

Rotation of Auditors under the Companies Act, 2013



The Companies Act, 2013 is being enacted in phases. As many as 98 Sections were notified w.e.f 12th September 2013 and 183 Sections were notified w.e.f. 1st April, 2014. Section 139(2) of the Companies Act, 2013 provides the mandatory rotation of statutory auditors for listed as well as certain class of the companies as prescribed. The provisions rotation of statutory auditors are not applicable to one person companies and small companies and shall be applicable to all companies having borrowings from financial institutions, banks or public deposits of ₹ 50 crore or more irrespective of the threshold limit as mentioned. It is also provided in the Act that the cooling period for the outgoing auditor shall be for five consecutive years. This article delves into this concept and more. Read on...



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Background

The question of rotation of an auditor is not new. Way back in 1972, there was a proposal to introduce rotation of the statutory auditors by adding clause (1B) in the Section 224 of the Companies Act, 1956 in the Companies Amendment Bill, 1972. The object was probably to have more independence of statutory auditors as well as to achieve more equitable

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As on date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding financial year, shall be appointed as auditor of the same company for the period of five years.

distribution of audit to the younger members of the profession. Lots of representations from the members and the institute were submitted to the Government on the proposed amended bill against the proposal and amongst the representations there was also a suggestion to put the ceiling on the audit by a member in place of having complete rotation of auditors. Thereafter, when the Companies Amendment Act, 1974 was notified, a clause (1B) in Section 224 of the Act was inserted whereby the ceiling of the Audit was provided. This provision was again modified in the year 2000 when the ceiling of 20 audits per partner was retained. However, our institute by issuing the notification restricted that the number of audit assignment of the companies, having paid-up capital of ₹25 lakh or more cannot exceed 10 per partner. Again, the Company Bill, 1997 proposed for the rotation of the auditor after 5 consecutive years, but this proposal was again dropped by the Government on the recommendations and suggestions received from our members and the institute and other stakeholders.

The question of independence of the auditor was also discussed considerably in recommendations of the Naresh Chandra Committee constituted by the Government of India in August, 2002. The committee suggested various suggestions through which the independence of the auditor can be maintained. The suggestions were basically on the concept that the auditor should not have financial, business or personal relationship with the client. But the committee did not recommend the rotation of the statutory auditors. Instead, the committee suggested that the partners or team leaders or the team should be rotated. The Committee also suggested that the listed companies or companies having paid up capital and free reserves exceeding ₹10 crore or companies having turnover exceeding ₹50 crore, the 50% of audit team (excluding article clerk and trainees) should rotate every five years and the outgoing team can again be engaged for audit after three years. The suggestions of the Naresh Chandra Committee were

incorporated in the Companies Amendment Bill, 2003. With the above background it can be said that the question of rotation of statutory auditor is now not new as it was dealt with by the Government and so many committees for the last three decades.

Provisions under the Companies Act, 2013

Rotation of Auditor:

The mandatory rotation of the statutory auditors has been provided under Section 139(2) of Companies Act, 2013 which provides that no listed company or the company belonging to such class or classes of companies as may be prescribed shall appoint or reappoint:

- (a) An individual as auditor for more than one term of five consecutive years, and
- (b) An audit firm has auditor for more than two terms of five consecutive years.

Therefore, the rotation of the statutory auditor is applicable to all listed companies and any other company or class of the company as may be prescribed.

The Central Government has notified the Companies (Audit and Auditors) Rules, 2014 and prescribed that these provisions shall be applicable to following class of the companies excluding one person companies and small companies.

- a) All unlisted public companies having paid up capital of ₹10 crore or more.
- b) All private limited companies having paid up capital of ₹20 crore or more.
- c) All companies having paid up share capital of below threshold limit mentioned in (a) & (b) above and having borrowing from financial institutions, banks or public deposits of ₹50 crore or more.

It means the provisions rotation of statutory auditors are not applicable to one person companies and small companies and shall be applicable to all companies having borrowings from financial institutions, banks or public deposits of ₹50 crore or more irrespective of threshold limit mentioned hereinabove.

It is also provided in the Act that the cooling period for the outgoing auditor shall be for five consecutive years which means:

- i) An individual auditor who has completed his term under clause (a) above shall not be eligible for reappointment as an auditor in the same company for five years from the completion of such term.

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- ii) The audit firm which has completed its term under clause (b) shall not be eligible for reappointment as auditor in the same company for five years from the completion of such term.

Transition Period

The provisions of this Section shall be applicable to every company existing on or before the commencement of this Act, *i.e.*, 1st April, 2014 which is required to comply with the provisions of this Section and shall comply with the requirement of this Section within three years from the date of commencement of this Act. It means, the transition period has been given for three year *w.e.f.* 1st April, 2014 to comply with these provisions.

The Rule 6(3) also provides that an auditor, whether an individual or audit firm, the period for which an individual or firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or 10 consecutive years as the case may be. The following illustration shall clear how an appointment shall be made in the first AGM after the commencement of this Act, *i.e.*, 1st April, 2014.

Illustration 1 (For individual auditor) :

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of Section 139(2)]	Maximum number of consecutive years for which he may be appointed in the same company (including transitional period)	Aggregate period which the auditor would complete in the same company in view of column I and II
I	II	III
5 years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Illustration 2 (in case of Audit Firm)

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of Section 139(2)]	Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)	Aggregate period which the firm would complete in the same company in view of column I and II
I	II	III
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 year	9 years	10 years

Note:

1. The Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.
2. The Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.

Other Provisions Relating to Rotation of Auditors

- a) As on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding financial year, shall be appointed as auditor of the same company for the period of five years.
- b) The Central Government has prescribed under Rule 6 of the Companies (Audit and Auditors) Rule, 2014, the manner of the rotation of the

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The provisions of this Section shall be applicable to every company existing on or before the commencement of this Act, i.e., 1st April, 2014 which is required to comply with the provisions of this Section and shall comply with the requirement of this Section within three years from the date of commencement of this Act. It means, the transition period has been given for three year w.e.f. 1st April, 2014 to comply with these provisions.

auditors by the company as under:

- i) The audit committees shall recommend to the board the name of the auditor, who may replace the existing auditor on the expiry of the term of such existing auditor.
- ii) Where a company is required to constitute the audit committee the board shall consider the recommendation of such committee and in other cases board shall consider the matter of rotation of auditor and makes its recommendation for the appointment of next auditor by the members in general meeting.
- c) For the purpose of rotation of the auditor, it is also provided that an incoming auditor or audit firm shall not be eligible if such audit or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firm. For this purpose the term 'Same network' means the firm operating or initiating hitherto or in future under the same brand name, trade name or common control.
- d) It is also provided if the partner, who is in-charge of the audit firm and also certifies the financial statement of the company, retires from the said firm and joins another firm of chartered accountants such other firm shall also be ineligible to be appointed for the period of five years.
- e) The members of the company may resolve that the audit firm appointed by it, the auditing partner and his team shall be rotated at such interval as may be resolved by the members or the audit shall be conducted by more than one auditor.
- f) The rights of the company to remove the auditor or the right of the auditor to resign before the expiry of the term are retained. Thus, the company can remove the auditor before the expiry of the term after following the prescribed



procedure under Section 140 of the Act. Similarly, an auditor can resign before the expiry of his term after following prescribed procedure under Section 140(2) of the Act.

International Perspective on Rotation of Auditor

Many countries are not in favour of the rotation of statutory auditor. Some countries which initially adopted the rotation of the auditors have rejected it afterwards. Recently, the US House of Representation voted 321 to 62 in favour of a bill which bans the mandatory rotation of the auditor. The law-makers in the US have overwhelmingly voted against a proposal that would have mandated the companies to rotate the auditors after every few years. However, China has adopted the rules of rotation of the auditors in 2010.

Conclusion

In view of the history of rotation of auditors and the provisions of Companies Act, 2013 the sole object for the rotation of auditors is to have more independence of the auditors. The independence of the auditors has already been taken care of strictly while the provision of disqualification of the auditor were framed under Section 141 of this Act, wherein the matter related to the financial, personal and business relationship of the auditor with the client has been taken care of. Further, Section 144 of the Act also provides the prohibited services which the auditor or the audit firm cannot provide. Thus, the Companies Act, 2013 has enough provisions relating to the independence of Auditors. Therefore, separate provisions for rotation of auditors may not be required. The rotation of auditor could be applicable only for the companies in which public are interested. ■