Chapter – 1
Eligibility, Qualifications and Disqualifications of an Auditor

Comparative Table of 2013 Act with 1956 Act

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102	**173**	Appointment of auditors is an ordinary business.	
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139	**224, 224A, 619**	Appointment of auditors, Intimation to ROC by Company	**ADT-1**
140	**225**	Removal, resignation of auditor and giving of special notice	
140(1)	**225**	Application to the Central Government for removal of the Auditors	**ADT-2**
140(2)	**225**	Filing of the resignation by the Auditors to the Registrar	**ADT-3**
141	**226**	Eligibility, qualifications and disqualifications of auditors	
142	**224(8)**	Remuneration of auditors	
143	**227, 228, 263A**	Powers and duties of auditors and auditing standards	
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144	**-**	Services not to be render by auditors	
145	**229, 230**	Auditor to sign audit reports.	
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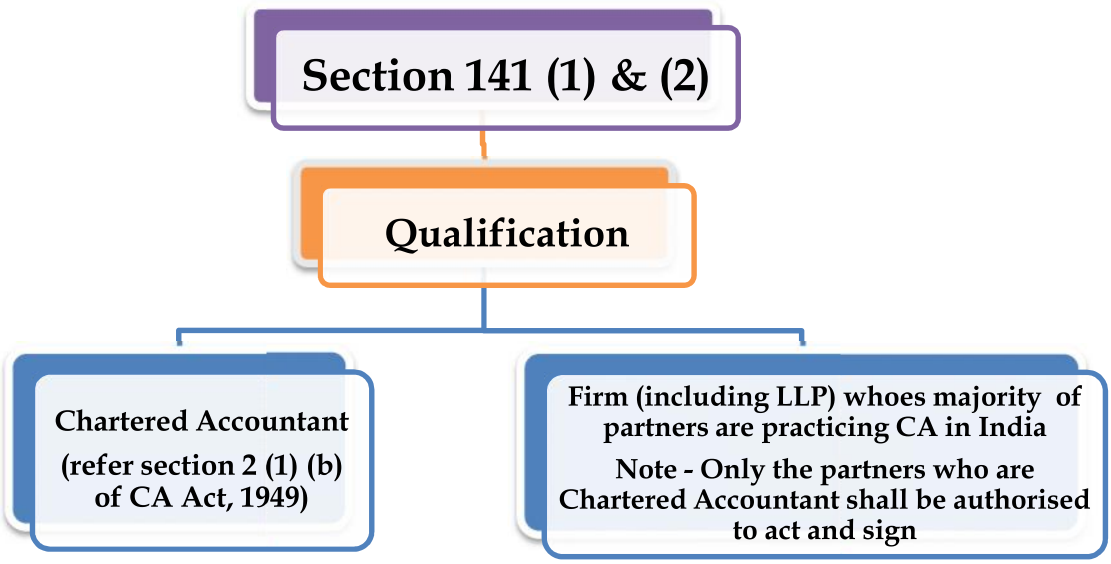
1. Qualifications of an Auditor



Note	**Explanation to section 139(4) of the 2013 Act provides that for the purposes of Chapter X, "firm" shall include Limited Liability Partnership incorporated under the LLP Act, 2008.**

Some Points to Remember

1.	The expression **'Chartered Accountant'** is defined in **section 2(*17*) of the Co's 2013** Act to mean a chartered accountant who – ✓ Satisfies the requirements of **section 2(1)(*b*)** of the Chartered Accountants Act, 1949; and ✓ **Holds** a **valid COP** under section 6 of that Act.
2.	A **LLP may practice as Chartered Accountants** with effect from 1st February, 2012 (the Amendment Act, 2011 comes into force) provided the following **conditions** are satisfied – **a.** It is an Indian LLP (LLP formed and registered under the Limited Liability Partnership Act, 2008) and **not a foreign LLP.** **b.** The partners of the LLP are **only CAs** in practice or **CA/(s) in practice** and **other recognized professionals** as may be prescribed. **c.** None of the partners of the LLP shall be a **company** [Sub-clause (*B*) of new clause (*ec*) of section 2(1) of the 1949 Act; *Explanation* inserted in section 25 of the 1949 Act] or **an Indian LLP** or **a foreign LLP. [see Note below]** **d.** The LLP is **registered with** the **ICAI.**
Note	☞ At the first glance it appears there is **no bar** on an Indian LLP of CAs having an Indian LLP/foreign LLP as a partner from practicing the profession of CAs. ☞ However, such an interpretation would conflict with the requirements of section 2(2) of the 1949 Act (as amended by the Amendment Act, 2011) which permit a CA to practice in partnership with only with other CAs in practice or in partnership with members of such other recognized professions as may be prescribed. ☞ LLPs, whether Indian or foreign, have a **distinct entity from partners.** ☞ Therefore, it appears that partnership with LLPs of CAs/other recognized professionals **cannot be treated as partnership with CAs/other recognized professionals** within the meaning of section 2(2) of the 1949 Act. **(This matter needs ICAI's clarification)**

3.	**Proprietary firm whether qualifies for appointment as auditor in firm name?**
	✓ According to new clause **(ca) of section 2(1)** of the 1949 Act, the term **"firm" inter alia includes "sole proprietorship" registered with ICAI.** ✓ New clause (haa) defines **"sole proprietorship"** to mean an individual who engages himself in the **practice of accountancy** or **offers to perform** services referred to in clauses (ii) to (iv) of sub-sec. (2).
4.	**Can Proprietary firm be appointed in its firm name?**
	✓ The **definition of "firm"** in Explanation to section 139(4) of the 2013 Act is **silent** on whether sole proprietorship CA firm which is recognized as "firm" in CA Act, 1949 is also covered in definition of firm. ✓ Though **definition** of "firm" in Explanation is an **inclusive one,** it appears that proviso to section 141(1) of the 2013 Act close the issue. ✓ A company must appoint the proprietor of the so-called firm by his **name in his individual capacity** as its auditor and the auditor's report will have to be **signed by the proprietor** himself in his own name. - **MCA's Circular – No. 8/229/56-PR, dated 20-3-1957.**

2. Disqualifications of an Auditor [Section 141(3)]

S.N.	**Disqualified Person**	**Description**
a.	**Body Corporate other than LLP registered under LLP Act, 2008**	**A body corporate other than a LLP** registered under the LLP Act, 2008 shall not be eligible to be appointed as auditor of a company.
Note	**Meaning of Body Corporate**	**Body Corporate" or "Corporation" includes a company incorporated outside India, but does not include— [Section 2 (11) Co's Act 2013]** (i) A **Co-operative Society registered** under any law relating to co-operative societies; and (ii) Any **other Body Corporate** (not being a company as defined in this Act), which the **Central Government** may, by **notification**, **specify** in this behalf;
b.	**An Officer or Employee of the Company**	1. The term **'employee' is not defined** in the 2013 Act. However, any employee of the company, whether **full-time or part-time** shall be **disqualified** from appointment as auditor of the company. 2. Unlike the 1956 Act, **employee** of the company's **holding company** or **subsidiary** or **co-subsidiary** or **ultimate holding** company is **not** so **disqualified.**
Note	**Meaning of Officer**	**According to section 2(59) of Co's Act, 2013, the term 'Officer' includes –** ✓ **Director** ✓ **Manager** ✓ **KMP – CEO, MD, CS, Manager, WTD, CFO [Sec. 2 (51) of Co's Act, 2013]** ✓ Any person in accordance with whose **directions** or **instructions** the Board of **Directors** or any one or more of the directors is or are **accustomed to Act.**
E.1	Suppose X, a practicing CA, is a director of PQR Ltd. X is disqualified under section 141(3)(*b*) read with section 2(59) as he, being a director, is an officer of the company.	
E.2	Suppose X, a practicing CA, is a director of P Ltd., the holding company of PQR Ltd. He is disqualified to be auditor of P. Ltd. but not disqualified to be auditor of PQR Ltd. by virtue of section 2(*59*) read with section 141(3).	

<table>
<tr><td>Case Law</td><td>Official Liquidator of National Live Stock Registration Bank Ltd. v. Velu Mudaliar</td><td>Broker, Solicitor, banker as such is not a promoter, nor an 'officer' of company</td></tr>
<tr><td>Letter No. – 8/17/2(30)/76 -CL-V, dated – 23/08/1976</td><td colspan="2">The term "Officer" includes an employee if he has been vested with the powers of financial control over one or more fields of operation of a company and, therefore, such an employee should be deemed to be falling under the category of the term "officer". In view of this position, the employees like chief accountant, works manager, sales manager, purchase manager, estate manager, etc., should be deemed to be officers</td></tr>
<tr><td>Letter No. – 8/65/2/30/63-PR, dated – 07/10/1963</td><td colspan="2">If in respect of discharge of any particular duty imposed by the Act any person occupies a position of responsibility in a company, he will be deemed to be an "officer" in relation to that duty and answerable as such.</td></tr>
<tr><td>Query</td><td colspan="2">Whether on his engagement as the income-tax consultant of a company either on payment of ad hoc fee or fees as retainer or on fixed periodical remuneration, a practising chartered accountant is to be regarded as an officer or employee of the company for the purpose of section 141(3)(b) of the 2013 Act, and consequently as being disqualified for appointment as auditor of the company?</td></tr>
<tr><td>Response</td><td colspan="2"><u>MCA had clarified the legal position in the context of corresponding provisions in the 1956 Act as follows</u> –
1. Where the chartered accountant is employed whole-time, he is an employee of the company.
2. In other cases generally speaking, there would appear to be only a contract for service and not a contract of service between the company and the chartered accountant.
3. In Dharangadhra Chemical Works v. State of Saurashtra, the Supreme Court has laid down that the prima facie test for the determination of the relationship between master and servant is the existence of the right in the master to supervise and control the work done by the servant not only in the matter of directing what work the servant is to do, but also the manner in which he shall do his work, or, to borrow the words of Lord Uthwatt, "the proper test is whether or not the hirer had authority to control the manner of execution of the act in question".
4. Applying this test in any case, where the chartered accountant is consulted only professionally on income-tax matters by a company, he cannot be said to be an officer or employee of the company.
5. A chartered accountant's main business is to render professional service for reward like a lawyer or a doctor.
6. Where such service is rendered professionally and not as an officer or employee of the company, a chartered accountant is not disqualified under section 226(3)(b) [MCA's : Letter No. 8/1/57-PR, dated 11-7-1957.]</td></tr>
<tr><td>c.</td><td>Partner or Employee of Officer or Employee of the Company</td><td>Financial or Personal relationships with the officer and employees of the company are prohibited, in order to promote independence of the Company Auditor.</td></tr>
<tr><td>E.1</td><td colspan="2">Suppose X, a practicing CA, is a director of PQR Ltd. X is disqualified under section 141(3)(b) read with section 2(59) as he, being a director, is an officer of the company. If he is a partner in X & Co., a firm of CAs. The other partners are Y and Z. Y and Z are disqualified to be auditors of PQR Ltd. under section 141(3)(c) as they are partners of an officer of the company.</td></tr>
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<tr><td>d.</td><td>Holding the Security interest</td><td>
<u>A person shall be disqualified from appointment as auditor if</u> –
✓ He or
✓ His relative or [refer appendix at the end of chapter]
✓ Partner –
Is holding any security [Refer Appendix at the end of Chapter] or interest in –
✓ The company; or
✓ Its subsidiary; or [refer appendix at the end of chapter] of its holding company; or [refer appendix at the end of chapter]
✓ Associate company; or [refer appendix at the end of chapter]
✓ A subsidiary of such holding company.

<u>Rule 10 (1) of Co's (Audit and Auditors) Rules, 2014</u>
However, disqualification is not attracted if the face value of security or interest held by the relative does not exceed ₹ 1,00,000.
Provided that the condition under this sub-rule shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities.
Provided further that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition or interest.
</td></tr>
<tr><td>Note</td><td colspan="2">
1. The threshold limit of ₹ 1,00,000 applies to securities held by relative and not to securities held by the person or his partner.
2. Disqualification is attracted in case of security/interest held by the person himself or his partner regardless of the quantum of holding.
3. Even insignificant amounts of securities held by the person himself or his partner would attract disqualification under section 141(3)(d)(i).
4. What matters here is face value and not market value.
5. Section 141(3)(g) refers to subsidiary of associate company. This clause, however, contains no such reference. Thus, if relative holds security or interest of face value exceeding ₹ 1,00,000 in subsidiary of associate company, disqualification under this clause is not attracted.
</td></tr>
<tr><td>e.</td><td>Indebtedness</td><td>
<u>A person shall be disqualified from appointment as auditor if</u> –
✓ He or
✓ His relative or [refer appendix at the end of chapter]
✓ Partner –
Is indebted to –
✓ The company; or
✓ Its subsidiary; or [refer appendix at the end of chapter]
✓ Of its holding company; or [refer appendix at the end of chapter]
✓ Associate company; or [refer appendix at the end of chapter]
✓ A subsidiary of such holding company
In excess of ₹ 5 Lakh shall not be eligible for appointment. [Rule 10(2)]
</td></tr>
</table>

Note	1. A **partner is disqualified if his firm is indebted** to the company for more than ₹ 1000 [now more than prescribed amount of ₹ 5,00,000]. 2. A **firm is disqualified if a partner** of that firm is so **indebted.** [Clarifications given by the Research Committee of the ICAI] 3. Since **"firm" includes LLP** and **partners of LLP are separate entity from the firm,** it would be better to amend and clarify the provisions as to whether audit firm which is LLP would be disqualified if any of its partners are indebted and vice versa.	
Query 1	Is the auditor indebted to the company if he draws his fees on a progressive basis? That is he draws his fees as and when a part of the work is done without waiting for the completion of the whole job?	
Response	ICAI's Research Committee has clarified that if as per the terms of his engagement with the client (*e.g.* a resolution passed at the general meeting), the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company.	
Query 2	A question arises what if auditor purchases goods on credit from his client and the client allows him the normal credit period allowed to other customers?	
Response	The Research Committee of ICAI has clarified that if auditor purchases goods or services on credit from his client company he is definitely indebted to the company. If the amount outstanding exceeds ₹ 1000 [now prescribed amount of ₹ 5,00,000], he would be disqualified and must vacate his office. That the credit period allowed to him is the same as allowed to other customers is no excuse.	
f.	**Guarantee and Security (Indirect Indebtness)**	<u>**A person shall be disqualified from appointment as auditor if**</u> – ✓ **He** or ✓ His **relative** or [refer appendix at the end of chapter] ✓ **Partner** – Has given a **guarantee or provided any security** in connection with the **indebtedness** of any **third person** to – ✓ The company; or ✓ Its subsidiary; or [refer appendix at the end of chapter] of its holding company; or [refer appendix at the end of chapter] ✓ Associate company; or [refer appendix at the end of chapter] ✓ A subsidiary of such holding company In **excess of ₹ 1 Lakh** shall not be eligible for appointment. **[Rule 10(2)]**
g.	**Business Relationship**	<u>**A person or a firm who, whether directly or indirectly, has business relationship with**</u> – ✓ The company, or ✓ Its subsidiary, or ✓ Its holding or ✓ Associate company or ✓ Subsidiary of such holding company or Associate company **Of such nature as may be prescribed. [See Note Below]**

Note	The **term business relationship** is defined in **Rule 10(4)** shall be constructed as any transaction entered into for a commercial purpose except – **(i)** Commercial transaction 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 and the rules or the regulations made under such Act.** (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.	
h.	**Relative of Director or KMP**	<u>**A person whose relative is a**</u> **–** ✓ **Director** or ✓ In the **employment** of the company **as** a D**irector** or **KMP**
Note	This **disqualification** would **not apply** if **relative** is **Director or KMP** of company's **holding company** or **subsidiary** company or **associate** company or **co-subsidiary.**	
Query	If **relative of a CA is Director/KMP** of the company, would the firm in which such CA is partner would also be so disqualified?	
i.	**Fulltime Employee & Ceiling Limit**	✓ A person who is in **full-time 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 **20 companies.**
Note	The words **"such persons"** (in plural) makes the limit of 20 companies applicable **both** to person in full-time employment elsewhere as well as to person holding appointment as its auditor.	
Circular No. – 35/3/78-CL-III, dated – 24/09/1975	**It would appear that the branch audits are not to be included while calculating the specified numbers of Company.**	
k.	**Convicted by Court for fraud**	<u>**A person is disqualified for appointment as auditor of a company if he**</u> **–** ✓ Has been **convicted by a Court** of an offence involving **fraud** and ✓ A period of **10 years** has **not elapsed** from the date of such conviction
Note	**A question arises whether "fraud" shall have the same definition as in section 447?** The definition in section 447 is expressly stated to be for purposes of that section. Therefore, it appears that the definition under section 447 is not applicable to section 141(3)(*h*). This matter requires clarification.	
l.	**Services Rendered u/s 144**	A **person** whose **subsidiaries** or **associate companies** or **any other form** of entity, is engaged at the date of appointment in **consulting and specialized** as provided in Section 144 is disqualified from appointment as auditor.
Note	<u>Restricted Services</u> – [<u>Section 144</u>] An auditor appointed under this Act **shall not** *directly or indirectly* provide any of the following **"other services"** (*i.e.* Services other than statutory audit under the 2013 Act) to auditee company or its holding company or subsidiary company **(a)** **Accounting and book keeping services;** **(b)** **Internal audit;**	

(c)	**Design and implementation of any financial information system;**
(d)	**Actuarial services;**
(e)	**Investment advisory services;**
(f)	**Investment banking services;**
(g)	**Rendering of outsourced financial services;**
(h)	**Management services; and**
(i)	**Any other kind of services as may be prescribed.**

Services other than the above may be provided by the auditor to the company only if the services are approved by the Board of directors or the audit committee, as the case may be.

Transitional Period – An auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this section shall comply with this section **before the closure of the first financial year after the date of such commencement**. **(Proviso to Section 144)**

Explanation to Section 144 –

For the purpose of this sub section, the term "directly or indirectly" shall include rendering of services by the auditor –

Individual Auditor rendering services	Audit Firm rendering services
Either through himself or	Either itself or
Through his relative or	Through any of its partners or
Through any other person connected or associated with such individual or	Through its parent or
Through any other entity, whatsoever, in which such individual has significant influence or	Through its subsidiary or
Through any other entity, whatsoever, in which such individual has control or	Through its associate entity or
Through any other entity whose name or trade mark or brand is used by such individual.	Through any other entity in which the firm has significant influence or
	Through any other entity in which the firm has control or
	Through any other entity whose name or trade mark or brand is used by the firm
	Through any other entity in which any partner of the firm has significant influence
	Through any other entity in which any partner of the firm has control
	Through any other entity whose name or trade mark or brand is used by any of its partners.

It may be noted that the expressions "significant influence', 'associate entity', 'associated person', 'connected person' are used in the *Explanation* to section 144 but are not defined in the Act.

3. Deemed Vacation of office of an Auditor [Section 141(4)]

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned above in **section 141(3) after his appointment**, he **shall vacate** his office as such auditor and such vacation **shall be deemed to be a casual vacancy in the office of the auditor.**

Appendix to Chapter

1.	**Definition of Holding Company**	**Holding Company – ** In relation to one or more other companies, means a company of which such companies are subsidiary companies. [**Section 2 (46) Co's Act, 2013]**
2.	**Definition of Subsidiary Company**	**Subsidiary Companies** [**Section 2 (87) Co's Act, 2013] –** In relation to any other company (that is to say the holding company), means a company in which the holding company— (i) **Controls[Refer Section 2 (27)] the composition of the Board of Directors**; or (ii) **Exercises or controls more than one-half of the total share capital** either at its own or together with one or more of its subsidiary companies – **Provided** that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed. *Explanation.*—**For the purposes of this clause**— (a) A company shall be deemed to be a subsidiary company of the holding company even if **the control** referred to in sub-clause (*i*) or sub-clause (*ii*) is of another subsidiary company of the holding company; (b) The **composition of a company's BOD** shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors; (c) The expression "company" includes any Body Corporate; (E.g. LLP) (d) "layer" in relation to a holding company means its subsidiary or subsidiaries;
Note	**The Ministry has clarified that the shares held by a company or power exercisable by it in another company in a fiduciary capacity shall not be counted for the purpose of determining whether the other company is subsidiary of the former. [Circular No. 20/2013 dated 27/12/2013]**	
Note	**Meaning of Total Share Capital –Co's (Specification of Definitions Details) Rules, 2014 – Rule 2 (r)** **"Total Share Capital",** for the purpose of clause (87) of Section 2 , means the **aggregate** of the – **(a) Paid – up Equity Share Capital**; and **(b) Convertible Preference Share Capital**;	
3.	**Meaning of Associate Company**	**Associate Company –** In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company. [**Section 2 (92) Co's Act, 2013]** **Explanation**—For the purposes of this clause, **"significant influence" means control of at least 20% of total share capital, or of business decisions under an agreement.**
4.	**Meaning of Relative [Section 2(77) of the Co's Act, 2013]**	**"Relative"**, with reference to any person, means anyone who is related to another, if— **(i)** They are **Members** of a **Hindu Undivided Family**; **(ii)** They are **Husband and Wife;** or **(iii)** One person is related to the other in such manner as may be **prescribed (see Note)**;
Note	**The Companies (Specification of Definitions Details) Rules, 2014 – Rule 4** **List of Relatives in terms of clause (77) of Section 2 –** A person shall be deemed to be the relative of another, if he or she is related to another in the following manner –	

	1. Father • Step Father.	4. Daughter • Step Daughter; • Daughter's Husband.
	2. Mother • Step Mother.	5. Brother • Step Brother.
	3. Son • Step Son; • Son's Wife.	6. Sister • Step Sister.

Case Law	**'Brother' does not include 'cousin' - *ITO* v. *Mahabir Jute Mills Ltd.* [1983]**

5.	**Definition of Securities**	"Securities" means the securities as defined in clause (*h*) of section 2 of the Securities Contracts (Regulation) Act, 1956. [See below]

The said clause (*h*) defines 'securities' as under –

"Securities" include –

(i)	Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
(ia)	Derivative;
(ib)	Units or any other instrument issued by any collective investment scheme to the investors in such schemes;
(ic)	Security receipt as defined in clause (*zg*) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
(id)	Units or any other such instrument issued to the investors under any mutual fund scheme;
(ie)	Any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
(ii)	Government securities;
(iia)	Such other instruments as may be declared by the Central Government to be securities; and
(iii)	Rights or interest in securities.

Case Law	The definition of "securities" in section 2(*h*) of the Securities Contracts (Regulation) Act,1956 covers both listed securities and unlisted securities. The **definition does not make any distinction between listed securities and unlisted securities.** **[*Naresh K. Aggarwala & Co.* v. *Canbank Financial Services Ltd.* [2010] 100 SCL 425 (SC)]**