing one. The history of the requirement of special notice for appointment of an auditor other than retiring one lies in Section 24(4) of UK Companies Act, 1947 [later Section 166 of the UK Companies Act, 1948]. The ostensible purpose of this provision was that auditors served a tenure of only 1 year and if the auditor was proposed to be removed pursuant to management discomfort, the auditor must be given an opportunity to represent before the general meeting. After all, the names of the auditors are recommended by the Board on the recommendation of the Audit Committee and the auditor is a bridge between the management and the shareholders.

However, the manner of appointment has undergone a major change with CA 2013 coming into force, from an annual appointment to a fixed term of 5 consecutive years with ratification at every general meeting for the balance tenure (requirement of ratification was subsequently done away with). Apparently, the law is now presupposing a term of 5 years and at the end of such 5 years, the auditors should generally vacate his office. In case of certain class of companies covered under Section 139(2), there is a negative restriction to the effect that the same auditor shall not serve for more than 5 years (in case auditor is an individual) or two terms of 5 consecutive years (in case of audit firm). However, there is no express mandate that the auditor completing the tenure of 5 years must be re-appointed unlike the erstwhile law.

CA 1956 & CA 2013- A comparative

Provision under CA, 1956	**Provision under CA, 2013**
Section 224 (2)	**Section 139 (9)**
Subject to the provisions of sub-section (1B) and section 224A, at any annual general	*Subject to the provisions of sub-section (1) and the rules made thereunder, a retiring auditor*

meeting, a retiring auditor, by whatsoever authority appointed, shall be re-appointed, unless -	*may be re-appointed at an annual general meeting, if—*
(a) he is not qualified for re-appointment ;	*(a) he is not disqualified for re-appointment;*
(b) he has given the company notice in writing of his unwillingness to be re-appointed ;	*(b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and*
(c) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed ; or	*(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*
(d) where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with.	No such provision
Section 225 (1)	**Section 140 (4)**
*(1) 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.*	*"(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.*

Making sense of appointment/re-appointment

Case 1	Auditor is not eligible for re-appointment.	In that case, Company will not wait even till completion of tenure.
Case 2	Auditor is eligible but not willing to be re-appointed.	Without willingness or consent, the Company cannot appoint the auditor.
Case 3	Auditor is eligible and is willing to be re-appointed, shareholders intend to appoint another audit firm after completion of term of 5 years.	Special resolution will be passed appointing some other auditor in terms of Section 139 (9) (c). It is not mandatory to continue with the same audit firm. There is no mention about special notice in Section 139 (9). However, the language of Section 139 and 140 refers to retiring auditor.

Case 4	Auditor resigns before completion of term.	Casual vacancy. No question of considering him for re-appointment.
Case 4	Company intends to remove the auditor before completion of tenure.	Company to obtain Central Government approval specifying the reason.

Extracts of JJ Irani Committee Report

Rotation of Auditors

> *"25. There was a detailed discussion on the need for rotation of Auditors. The view that rotation of Audit partner should take place every five years in the case of all listed Companies was also considered by the Committee. However, the Committee thought it fit that the matter of change of Auditors be left to the shareholders of the Company and the Auditors themselves rather than be provided under law.*

Appointment of Auditors other than Retiring Auditors

> *"28. The Committee discussed and agreed that the existing provisions of the Companies Act relating to appointment of Auditors were well established and should continue. However, the retiring auditor should be appointed if in the Annual General Meeting, the accounts of the company for the immediately preceding financial year are not approved."*

Extracts from 57th Standing Committee on Finance Report 2011:

> *"The procedure has been proposed to be modified in respect of appointment of auditors. It is proposed that shareholders may have the power to appoint auditors for straight five years, instead of on year to year basis. This would ensure that promoter/company/ management does not change auditor who is doing good job pre-maturely. Auditor's early resignation and removal have been made possible. Approval of Central Government provided in case an auditor is removed before his tenure."*

Evidently, there has been a shift in the requirements of the old law in respect of the tenure of the appointment of auditors and mandatory rotation. Further, considering the recommendations made in the Reports of JJ Irani Committee and the Standing Committee, the requirement of mandatory rotation of auditors was viewed favourably basis which the new law was framed. If the rotation of auditors is mandatory for certain class of companies, why will it be viewed adversely in case of companies not covered under Section 139(2) if the rotation is carried out after completion of the tenure of the appointment.

Whether the concept of retiring auditor still exists?

The continuity in office which was at the back of Section 224 of the erstwhile Act has now been replaced by a quinquennial term. Hence, the assurance of reappointment is no more a structure of the law. On the contrary, there is a negative sanction for continuing beyond 5 years in case of larger companies [covered u/s 139(2)]. There is no case of retirement of auditors any more. There is only a block term of 5 years. In case of a firm, it is a case of reappointment, but not based on retirement. The term itself is over. The term cannot be 10 years from the beginning. The

section permits a reappointment in case of a firm for one more term of 5 consecutive years. There ought to be no legitimate expectation for reappointment beyond 5 years.

However, it is observed that the language of Section 139(9) and 140(4) continue to have the remnants of the old scheme, though these provisions are not consistent with the scheme of the new law at all. Hence, the defence against non- reappointment inherent in Section 139(9) and 140(4) should not be relevant anymore. Therefore, it seems that the special notice and an opportunity to defend in 140(4) is not needed, but what is crucial is the audit committee's recommendation. Section 139(1) provides that an auditor shall be appointed for a block of 5 years. But we need to continue with same auditor continuously till Section 139(9) or Section 140 (4) gets attracted, will result in an altogether new interpretation.