

# Lecture 1

## Company Audit

### Topics Covered in this Chapter:

- Chapter X of Companies Act, 2013 "Audit and Auditors" (Sections 139 to 148)
- Companies (Audit and Auditor's) Rules, 2014
- Companies (Cost Records and Audit) Rules, 2014
- Chapter IX of Companies Act, 2013 "Accounts of Companies"  
[Sec. 128, 129, 130, 131, 132 (NFRA), 133 and 134]
- Audit of Limited Liability Partnerships (LLP Audit)
- Guidance Note on Internal Financial Controls (IFC) over financial reporting

### (i) Appointment of Auditors:

#### I. Appointment of first auditor:

(A) Non Government Co. - Sec. 139(6)

(B) Government Co. - 139(7)

First auditor shall be appointed  
by BOD within 30 days of  
incorporation of company

First auditor shall be appointed  
by CAG within 60 days  
of incorporation of company

↓ If BOD fails

↓ If no auditor appointed by CAG

BOD shall inform the members and  
members will appoint the first  
auditor in general meeting (EGM)  
within 90 days\*

BOD shall appoint the first  
auditor within next 30 days

↓ If BOD fails

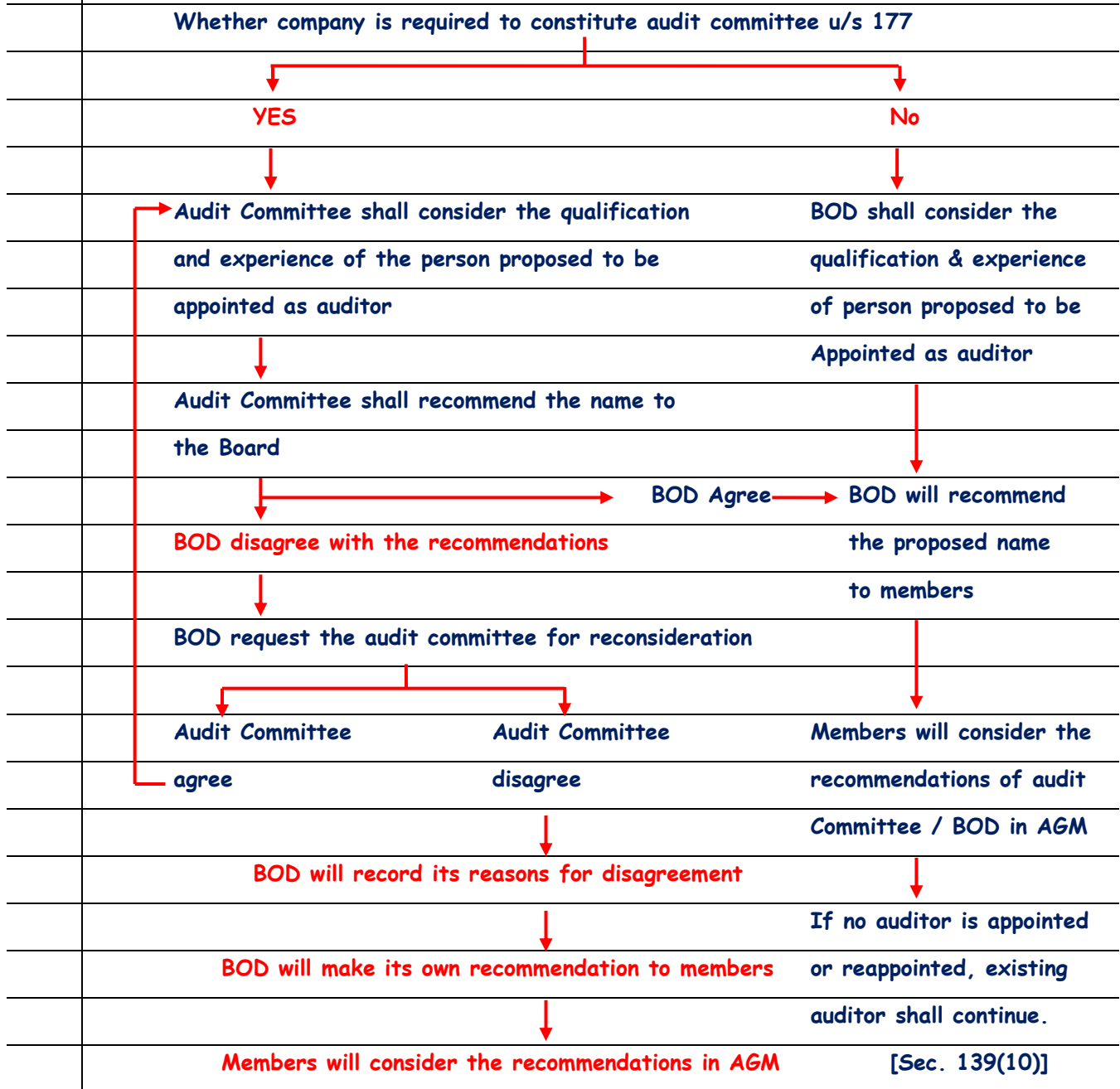
BOD will inform members and  
members will appoint the first  
auditor in GM within 60 days\*

**Tenure of First auditor (all companies):  
till conclusion of first AGM.**

\* Though law does not prescribe the date from which period of 90 days (Non Govt. Co.)/  
60 days (Govt. Co.) will start, it may be interpreted that such period will start from expiry  
of 30 days of time period within which BOD have to appoint the auditor.

<b>II. <u>Appointment of subsequent auditor:</u></b>	
↓	↓
<b>(A) Non Government Co. - Sec. 139(1)</b>	<b>(B) Government Co. - 139(5)</b>
↓	↓
Subsequent auditor shall be appointed at First AGM and thereafter at every 6 <sup>th</sup> AGM	Subsequent auditor shall be appointed by CAG, for each financial year
<b><u>Tenure:</u></b> till conclusion of 6 <sup>th</sup> AGM.	↓
	within 180 days from the commencement of financial year.
<b>Note:</b> Appointment of auditor shall be made in prescribed manner (Rule 3 of CAAR), subject to following conditions:	<b><u>Tenure:</u></b> till conclusion of next AGM.
↓	
<b><u>Condition 1: Ratification:</u></b> Omitted	<b>Q.</b> If no auditor is appointed by CAG?
<b><u>Condition 2: Written Consent:</u></b> Before appointment, a written consent of the the auditor and a Certificate that appointment if made, shall be in accordance with the provisions of this Act, shall be obtained.	<b>Q.</b> Whether existing auditor can continue if no auditor is appointed by CAG within 180 days?
<b><u>Condition 3: Content of Certificate:</u></b> Certificate shall indicate that criteria as specified u/s 141 of Companies Act, 2013 has been fulfilled.	<b>Q.</b> Whether there is an overlapping of work among two auditors if auditor of one FY continues and before completion of his tenure another auditor is appointed within 180 days of commencement of new FY.
<b><u>Condition 4: Intimation to auditor and ROC:</u></b> Company shall inform the auditor about his appointment and file a notice of appointment with ROC in Form ADT 1 within 15 days of appointment.	

**Rule 3: Manner of Selection and Appointment of auditor:**



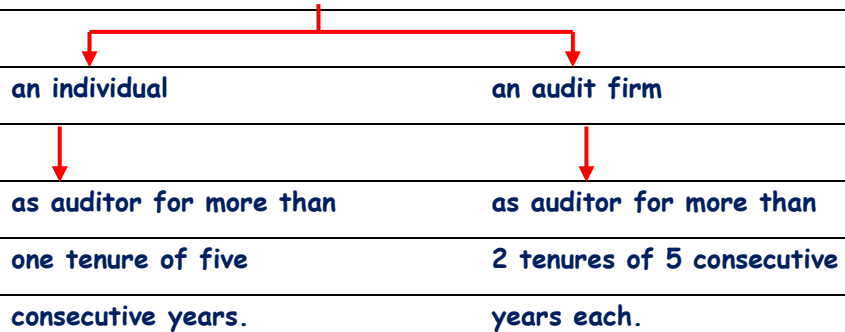
**Rule 4: Contents of the Certificate:** The auditor appointed shall submit a certificate that:

- (a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the CA Act, 1949 and the rules or regulations made there under;
- (b) the proposed appointment is as per the term provided under the Act;
- (c) the proposed appointment is within the limits laid down by or under the authority of the Act;

(d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

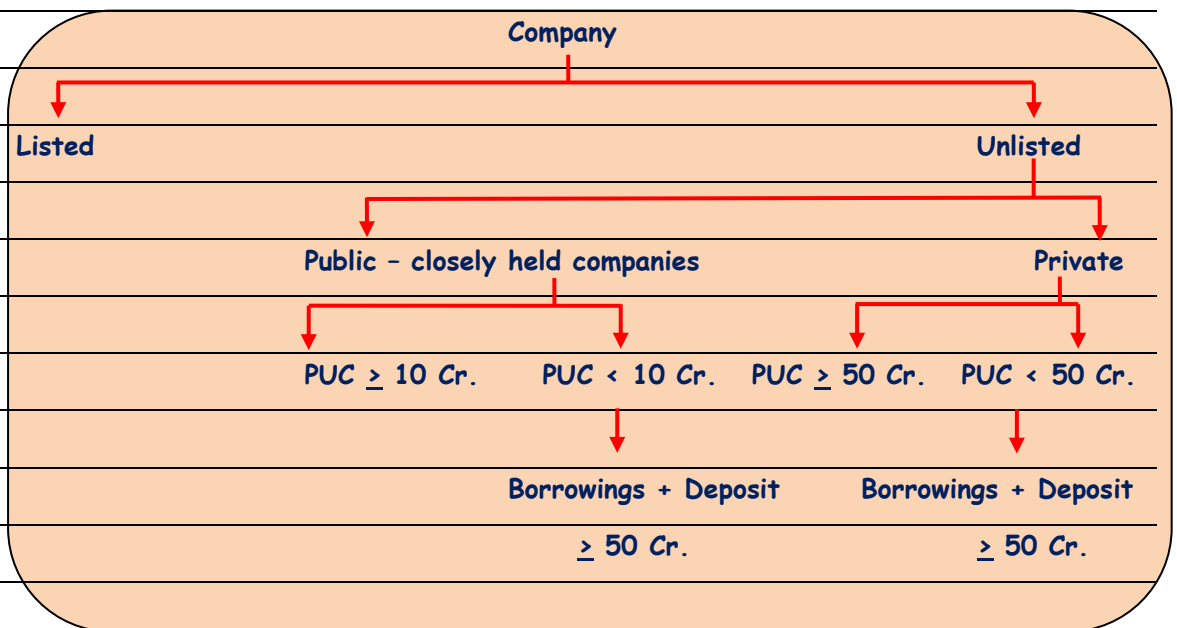
**(ii) Rotation of Auditors:**

**(a) Sec. 139(2):** A listed company and other prescribed companies\* (excluding OPC and Small Companies), shall not appoint



**\*Prescribed Companies (Rule 5 of CAAR, 2014):**

- (a) Unlisted public companies having PUC  $\geq$  10 Cr.
- (b) Private limited companies having PUC  $\geq$  50 Cr.
- (c) Companies not covered in (a) and (b), having public borrowings from banks and financial institutions and public deposits  $\geq$  50 Cr.



<b>Examples:</b>		PUC	Borrowings	Whether Rotation applicable
ABC Ltd.	Listed	5 Cr.	10 Cr.	Yes
A (Pvt.) Ltd.	Listed	8 Cr.	35 Cr.	Yes
XYZ Ltd.	Unlisted	5 Cr.	45 Cr.	No
		15 Cr.	45 Cr.	Yes
		5 Cr.	55 Cr.	Yes
		15 Cr.	55 Cr.	Yes
ABC (P) Ltd.	unlisted	45 Cr.	45 Cr.	No
		55 Cr.	45 Cr.	Yes
		45 Cr.	55 Cr.	Yes
		55 Cr.	55 Cr.	Yes

**Other provisions covered u/s 139(2):**

(i) **Cooling off Period:** Individual auditor or audit firm shall not be eligible for appointment



in same company



for a period of 5 years after completion of their respective tenures.

(ii) **Common Partner:** Audit firm having common partner



as on date of appointment



with the firm whose tenure has just expired



shall not be eligible for appointment for a period of 5 years.

Example: AB & Associates having 3 partners A, B and C is auditor of ABC Ltd., a listed entity. AB and Associates serves 2 tenures of 5 years each.

- (a) Whether RX & Co. having partners R, X and C can be appointed as auditor in ABC Ltd.
- (b) Whether PQ and Associates having two partners P and Q be appointed as auditor in ABC Ltd.
- (c) What will be the consequences, if after appointment of PQ and Associates as auditor in ABC Ltd. Mr. A joins PQ and Associates as partner.

Answer: (a) No (b) Yes (c) No consequences

(iii) Implications of Sec. 139(2): Sec. 139(2) shall not prejudice the right of

- (a) Company: to remove the auditor before completion of tenure.
- (b) Auditor: to resign before completion of tenure.

(b) Rotation among auditing partner and joint auditor [Sec. 139(3)]:

Members of the company may resolve

- (a) rotation of auditing partner and his team at prescribed interval
- (b) that audit may be carried out by more than one auditor

Q: ABC LTD. appoint M/S RS & Associates as auditor. Members are willing to pass a resolution that auditor is to be appointed for a term of 5 years subject to the condition that auditing partner changes every year, to which M/S RS and Associates raises objection. Comment.

Answer: Objection is not tenable as members are entitled to pass a resolution for rotation of auditing partner at prescribed interval.

(c) Powers of C.G. [Sec. 139(4)]:

- C.G. may prescribe the manner of rotation for the purposes of Sec. 139(2).
- Rule 6 of Companies (Audit and Auditor's) Rules, 2014 prescribes the manner of rotation.

	<b>(d) <u>Manner of Rotation (Rule 6):</u></b>
	<b>(i) Audit committee or Board of Directors, as the case may be, shall recommend the name of auditor, who replaces the incumbent auditor (Existing auditor). Board of Directors shall forward the recommendations to the members and members will appoint the auditor in AGM.</b>
	<b>(ii) For the purpose of rotation, following provisions shall apply:</b>
	<b>(a) For calculating period of 5 years / 10 years, period served prior to commencement of this Act, shall also be considered.</b>
	<b>(b) Individual auditor / audit firm, shall not be eligible to be appointed as auditor for a period of five years if it belongs to same network to which retiring auditor belongs to.</b>
	<b>Example: Tenure of existing auditor (ABC and Co.) in PQR Ltd., a listed entity expires. PQR Ltd. wants to appoint MN and Associates as auditor for next tenure. Comment, if</b>
	<b>(1) Mr. A is partner in both firms as on date of appointment.</b>
	<b>Ans: MN and Associates is disqualified due to proviso to Sec. 139(2) as having common partner.</b>
	<b>(2) Both firms belong to same network.</b>
	<b>Ans: MN and Associates cannot be appointed as it belongs to same network to which retiring auditor belongs to. [Rule 6]</b>
	<b>(3) ABC and Co. belongs to network A, whereas MN and Associates do not belong to any network. Hence company appoint MN and Associates as its auditor for next tenure. However, after five months of appointment, MN and Associates joins Network A.</b>
	<b>Ans.: MN and Associates need to vacate the office and casual vacancy arise.</b>

(c) Break in the term should be for a continuous period of 5 years.

(d) A partner in charge, of audit firm, who certifies the financial statements of the Company, if retires from the firm and joins another firm,



another firm shall also be ineligible for being appointed as auditor for a period of 5 years.

<b>Summary:</b>	(i) <b>Common Partner</b>	-	date of appointment
	- Sec. 139(2)		
	(ii) <b>Common Network</b>	-	date of appointment + 5 years
		-	Rule 6
(iii) <b>Certifying Partner</b>	-	date of appointment + 5 years	
		-	Rule 6

**Comprehensive Example:**

- ABC and Associates having three partners A, B and C serves two tenures of 5 years each in XYZ Ltd. (a listed company). On behalf of ABC and Associates, Mr. B certifies the financial statements of XYZ Ltd. ABC and Associates belongs to Network A.

- XYZ Ltd. is considering the appointment of PQR and Associates as its auditor in its upcoming AGM. PQR and Associates is having three partners P, Q and R and belongs to Network X.

**Q. 1: Whether PQR and Associates can be appointed as auditor?**

**Ans.: Yes**

**Q. 2: If after appointment, Mr. A joins PQR and Associates, whether PQR and Associates need to vacate the office.**

**Ans.: No**

**Q. 3: Whether any consequences arise, if Mr. B resigns from ABC and Associates and joins PQR and Associates, 3 months after its appointment?**

**Ans.: PQR and Associates need to vacate the office.**



	<b>Q. 4: Whether any consequences arise, if Mr. C resigns and joins PQR and Associates, 3 months after appointment of PQR and Associates.</b>
	<b>Ans.:</b> No consequences, as Mr. C is not a certifying partner.
	<b>Q. 5: Whether any consequences arise, if PQR and Associates joins Network A, 6 months after its appointment.</b>
	<b>Ans.:</b> PQR and Associates need to vacate the office.

**(iii) Filling of Casual Vacancy:**

**(a) Meaning of Casual Vacancy:** Any vacancy Created after valid appointment but (Not defined in law) before completion of tenure may be considered as casual Vacancy.

**Examples:** Vacancy created due to death, Resignation, disqualification, etc.

**Note:** Vacancy Created due to non-acceptance of auditor appointed in AGM will not be considered as Casual Vacancy.

**(b) Filling of Casual Vacancy: Sec. 139(8)**

**Govt. Co.**

**Non Govt. Co.**

Casual Vacancy be filled by CAG with 30 days

due to reasons other than resignation

due to resignation

If CAG does not fill the Vacancy

Casual vacancy be filled by BOD within 30 days

Casual Vacancy be filled by BOD within 30 days

BOD may fill the Vacancy within next 30 days.

with a condition that appointment made by BOD shall be approved by members in EGM to be

**IF BOD fails?**

**Tenure:** till conclusion of Next AGM.

convened within 3 months from date of recommendation.

(iv)	<b>Re - appointment of auditor: Sec. 139(9):</b>
	Retiring auditor may be re-appointed, if:
(a)	he is not disqualified (i.e. qualified);
(b)	he is not unwilling to continue (i.e. willing to continue);
(c)	no special resolution was passed by the company w.r.t.
	- appointing someone else as auditor                      Or                      providing expressly that retiring auditor shall not be re-appointed

**Notes:**

- To reappoint the retiring auditor, ordinary resolution is required.
- Special resolution is required to appoint auditor in place of retiring auditor who was eligible and willing to be re-appointed.
- Provisions of Sec. 139(9) are applicable in case of:
  - (a) Companies not covered u/s 139(2) read with Rule 5.
  - (b) Companies covered u/s 139(2) and auditor is an audit firm.

**Types of resolution required in various cases:**

(a)	Appointment of First auditor by Board of Directors	Board
(b)	Appointment of First auditor by Members in EGM	OR
(c)	Appointment of Subsequent auditor in First AGM (Same Auditor)	OR
(d)	Re-appointment of retiring auditor in 6 <sup>th</sup> AGM (Same Auditor)	OR
(e)	Appointment of Subsequent Auditor in 6 <sup>th</sup> AGM (Different Auditor)	
	I. Retiring auditor not reappointed being not eligible for another term due to cooling period.	OR
	II. Retiring auditor was eligible and willing for another tenure but not re-appointed.	SR
(f)	Filling of casual vacancy by Board	Board
(g)	Filling of casual vacancy arises due to resignation of existing auditor.	Board & OR

**(v) No appointment/ reappointment in AGM [Sec. 139(10)]:**

If no auditor is appointed / reappointed at AGM, retiring auditor shall continue.

**Note: Sec. 139(10) can be applied provided**

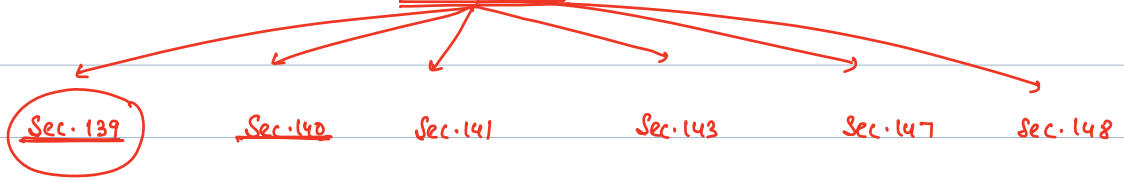
- no disqualification u/s 141 attracted over the retiring auditor.
- retiring auditor is willing
- rotation provisions are not applicable.

**(vi) Recommendations of audit Committee [Sec. 139(11)]:**

If Company is required to constitute audit committee u/s 177 of this Act, all appointments including filling of casual vacancies, shall be made after considering the recommendations of audit committee.

**DO Practice - Questions on Appointment and Rotation of Auditors**

Sec 139-148



Sec. 142

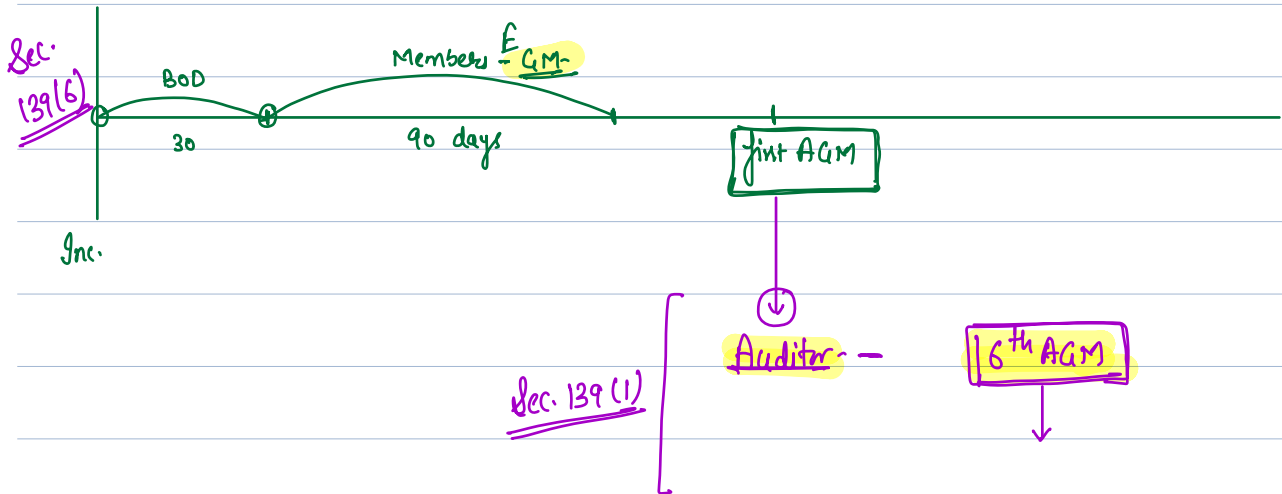
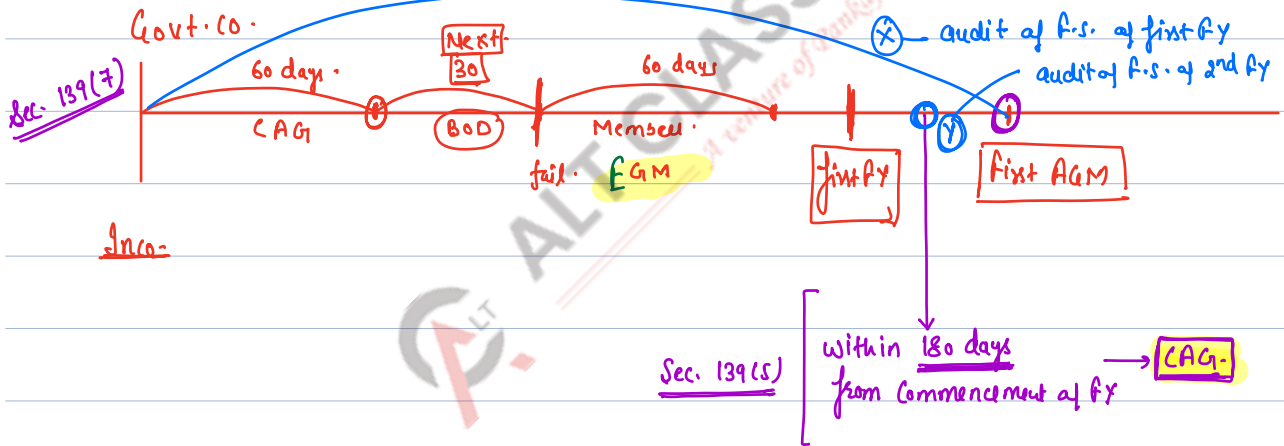
Sec. 144

Sec. 145

Sec. 146

Sec. 139: Appointment - first auditor - (a) Govt. Co. (b) Non Govt. Co.  
 - sub. auditor (a) Govt. Co. (b) Non Govt. Co.

Sec. 139(7)
139(6)  
139(5)
139(1)



✓ Note: As per Rule 2A of Companies (Specification of Definitions Details) Rules, 2014, for the purpose of Sec. 2(52) of Companies Act, 2013, private companies which have listed their NCD securities on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008 shall not be considered as listed company.



Ex: A(P) Ltd. - NCD - listed as per SEBI Regulations.

I Puc : 10 Cr. B + D = 20 Cr.

II Puc : 55 Cr. B + D = 20 Cr.

III Puc : 25 Cr. B + D = 55 Cr.

Ans: Assumption - I (Ignoring Rule 2A)

Rotation provision applicable in all cases as A(P) Ltd. is a listed company.

Assumption - II (Considering Rule 2A)

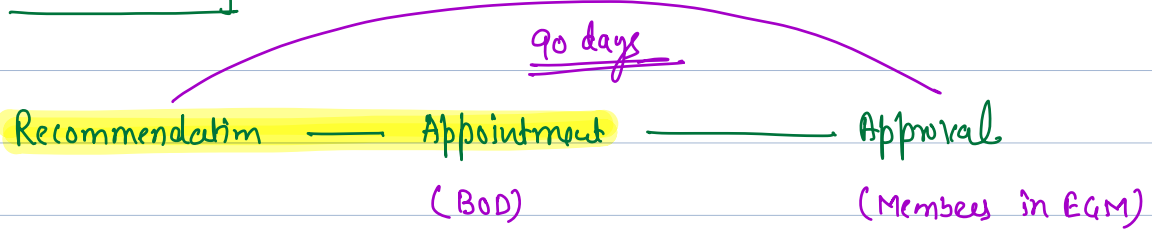
A(P) Ltd. will not be considered as a listed company u/s 2(52) of CA, 2013.

Situation - I : Rotation provision not applicable.

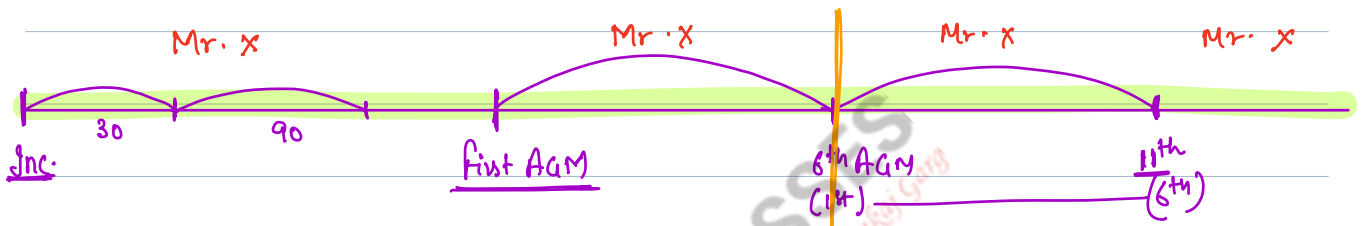
" - II : " " applicable as Puc  $\geq$  50 Cr.

" - III : " " " as B + D  $\geq$  50 Cr.

Casual vacancy.



Non-Govt. Co. : OPC / Small Co. / Co. not covered under Rule 5



Condition - 1 : Non disqualified ✓

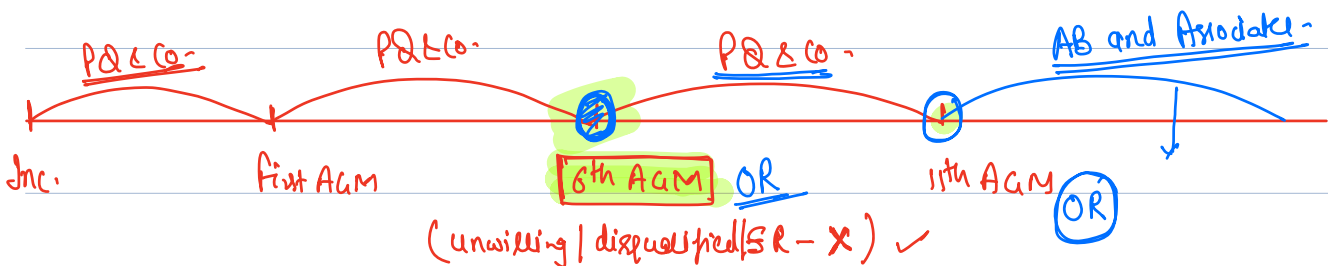
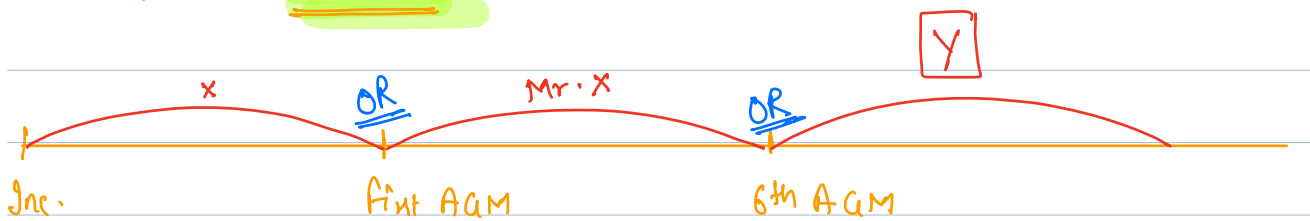
" - 2 : Non Unwilling ✓

" - 3 : No SR → to appoint someone else

OR

Not to reappoint retiring auditor

Non Govt Co. Listed Co.



Ex: ABC Ltd (listed company)



Mr. A (auditor) - completed tenure of 5 years.



cooling period

AGM to be held on 29.09.2022 - Mr. B - is to be appointed as auditor.

death - 29.09.2022 - road accident.

Q: Whether any Casual Vacancy arises in office of auditor: - No

Q: Whether Mr. A can continue → No

Q: Solution to this problem: EGM - Members