

## **“NCLT’s Power to remove a Statutory Auditor: A Perspective”**

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On 21<sup>st</sup> April 2020, the Bombay High Court ruled on the petition filed by top audit firms Deloitte Haskins and Sells and B S R and Associates LLP against the prosecution lodged by Central Government and the subsequent order of the National Company Law Tribunal (‘NCLT’) in relation to audit conducted by them for Infrastructure Leasing & Financial Services (‘IL&FS’).

The dispute was raised as a writ petition before the Bombay High Court to vehemently oppose the five year debarment entailed to the second proviso to section 140(5) of the Companies Act, 2013, (‘the Act’). The petitioners had cited the provision as ‘civil death’ for a statutory auditor. Further, proceedings under section 447 of the Act, punishment by National Financial Reporting Authority (‘NFRA’) and Institute of Chartered Accountants of India (‘ICAI’) for the same offense, being affected by the principle of double jeopardy, a review of the provisions was sought.

Amongst the various issues decided by the Court, there has been a considerable discussion on the interpretation of section 140 of the Act by the Bombay High Court and the contours of jurisdiction to be exercised by the different forums under purview.

### **Discussion on the wordings of section 140(5) of the Act**

In its judgement, the Bombay High Court has observed that the nature of section 140 of the Act is curative and not penalising. Limiting the purview of the provision to the section heading, which deals with resignation and removal of auditors, the power given to the Tribunal is only to separate the Chartered Accountant (‘CA’) from the company, observed the Bombay High Court.

While upholding constitutionality of section 140 under the Act, the Bombay High Court interpreted sub-section 5 of section 140 of the Act in detail by segregating the powers granted to NCLT for considering ‘satisfaction’ and passing an order for removal of the auditor. It may be understood as a stage-by-stage process which is interpreted in this section. The sub-section reads as follows:

*S. 140 (5) Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either suo moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditor:*

*Provided that if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of*

*such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place:*

*Provided further that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.*

The term ‘satisfaction’ has been given meaning by referring to various statutes and precedents. It has been given to mean “an affirmative act” as per the decision laid down in the case *Rajesh Awasthi v. Nand Lal Jaiswal*.<sup>1</sup>

The case of *Swadeshi Cotton Mills vs. Union of India*<sup>2</sup>, discusses the power to take over industrial undertakings without investigation by the Central government if it is satisfied to pass such order. The satisfaction in this case is required to be based on relevant evidence. It further highlights that if the order of the Central Government is found to be arbitrary or not based on a logical reasoning, it shall be reviewed by the Court and quashed.

#### **Nature of the term ‘satisfaction’**

In the present case, the Bombay High Court further proceeds to lay an onus of professionalism on the statutory auditors, by asking them to step down in case such satisfaction is reached by NCLT, and before the passing of any final order. The Bombay High Court has observed that –

“Satisfaction reached by the independent & impartial tribunal like NCLT needs to be respected by the company auditor and the subject company also is expected not to oppose it.....A chartered accountant who has opted to be the company auditor obviously cannot claim any personal interest, must remain neutral & his commitment to the profession obliges him to accept that satisfaction of NCLT. If the Company or the said CA honour that satisfaction, the NCLT is not required to or expected to pass final order.”

Once the statutory auditors step down, the final order need not be passed by NCLT and the debarment which is a consequence of the final order is avoided.

#### **Analysis of the Bombay High Court’s observation on ‘satisfaction’ u/s 140(5) of the Act**

NCLT can take cognizance of a matter concerning action of a statutory auditor in a fraudulent manner taken either suo moto or on an application by the Central Government or any concerned person. Based on its judgement, if NCLT is satisfied regarding the direct or indirect involvement of the CA, the statutory auditor being an independent professional should respect the NCLT’s judgement and step down. This action would ultimately avoid a final order to be passed against him, thus not invoking debarment attached to the provision.

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<sup>1</sup> (2013) 1 SCC 501

<sup>2</sup> (1981) 1 SCC 664

Looking at the decision from the point of view of a CA, by stepping down as the statutory auditor, or his removal by passing of a special resolution, there is surely going to be damage caused to the auditor's reputation. The only benefit is that the debarment under sub-section (5) of section 140 of the Act is avoided and a pending suit for professional misconduct (which is required to be disclosed in case of fresh appointments) is avoided.

Further, clarity is required on whether this interpretation implies that once the NCLT has reached the satisfaction of the affairs being conducted in a fraudulent manner directly or indirectly, a parallel investigation will be automatically triggered under the NFRA.

A greater faith has been placed in the ability of the NCLT, however the fact of not being able to contest the findings of NCLT for fear of facing debarment does not give a chance for the auditor's right to be heard. The manner of expression of the 'satisfaction' by NCLT is also not known clearly.

While the interpretation accorded by the Bombay High Court clarifies the jurisdictional contours for the authorities, a greater responsibility now lies on the shoulders of an auditor.

### **Limitations on access for the statutory auditor**

According to the provisions of the Act, statutory auditors while conducting audit have been given immense freedom to access books of accounts located not only in the registered office but at any place where the records are kept. They have limited access to the books maintained by the subsidiary and associate companies, which is required for the purposes of consolidation. However, companies have the freedom to select separate auditors for their branch offices, subsidiary and associate companies. When the audit concerns huge chains and links, it may not be possible for the auditor to keep track of the all the material transactions. He would have to rely on the reports made by the other auditors. A matter of missing out on important transactions is possible as the other auditor of a subsidiary company or branch office may miss out or not stress enough on certain facts, which do not seem important in the smaller picture of the subsidiary.

The possibility of a genuine oversight cannot be rejected entirely. However, every effort is now required to be made by the auditor to avoid any such oversight.

### **Distinction between the powers of NCLT and NFRA**

NCLT has been given powers to only sever the connection between the existing auditor on reaching a subjective satisfaction of the involvement of the CA based on the power to summon documents and witnesses granted to it under rule 135 of the National Company Law Tribunal Rules, 2016.

Punishment for involvement in fraud is to be ascertained by proper investigation by NFRA as per sub-section 4 of section 132 of the Act. The appeal against the judgement may be made to National Company Law Appellate Tribunal ('NCLAT').

Further, to provide clarification on the jurisdiction, emphasis has also been given on the composition of the authorities. The President of NCLT is a person who is or has been a Judge of High Court. Similarly, judicial members have a legal background. The NFRA on the other hand does not mandate members having a legal background. Thus, according to the Bombay High Court, the NCLT is in a better position to exercise legal judgement.

### **Conclusion**

While the judgement affords more clarity on the section 140(5) of the Act, it is amply clear that the auditor is required to be extremely careful. There would have to be more dialogue between different auditors of branch offices, subsidiary companies and associate companies, to catch any transaction which may be harmful in the interest of the stakeholders.

As section 143 of the Act extends to other professionals like practicing company secretaries and cost accountants, it only seems probable that this judgement would apply to them as well. The burden on these professionals as independent parties has increased manifold after this judgement, giving rise to a need for constant communication, questions and verifications to ascertain the assurances made in their reports and highlight wrongful activities, if any.