

Article

Provisions relating to Audit and Auditors in Companies Bill, 2012



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The auditors of a company are an integral part of the company and can be considered to be the “watchdogs”. In today’s world of scams, the role and responsibility of the auditor towards the company has only increased manifold. Here, we present a comparison of the provisions in the Companies Act, 1956 (“**Act**”) and Companies Bill, 2012 (“**Bill, 2012**”) relating to audit and auditors. The Companies Bill, 2012 has ushered an era of increased transparency and accountability. Among other provisions, the Bill, 2012 has been in news for the provisions on auditors.

Act	Bill, 2012
Appointment	
<ul style="list-style-type: none"> • Every company shall appoint an auditor at each AGM who shall hold office from the conclusion of that AGM till the conclusion of next AGM (<i>Section 224</i>) • Written certificate from the auditor that the appointment or reappointment has been made within the limits in S.224 (1B) i.e. not an auditor in more than 20 companies. 	<ul style="list-style-type: none"> • At the first AGM of the Company, auditor to be appointed who will hold office from the end of the AGM till the sixth AGM and thereafter, till the conclusion of every sixth AGM • Written consent and certificate from the auditor to be obtained. The certificate to also indicate if the auditor satisfied the provisions of Section 141 discussed later • Company to inform the auditor of his appointment and also file a notice of such appointment with the Registrar within 15 days of meeting in which auditor is appointed. (<i>Clause 139</i>)
<p><i>Analysis: The Bill, 2012 has made it mandatory to appoint an auditor for a period of five years. The reason behind doing the same is not known, but this can be a welcome gesture as it is usually seen that the process of re appointment of an auditor is only viewed as a formality. We are of the view that the Bill, 2012 prohibits the appointment of the same firm as auditor even if the some other partner of the firm will be signing the annual accounts on behalf of the firm. Although, this will give rise to transparency and a fairer chance to the other audit firms, it puts a firm with multiple partners at a disadvantage. The new Bill also requires the company to inform the ROC about the appointment of an auditor within 15 days. This does away with the present system of the auditor intimating the ROC. It is seen that the auditor used to intimate the ROC at his own will and the company at times used to be in the dark about the delay.</i></p>	
No similar provision	<ul style="list-style-type: none"> • Listed company shall not appoint: <ul style="list-style-type: none"> ➤ An individual as auditor for more than one term of five consecutive years and ➤ An auditor firm for more than two terms of five consecutive



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	<p>years</p> <p><i>Provided</i> that the individual or auditor firm will not be eligible for reappointment in the same company for five years from the completion of term.</p> <p>Also as on the date of appointment no audit firm having a common partner or partners to the other audit firm shall be appointed whose tenure has expired in the immediate preceding financial year (Clause139).</p>
<p><i>Analysis: This provision is unique to the Bill, 2012. With this provision, the company will be forced to appoint a new individual or firm as its auditor for a maximum of five years. This will also ensure that the company does not appoint any other firm having a common partner. This provision is applicable only to a listed company at present. The listed companies have been provided with a breather period of three years to implement this Clause once the Bill, 2012 comes into effect.</i></p>	
<p>Tenure and frequency of audit</p>	
No similar provision	<p>The members of a company can resolve to rotate the auditor every year or that the audit shall be conducted more than one auditor (Clause139).</p>
<p><i>Analysis: This provision gives the members of the company the opportunity to take active part in management. Also, the members are given the power to decide on the tenure of the auditor of the company. This provision is a positive step towards empowering the members and keeping them in the loop about the conduct of business of the company. On the other hand, this provision ignores the vital principle of continuing knowledge. It is possible that shareholders holding majority might force to pass the resolution for rotation of auditors which might actually not be required.</i></p>	
<p>Appointment of auditors of a Government company</p>	
No similar provision	<p>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 Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of one hundred and eighty</p>



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	<p>days from the commencement of the financial year, who shall hold office till the conclusion of the AGM (<i>Clause 139</i>)</p>
<p><i>Analysis:</i> <i>The spirit of this provision is the same as in Companies Bill, 2009. Further, the auditors appointed in the manner prescribed under this sub-section in the new Bill, will not be holding office for more than one year unless reappointed. This is unlike the appointment of auditors in an AGM by the members of the company.</i></p>	
<p><i>Appointment of first auditor of the company</i></p>	
<p>The first auditor(s) of the company shall be appointed by the Board of directors within one month of the date of registration of the company and the auditor or auditors so appointed shall hold office until the conclusion of the first AGM and if the Board fails to exercise the powers under this sub-section, the company in general meeting may appoint the first auditor (<i>Section 224 (5)</i>).</p>	<p>The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty 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 ninety days at an Extraordinary General Meeting (“EGM”) appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting (<i>Clause 139</i>).</p>
<p><i>Analysis:</i> <i>The major point of difference between the Act and the Bill, 2012 is that the it has specified the number of days within which the EGM should be convened. This gives clarity and also makes it obligatory on the company to hold an EGM for the purpose of appointment of auditor. Thus, the responsibility of ensuring that the first auditor is appointed comes on the company.</i></p>	
<p><i>Casual vacancy in the office of an auditor</i></p>	
<ul style="list-style-type: none"> • The Board may fill any casual vacancy in the office of any auditor, but while any such vacancy continues, the remaining auditor or auditors, if any may act: Provided that where such vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in general meeting. <p>Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM (<i>Section 224</i>).</p>	<p>The Bill, 2012 has dealt with this by classifying the class of companies as:</p> <ul style="list-style-type: none"> ➤ Company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India. ➤ Company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India (<i>Clause 139</i>)
<p><i>Analysis:</i> <i>The Act does not differentiate between casual vacancy caused in a company</i></p>	



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whose accounts are not audited by CAG and a company whose accounts are audited by CAG. Further, the Act also does not mention any time frame within which the auditor in casual vacancy should be appointed. The Bill, 2012 is illustrative and envisages two scenarios. Further, it is clear about the time period for appointment of auditor in casual vacancy and also the tenure ship.

Removal of Auditor

Any auditor appointed under the Section 224 may be removed from office before the expiry of his term only by the company in general meeting, after obtaining previous approval of the Central Government in that behalf. This is however subject to proviso of Section 224(5)

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 (Clause 140).

Analysis: *The Bill, 2012 has given an opportunity to the auditor to be heard. This can be viewed as a welcome change by the auditor fraternity.*

Similar to the Act, the Bill, 2012 also requires that Special Notice be served for the appointment of a new auditor or for not re-appointing the retiring auditor. However, this shall not be required for an auditor who has completed consecutive tenure of five years. The Tribunal has been given powers to look into the intent of representation of the auditor and accordingly order if the representation should be sent out to members.

Resignation of Auditor

No such provision

The auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form with the company and the Registrar or with the Comptroller and Auditor-General of India, as the case may be, indicating the reasons and other facts as may be relevant with regard to his resignation.

Fraudulent act by Auditor

The Act does not have any provisions on the lines of changing the auditor of the company guilty of fraud. The Bill, 2012 provides that in case the Central Government or Tribunal is satisfied, it may order to change the auditor within 15 days and in case final order is passed then the auditor shall not be appointed for a period of five years in any other company and be further liable u/s 447 of the Bill which prescribes monetary as well as penal punishment. This is a welcome change and may prove as a deterrent for conduct of fraudulent activities.



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This action can be initiated by the Tribunal <i>suo moto</i> or on an application made to it by the Central Government or by any person concerned.
<i>Eligibility of Auditors</i>
The criterion for eligibility has been retained in the Bill, 2012. Where a firm including a limited liability partnership 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 (<i>Clause 141</i>). This is line with the recent MCA notification vide S.O. 115(E) dated May 23, 2011 ¹ .
<i>Remuneration of Auditor</i>
Unlike the Act, the Bill gives the entire powers to the members to decide the remuneration of the auditors at a general meeting. It also explains the scope of the term “remuneration” as one which would not include any extra services rendered by the auditor at the specific request of the company. (<i>Clause 142</i>)
<i>Disqualification of Auditors</i>
In addition to the criteria for disqualification of auditors in the Act, the Bill, 2012 prescribes new criteria which are <i>inter alia</i> detailed below: <ol style="list-style-type: none">1. A person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed.2. Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services <p><i>Analysis:</i> <i>The Bill, 2012 has retained the provision of disqualifying the auditor in case the partner or his relative hold interest or security in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company from the Companies Bill, 2009. This provision does not seem to be practicable as the auditor will not be able to restrain his relative from holding shares. However, it needs to be seen as to who are covered under the definition of “relative” in the Bill, 2012.</i></p>

A few firsts:

1. Clause 144 of the Bill, 2012 prescribes certain services not to be rendered by the auditor such as internal audit, actuarial services, investment banking services.
2. Automatic re-appointment of existing auditor where no auditor is appointed/reappointed in an AGM (Clause 139).

¹ [http://mca.gov.in/Ministry/notification/pdf/S.O.1152\(E\)_23may2011.pdf](http://mca.gov.in/Ministry/notification/pdf/S.O.1152(E)_23may2011.pdf)

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3. Auditing standards to be made mandatory (Clause 133).
4. Where a company is required to constitute an Audit Committee under clause 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 (Clause 139).
5. The Bill, 2012 prescribes that any qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company. *This is a slight shift from the provisions in the Act and Companies Bill, 2009, which prescribe reading out of the complete audit report only* (Clause 145).
6. The Bill, 2012 has also prescribed that in case of any matter in which the auditor has the right to be heard at any meeting, then that matter may not be transacted through postal ballot (Clause 110).
7. National Financial Reporting Authority to be constituted which shall prescribe make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors and also monitor and enforce compliance with the auditing standards (Clause 132).