

Appointment of auditors to fill casual vacancy

Dr S. Chandrasekaran

The term casual vacancy has not been defined in the Companies Act, 2013 (Act). As per Black's Law Dictionary "casual" means "not expected, foreseen, or planned." Thus it can be interpreted as vacancy arising due to resignation, disqualification and resignation.

Interestingly, abrupt resignations of auditors have taken place in over 30 NSE-listed companies since April 1, 2020 of financial year 2020-21. This is a cause of worry not only for the companies but also for the stakeholders of such companies. Statutory auditors, at the time of their resignation has to clearly spell out the detailed reasons for their resignations and the listed companies are required to disclose the same to the stock exchanges as soon as possible but not later than twenty-four hours of receipt of such reasons from the auditor. SEBI Circular No.



CIRCULAR

CIR/CFD/CMD1/114/2019

October 18, 2019

To

All Listed Entities / Material Subsidiaries
All the Recognized Stock Exchanges

Madam / Sir,

Sub: Resignation of statutory auditors from listed entities and their material subsidiaries

1. Listed companies are required to make timely disclosures to investors in the securities market for enabling them to take informed investment decisions.
2. Under Sub-clause (2) of Clause A in Part C of Schedule II under Regulation 18(3) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**SEBI LODR Regulations**"), the Audit Committee of a listed entity, *inter alia*, has to make recommendations for the appointment, remuneration and terms of appointment of auditors of a listed entity. Under Sub-clause (7), the Audit Committee is also responsible for reviewing and monitoring the independence and performance of auditors and the effectiveness of the audit process.

3. Further, Sub-clause (7A) inserted under Clause A in Part A of Schedule III

CIR/CFD/CMD1/114/2019 dated October 18, 2019 is about resignation of statutory auditors from listed companies and their material subsidiaries. It seems that the resignations of the auditors are mostly due to non-cooperation; among other grounds, one of the reasons is that “the auditors quit after the companies proposed a reduction in their fees, which was unviable.” Such situations put the companies on tenterhooks since the Board of directors of companies, other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, have to fill the causal vacancy of auditors within thirty days and such appointment on casual vacancy is also to be approved by the company in a general meeting convened within three months of the recommendation of the Board. The auditors appointed for the casual vacancy shall hold the office till the conclusion of the next annual general meeting. There is no requirement for the approval of members if the casual vacancy arises due to reasons other than resignation.

Different situations of appointment of auditors

Broadly, the appointment of auditors is in three different situations.

- (1) The first auditors of the company are appointed by the Board of directors within thirty days from the date of registration of the company (section 139(6)).
- (2) Subsequent appointment of auditors is from the conclusion of first general meeting till the conclusion of every sixth annual general meeting. Such appointment of auditors in a listed company or company belonging to such class or classes of companies excluding one-person companies and small companies (section 139(2)):
 - a) An individual as auditor for one term of five consecutive years; and
 - b) An audit firm as auditor for two terms of five consecutive years.
- (3) Casual vacancy filled in by the Board of directors within thirty days and in case of casual vacancy caused due to resignation of auditor, such appointment shall also be approved by the shareholders in the general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting (section 139(8)).

Tough time for the Board of directors to fill casual vacancy

The Board of directors has to fill the vacancy of auditors within a period of thirty days from the date of resignation of auditors. Before that, the

management has to identify new auditors, seek their written consent to act as auditor to complete the audit process within the shortest time period available, to obtain a certificate satisfying the criteria as provided in section 141 of the Act.

Sub-section 11 to section 139 further provides that where a company is required to constitute an audit committee under section 177, for all appointments, including the filling of a casual vacancy of an auditor under this section, the audit committee to consider and recommend the appointment to the Board of directors. Thereafter, the Board of directors has to decide and to recommend the same to the shareholders for their approval. It is a tough time for the Board of directors to initiate the process of finalising the new auditor to fill the casual vacancy.

It may be worth considering that the decision of the Board of directors for appointment of auditors need not be in a duly convened board meeting and it can be vide circular resolution. Neither the provisions of Act nor the Secretarial Standards 1 issued by the Institute of Company Secretaries of India restrict the appointment of Auditor by circular resolution of the Board of directors, except for appointment of secretarial auditor and internal auditor. Therefore such appointment can be made by the Board by way of circular resolution.

Will casual vacancy appointment be considered as a term of appointment?

As discussed above, the situation of appointment of first auditors by the Board till the first annual general meeting and the recommendation of auditors due to casual vacancy of auditors to the shareholders for their approval till the next annual general meeting are only a stop-gap measure. Whereas the appointment of auditors by the shareholders pursuant to sub-section 2 of section 139 is a clear distinction of appointment of auditors with one or two terms as may be applicable. Therefore, the view is that the casual vacancy of auditors filled in does not apply to the terms of appointment of auditors.

Conclusion

The recent development of resignations of auditors in listed companies is not a good sign for the stakeholders. It is also a tough call for the Board of directors of such companies to fill the vacancy on the resignation of auditors. However, the filling of vacancies of auditors for casual vacancies will not attract the provisions of section 139(2) of the Act.

(Dr S. Chandrasekaran is Senior Partner, Chandrasekaran Associates, Delhi.)