Section 141 of the Companies Act, 2013

on Eligibility, qualifications and

disqualification of auditors

**Section 141 of the Companies Act, 2013 on Eligibility, qualifications anddisqualification of auditors Vis a Vis Implementation Guide to SQC I—Annexure II on Illustrative Independent Policies – Financial Interests**

**Introduction:**

To move with time is *sine qua non* so as to move forward. ‘Update’ so as to be ‘uptodate’is not only the modern day thirst but also a thrust from time immemorial so as to catch up with time. Standard on quality Control (SQC I) has been issued on April 2008 to help implementing more effectively and also ensuring the quality of the service by the CA Firms to its clients. “SQCI is to be read in conjunction with the requirements of the Chartered Accountants Act, 1949, the Code of Ethics and any other relevant pronouncement of the Institute and other relevant legal or regulatory requirement (together referred to as “The Code”).

The purpose of the article is limited to the topic on Section 141 of the Companies Act, 2013 on Eligibility, qualifications and disqualification of auditors Vis a Vis Implementation Guide toSQC I Annexure II on Illustrative Independent Policies particularly to Financial Interests.

The SQCI was drafted when the companies Act 1956 was in operation. Now that the

Companies Act 2013 is in function, it is high time that the Standard should have been

revisited to quench the need for revision, where necessary.

Coming to the topic on hand, on financial Interests, SQCI uses the term ‘Partners and

employees of the Firm and their immediate family members’ in IG Annexure II as

against the word ‘relative’ used (in the place immediate family members) under both the

Acts The list of relatives is reduced from 22 as per Schedule IA to be read with Section 6©

of the old Act to No.8 as per rules to Section 2(77) of the new Act.

**Relative (as per Companies Act) VS Immediate family members (as per SQCI):**

In the absence of clarity by way of definition as to who constitute ‘immediate family member’

as per SQCI, it is very difficult to decode or make out. But, the word ‘immediate’, speaks for

it, negatively, it suggests it does not include ‘extended’ family. In modern day culture, it will

be like chasing a shadow, perhaps keeping this in mind, SQCI has intentionally employed

the word ‘immediately’ in relation to family. Hats off to the Institute! On the other hand, if we

revisit the definition of ‘relative' as per the new Act, it would be extremely difficult to get

information in respect of certain relatives in the present scenario especially, for example,

from brothers/sisters who branch out to another families, besides they are not within reach to

demand such information since well spread across globe and, more of than not in a

relationship model of ‘love and hate’, if not in ‘tug of war’ mode. In a situation like this, it is

the ordained duty/ responsibility of the Institute to raise in time and take it up with MCA for

proper revision of the rule to come out of the knot: and Institute also clearly spells out in

black and white as to who are immediate family members.

**Employees of the Firm:**

Coming to the other aspect as to ‘employees of the Firm’ it is ideal to make crystal clear as

to the extent of applicability whether applicable only in the case of particular auditee where

they are members of the assurance team (“AET”) or wholesale applicable for all auditees of

the Firm, if they are members of the assurance team (“AET”) of the Firm. Better clarity

dawns and brought in.

**Eligibility:**

As per the Section, only chartered accountants are eligible for appointment of auditors.

Where a firm including a limited liability partnership is appointed as an auditor of company,

only the partners who are chartered accountants shall be authorised to act and sign on

behalf of the firm. However, (a) a body corporate other than a limited liability partnership

registered under Limited Liability Partnership Act, 2008; (b) an officer or employee of the

company ;(c) a person who is a partner, or who is in the employment, of an officer are not

eligible for appointment of auditors.

**Not eligible for appointment as auditor:**

Further, a person who or his relative or partner is not eligible for appointment as auditor

as detailed hereunder where a relook or further clarity is required that are dealt with item wise

**Holding any security of or interest:**

In terms of Section 141 (3) (d (i)) of the companies act 2013, person who, or his relative or

partner is holding any security of or interest in the company or its subsidiary, or of its

holding or associate company or a subsidiary of such holding company:, he/the firm shall not

be eligible to appointment as an auditor of a company. However, the relative may hold

security or interest in the company of face value not exceeding of one Lac rupees as

prescribed in Companies (Audit and Auditors) Rules, 2014 (Sub Rule 10).

But, on the other hand, as per Annexure II to Implementation Guide to Standard on Quality

Control (SQC1) under the subhead Financial Interests, ‘Partners and employees of the

Firm and their immediate family members engagement are prohibited from making

investments in equity or debt instruments in the auditee if they are members of the

assurance team (“AET”).( Para17). Again, as per Para18,’should any such investment be

made inadvertently (e.g., upon receiving an inheritance or gift), the partner/employee shall

ensure that it is disposed of within a period of one month from the date of investment’

In the light of the above said provisions of the Act, the above said IG to SQCI may have to

be relooked for reasons explained above. The differences are glaring and vocal. As per the

Companies Act, holding of any security of or interest in the company or its subsidiary, or of

its holding or associate company or a subsidiary of such holding company is totally taboo for

the partner.But for relatives, the companies act is a little moderate as compared to the SQCI,

in the sense, the relative may hold security or interest in the company of face value not

exceeding of one Lac rupees as prescribed in Companies (Audit and Auditors) Rules, 2014

(Sub Rule 10).

But, SQCI appears to be a little dithering in the case of Partners and employees of the

Firm in the sense they are prohibited from making investments in equity or debt instruments

in the auditee if they are members of the Assurance Engagement Team (“AET”). (Para 17).

It is perplexing to understand/ decipher the real meaning of AET whether

it means the AET of a particular of a particular auditee or covers and includes members of the entire assurance team of the audit as focused above.

Again, the provisions of the Act are silent on the other members of the audit team. Does it

mean it does not cover other employees of the audit team?

Don’t you think ICAI should address the issue?

**Indebtedness/ Borrowing:**

In terms of Section 141 (3) (d) (ii) of the companies act 2013, a person who, or his relative or

partner or any of my relatives or partners are not indebted to the company or its subsidiary or

its holding or associate company or a subsidiary of such holding company where the Firm

acts as the Statutory Auditors, in excess of rupees five lacs as prescribed in the above said

ruleis not eligible to appointment as an auditor of a company.

But, Para 19 of Annexure II to Implementation Guide to Standard on Quality Control

(SQC1) under the subhead Financial Interests speaks a little different language which runs

as follows “Partners and employees of the Firm and their immediate family members, if they

are members of the AET, are prohibited from making a borrowing from an auditee, unless the

auditee is a financial institution that lends in the normal course of business, and the

borrowing was on its normal lending terms.

IG to SQC I provide correct exemptions. Doesn’t it?

Don’t you think ICAI should address the issue?

**Giving Loan:**

As per Para 19 of Annexure II to Implementation Guide to Standard on Quality Control

(SQC1) under the subhead Financial Interests of Annexure II to Implementation Guide to

Standard on Quality Control (SQC1) under the subhead Financial Interests, Partners and

employees of the Firm and their immediate family members, if they are members of the AET,

are prohibited from giving a loan to an auditee or to an officer, director, or major shareholder

of an audit.

But, Section 143 is not vocal on giving loans but, possible more likely to come under other

‘interest’ referred to in Section 141 (3) (d) (i) of the Act quoted above.

Don’t you think ICAI should address the issue for clarity?

**Guarantee or security:**

In terms of Section 141 (3) (d) (iii) of the companies act 2013, a person who, or his relative

or partner or any of my relatives or partners has given a guarantee or provided any security

in connection with the indebtedness of any third person to the company, or its subsidiary, or

its holding or associate company or a subsidiary of such holding company where the Firm

acts as the Statutory Auditors in excess of one lakh rupees as prescribed in above said rule

is not eligible to appointment as an auditor of a company.

**Business Relationships:**

In terms of Section 141 (3) (e) of the companies act 2013, person who, or his relative or

partner 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 prescribed in Rule 10(4) that runs

as follows:

“The term “business relationship” shall be construed as any transaction entered into for a

commercial purpose, except –

(i) commercial transactions which are in the nature of professional services permitted

to be rendered by an auditor or audit firm under the Act and the Chartered Accountants

Act, 1949 and the rules or the regulations made under those Acts;

(ii) commercial transactions which are in the ordinary course of business of the company at

arm’s length price like sale of products or services to the auditor, as customer, in the

ordinary course of business, by companies engaged in the business of telecommunications,

airlines, hospitals, hotels and such other similar businesses.

But, As per Para 26 of Annexure II to Implementation Guide to Standard on Quality Control

(SQC1) under the subhead Financial Interests of Annexure II to Implementation Guide to

Standard on Quality Control (SQC1) under the subhead Business Relationships is a little

docile and to quote‘Partner and employees of the Firm, if they are members of the AET, are

prohibited from having a business relationship with or joint investment (e.g., partnership

interests) in an auditee or with an officer, director, or major shareholder of that auditee.

Don’t you think ICAI should address the issue to a little elaborate?

**Other non eligibilities:**

As per Section 141 (3) (f) (g) (h) of the Act, the following persons are not eligible to

appointment as an auditor of a company.

(f) a person whose relative is a director or is in the employment of the company as a director

or key managerial personnel

(g) a person who is in fulltime employment elsewhere or a person or a partner of a firm

holding appointment as its auditor, if such persons or partner is at the date of such

appointment or reappointment holding appointment as auditor of more than twenty

companies is not eligible to appointment as an auditor of a company.

(h) a person who has been convicted by a court of an offence involving fraud and a period of

ten years has not elapsed from the date of such conviction is not eligible to appointment as

an auditor of a company.

(i) 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 as provided in

section 144 is not eligible to appointment as an auditor of a company. For brevity, the section is not quoted that may be referred to.

But, Para 32 to38 of the said Annexure to SQCI underneath ‘Scope of Services’ are more of

generic that may also be consulted.

**Additional Prohibitions as per the Annexure to the SQCI:**

As per Para 21, Partners and employees of the Firm and their immediate family members, if

they are members of the AET, are prohibited from being an executor, administrator, or

trustee of a trust/estate, and have authority to make investment decisions for the trust/estate,

that had an investment in an auditee.

As per Para, 22, Partners and employees of the Firm and their immediate family members, if

they are members of the AET, are prohibited from obtaining a new, or make significant

changes to an existing, insurance product of any kind, from an insurance company auditee.

**Conclusion:**

Auditors are to be clear about their eligibility for appointment of auditors of an audit. Section

141 of the new Companies Act and the SQCI (Annexure I) should by and large speak in one

voice except where it’s for general compliance. Auditing community should not be in pellmell

for want of clarity about certain issues that are addressed in the article. We hope the ICAI

will raise to the call.. As has been pointed earlier, relatives for the Section should be properly

pruned to include only immediate relative at least for the pose of this particular section. It is

hoped it will not fall on the deaf ears of the Institute so that auditing community is not called

upon to give a difficult declaration that is likely to be only on supposed premises. Only the

Institute can take it up with the MCA with plausible and creditable reasons for proper

amendment to the term ‘relative’, at least for the purpose of the Section so that auditing

community is not loitering in delusion.

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