

Analytical Speaking

Rotation of auditors: Inconsistency between Companies Act, 2013 and Draft Rules, 2013



CS Nidhi Ladha
nidhiladha@vinodkothari.com
September 9, 2013

Check at:
<http://india-financing.com/staff-publications.html>
for more write ups.

Copyright:

This write up is the property of Vinod Kothari & Company and no part of it can be copied, reproduced or distributed in any manner.

Disclaimer:

This write up is intended to initiate academic debate on a pertinent question. It is not intended to be a professional advice and should not be relied upon for real life facts.



Article

Following the trend of USA which replaced its 37 years old companies act in 2006, India is also replacing its nearly six decades old Act, the Companies Act, 1956 (the 1956 Act) with the new Companies Act, 2013 (the Act) as already assented by both the Houses of Parliament on December 18, 2012 and on August 8, 2013 respectively and nod from the Hon'ble President on August 29, 2013. The Companies Bill which was in pipelines since 5 years has now been enacted as Act no. 18 of 2013 which will replace the 1956 Act fully.

The 1956 Act had some 658 sections and 14 schedules and the Act has 470 sections and 7 schedules. This does not mean that the Act has now been made smaller or simpler. The words 'as may be prescribed' is appearing at 416 places in the Act which means a huge amount of law will be enacted by way of rules to be issued by the government in process.

As the Act has already got the assent of the President last month, the Ministry of Corporate Affairs has placed on its portal, the draft rules for public comments on September 6, 2013¹ (Draft Rules) inviting comments till October 8, 2013.

This write-up deals with the conflicting provision in the Draft Rules and the Act relating to rotation of auditors in listed and in certain class of companies to be specified.

Provision under the Act

Among others, one of the major changes which the new Act is proposing is that it has now put a restraint on the terms of the auditors. Under the 1956 Act, statutory auditors were to be appointed by companies annually. However, section 139 of the Act now requires appointment (which has been defined by way of an explanation under sub-section (1) to include re-appointments also) of auditors at every sixth annual general meeting (AGM) and the appointment is to be ratified at every AGM.

At the sixth AGM, the auditor is eligible for reappointment, in terms of section 139 (9), subject, however, to the mandatory retirement provisions of sub-section (2) of the said section.

Additionally, in terms of sub-section (2), in case of listed companies or companies of a class to be notified, there is a bar on reappointment of an auditor, if he has already held: (a) one term of 5 years in case of an individual; or (b) two consecutive terms of

¹ The draft Rules are available on the MCA portal at: <http://14.140.191.91/>



Article

5 years in case of a firm. Once the bar on reappointment applies, there is a mandatory cooling-off period of 5 years.

On one hand where the Act has enhanced the scope of auditors by mandating internal audit for such class of companies as may be specified, on the other hand, by imposing civil liability on the auditors, the Act now requires auditors to be more cautious and careful while auditing.

Provisions under the Companies Rules, 2013

After the new and strict provisions relating to audit and auditors in the Act, the Draft Rules seems to be another challenge for the chartered accountants. Rule 10 of the Draft Rules deals with provisions relating to audit and auditors.

Rule 10.4 (4) of the Draft Rules reads as:

“For the purpose of the rotation of auditors:

(i) In case of an auditor (whether an individual or audit firm), the period for which he or it has been holding office as auditor prior to the commencement of the Act shall be taken into account in calculating the period of five consecutive years or ten consecutive years, as the case may be.

(ii) 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 or is operating under the same trade mark or brand.”

Para (i) above says that for the purpose of rotation of auditors under section 139 (4) (applicable to listed and other to be specified class of companies), the existing term of auditors shall also be taken into account. This is clearly contrary to the language of section 139(2) of the Act which refers to "one term of 5 years" or "two terms of 5 years each".

Prior to the commencement of the Act, there is no appointment of for a term of five years at all. Even if an auditor has been holding his office for 5 years under the 1956 Act, it is not one term of 5 years, but 5 terms of one year each. If an auditor gets reappointed, it does not mean the term is any longer than annual. However, under the Act, before issue of Draft Rules, it was predicted that the 'term' will be new term starting after notification of the Act. The Draft Rules have, though divergent with the Act, made it clear, the existing term under the 1956 Act will also be counted for



Article

calculating the 5 years or 10 years term. It would mean that if the tenure of appointment of auditors under the Act will effectively be 4 years or 9 years and all related conditions are to be read with such term only.

As the Draft Rules are open for public comments till October 8, 2013 only, the chartered accountants should raise objection/concern over this particular point to MCA.

Also see our other related write-ups:

- Presentation on Companies Act, 2013 at <https://india-financing.com/component/content/article.html?id=279>
- Article on 'Companies Bill: From Rule of Law to the Law of Rules' at [https://india-financing.com/Companies Bill from the Rule of Law to the Law of Rules%20\(1\).pdf](https://india-financing.com/Companies Bill from the Rule of Law to the Law of Rules%20(1).pdf)
- Article on 'Corporate Social Responsibilities- One of the major highlights of Companies Bill, 2012' at <https://india-financing.com/Companies Bill 2012 Corporate Social Responsibilities.pdf>
- All other articles on Companies Bill, 2012 at <https://india-financing.com/component/content/article/281.html>
- Other articles on corporate laws at <https://india-financing.com/staff-publications-corporate-law.html>
- Our other staff publications at <https://india-financing.com/staff-publications.html>